Business Responsibility:

A Reply to Milton Friedman

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[On September 13, 1970, an article appeared in the *New York Times Magazine* entitled "The Social Responsibility of Business Is to Increase Its Profits."[1] The author was the well known economist, columnist, and sometime advisor to Presidents and Presidential aspirants, Milton Friedman. Professor Friedman, who also holds an honored position on the economics faculty at the University of Chicago, put his case so boldly and provocatively as to create a veritable floodtide of critical reaction -- from the business community and the university business schools. The following article assesses Professor Friedman's argument, and concludes that he is more wrong than right.]

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Let us begin by trying to identify the core of Professor Friedman's argument. The title of his article sums it up rather well, namely, the social responsibility of business is to increase its profits. But a bit more fulsome and somewhat more accurate way to put his case is that <u>business has no social responsibilities beyond that of striving legally and ethically to increase its profits</u>. It is this latter way of stating the proposition that gives the argument its sharp edge and plunges students of business into such deep controversy among themselves. In a capitalist or market society, it is not in any way unusual or radical to suggest that business has a broad responsibility to increase its profits. What <u>is</u> uncommon and controversial is the further suggestion that business has <u>no</u> responsibility to society beyond the quest for more profits.

Even here at the very beginning, though, an internal inconsistency appears. In the opening paragraphs of the article, Professor Friedman asserts that "Only people can have responsibilities," and that "'business' as a whole cannot be said to have responsibilities," although a corporation as an articificial /legal/ person has "artificial responsibilities." But in the concluding sentence of the article, we are told that "'there is one and only one social responsibility of business,' namely, that it should increase its profits." The beginning and concluding assertions are quite patently contradictory.

In the remainder of the paper, I plan to examine the Friedman argument in three ways. One will be to find areas of agreement. A second is to identify where Professor Friedman is simply wrong. A third approach will be to indicate what Professor Friedman has left unsaid -- omissions which are central to the issues raised by his position.

Where Professor Friedman Is Right

Quite clearly, Professor Friedman has made some useful and valid observations about the doctrine of business responsibility. Among those that I would agree with are the following:

He is correct in remarking that the precise and substantive meaning of "social responsibility" is not usually made clear by those who advocate the doctrine. Most such discussions are truly "notable for their analytical looseness and lack of rigor." This has long been true and well known (though not often admitted) by those who have followed the evolution of the social responsibility doctrine over the years. I, myself, made this a major point in an article published over a decade ago.[2] What

Professor Friedman doesn't explain is just why this state of affairs continues to exist. I believe it results from a collapse of the intellectual tradition of laissez faire and the related failure to find either adequate ideas to replace that tradition or adequate regulating mechanisms to replace the postulated automaticity of an ideal market model. The older value systems and theories are no longer relevant but new ones have not yet been developed and applied. One result of this lag is an incredibly mushy type of thinking and talking about business' social responsibilities.

Professor Friedman is also eminently correct when he maintains that much of the rhetoric of social responsibility is public relations eyewash. His phrases describing this PR effort are sharp and telling: "pure rhetoric,""just window dressing," "hypocritical window dressing," and "tactics . . . . approaching fraud." This is not to say -- and Friedman doesn't say so -- that all professions of business responsibility are uttered for purposes of polishing up the corporate image. But anyone who delves into this literature, especially the speeches of business executives, can't help but conclude that it serves more than one purpose. I myself believe that anyone who can't see this aspect of the doctrine is either a fool or a hypocrite.

In his article Professor Friedman acknowledges that the corporation is a political system. He opposes its further politicization. In making the point that the corporation has a political character, Professor Friedman is only partially correct; and I shall deal below with the flaw in this part of his reasoning. But to the extent that he may mean that the modern corporation is a system of power, that it exhibits a distribution of rights and a hierarchical allocation of powers, that it contains an internal system of checks and balances, that with respect to many internal processes it legislates, administers, and ajudicates, and that it coerces and/or promotes a measure of social conformity -- all political functions and processes in a broad sense -- then he is on solid ground.

It is also true, as the author states, that many corporation executives who favor social-action programs under the aegis of private enterprise often lack the social expertise necessary to define, understand, and effectively attack the problem. Not only is there a question of the legitimacy of their assuming such social functions, which Professor Friedman makes much over, but it is quite likely that their perhaps well-intended actions will only aggravate an already difficult social condition. Actually, there is very little evidence to sustain this point of view, but I share Friedman's scepticism about the social engineering aptitudes of most corporation executives.

Finally, I find Professor Friedman's willingness to confront the doctrine of social responsibility and ask that it measure up to reason quite refreshing. There is a sense in which the doctrine has become a cult, a sacred cow, beyond question in the minds of its most vociferous defenders. Attacking it is almost a heretical despoiling of the temple. If the notion cannot be defended reasonably and logically, then it deserves to wither away as effective business philosophy.

Where Professor Friedman is Wrong

When one examines the Friedman article carefully, it becomes evident very quickly that its quality of reasoning and analysis is not up to the characteristic sharpness normally associated with his professional work. It contains errors of fact, errors of interpretation, and errors of omission. Some of these errors are shocking, in view of the public status and confidence enjoyed in recent years by Professor Friedman. Especially is this true with respect to some of the factual errors made, to which I now turn.

In more than one passage, Professor Friedman asserts that corporation managers are employees and agents of the owners. This statement is true only in a very limited, legal sense. It is trivially true. Operationally, in the vast majority (actually, probably all) of the large corporations which are the subject of Professor Friedman's analysis, the situation is more nearly the other way around. Corporation managers are "employees of the owners" only in a very peculiar way; actually, they are "the boss" and all other parties in the company "work for" them. The owners, moreover, tend to be passive participants, with only the slightest contact with the day-to-day and year-to-year routines of the company they own. The notion that managers of today's typical large corporation see themselves in any important way that affects their major decisions as "agents of the owners" is pure fiction and a convenient rationalization. It is difficult to understand why Professor Friedman would choose to emphasize the de jure relationship of manager to owner when he is fully cognizant that the <u>de facto</u> relationship is not only different but sufficiently different to make the former a myth.

Closely related to this first error is another. We are told that corporation stockholders can "fire" their managers if they are not satisfied with their performance. ("Will not the stockholders fire him?") In the great majority of cases, this is simply not true. In very rare instances, dissident stockholders have ousted entrenched management. But it isn't often done, or even attempted. Shareholders know the legal, organizational, and financial disadvantages under which they would wage such a struggle. They have other, more effective, and more economical means of retaliation -- they can sell out, provided the market conditions are favorable. To this latter kind of stockholder protest, management is quite responsive. To the direct threat of being "fired," they are not. The long evolution inside the corporation which has separated ownership from control belies the entire notion that the typical corporation executive is fearful of finding in his pay envelope a pink discharge slip signed by the collective body of shareholders. On the contrary, it is the shareholders who, with trepidation, open their dividend envelopes in fear that "their" managers have not been generous enough in the quarterly declaration.

Is it really true that "Only people can have responsibilities"? Of course, it isn't. Corporations, as "artificial persons" before the law, have a whole host of legal responsibilities. They must pay taxes, maintain their property in safe condition for their workers, pay their employees no less than the legal minimum wage, not engage in non-competitive practices forbidden by the antitrust laws, and comply with laws of city, county, state, and federal governments generally. Moreover, many private business corporations assume major (though informal) responsibility for the welfare and general happiness of their employees through various recreational programs, by providing pleasant and comfortable surroundings beyond the needs of increased productivity, and by constructing attractive buildings and plants that add to the overall appearance of the communities in which they conduct business. By failing to see or acknowledge these common practices of many large corporations, and by insisting on a very narrow, legalistic concept of the corporation, Professor Friedman is simply not providing his readers with an accurate factual picture of today's business. Although he says that "A corporation is an artificial person and in this sense may have artificial responsibilities," he also insists that "'business' as a whole cannot be said to have responsibilities, even in this vague sense." This is murky reasoning, at best. At worst, it is just incorrect.

Professor Friedman holds forth the possibility that corporation profits and stock prices are reduced by executive "actions in the name of social responsibility." I know of no empirical evidence to support this contention. Friedman cites none, most probably because there is none available to him. Consider the immense significance such evidence would have for stock market speculators, or for those who go to the financial markets with dividend yields in mind. If Professor Friedman has such information, surely he would release it in the broader interest of scuttling once and for all the doctrine of social responsibility.

The reader is also told that corporation executives who engage their companies in socially responsible activities may have a rude shock in store. The socially over-zealous executive will find that "His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibilities." Again, there is no empirical evidence to support such an argument. Both customers and employees may and do transfer their purchases and skills to other companies, but no one has yet demonstrated that such transfers result from corporate engagement in programs labelled socially responsible. Preponderant opinion, as opposed to empirical fact, is just the opposite -- that corporations are more likely to curry the favor of customers and employees by identifying the company's image with general attempts to improve the quality of life of the community. The current scramble of various companies to be considered sensitive to the problems of environmental pollution is an illustration. But the hard truth is that neither side can support its position with demonstrable evidence. Professor Friedman in this case is simply whistling in the dark.

Errors of Interpretation:

The article exhibits several errors of this kind, and I shall mention some of them.

A Necessary Conflict?

In his attempt to define the social responsibility of a corporate executive, as contrasted with his own personal responsibility as a member of society, Professor Friedman states that "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" (emphasis added). Or, in another passage, that social responsibility "must mean that he is to act in some way that is not in the interest of his employers." Let us grant Professor Friedman the benefit of the doubt and agree with him that conflicts of interest can arise between corporation managers and stockholders, managers and workers, managers and customers, and that the manager's decision to engage in socially responsible corporate actions may reduce dividend income and workers' wages and raise prices to customers (as noted above, there is no empirical evidence that any of these things actually happen).

But this hypothetical outcome is not the only one that could conceivably occur. What about those instances when stockholders may agree with the socially responsible actions of "their" managers (as could conceivably occur when the body of stockholders believed that the company should hire and train the long-term unemployed residents of Black ghettos)? Or what about other instances when consumers and managers might agree on the desirability of engaging in various socially responsible activities (as could conceivably occur upon approval of expensive advertising campaigns aimed at alerting the consuming public to the problems and dangers of environmental pollution)? In such cases where broad consensus is achieved between corporate managers and those groups "whose money is being spent" on socially responsible programs, it doesn't really matter which group spends the money. The economic and social impact would hypothetically be the same, whether the funds are expended by the managerial cadre or the stockholders.

By omitting this hypothetical possibility of agreement and consensus, Professor Friedman makes it appear as if socially responsible actions of corporation executives are per se in conflict with the economic interests of workers, stockholders, and consumers. But there is no logical reason why this need be true. And in omitting the other possibility, Professor Friedman has misled his readers by providing them with only one of two possible interpretations.

Strange Subversion

Perhaps the most seriously misleading interpretation contained in the Friedman article deals with his charge that the doctrine of social responsibility, when acted upon by corporations, undermines capitalism and leads ultimately to socialism and collectivism. /In this connection, it is probably best to overlook as an embarrassing bit of extremism, or possibly grandstanding, Professor Friedman's comments that various social problems are nothing but "the catchwords of the contemporary crop of reformers," as well as his reference to "the intellectual forces that have been undermining the basis of a free society these past decades." Pure Birchism, these comments are neither necessary to his argument nor characteristic of his style.7

The argument concerning collectivism goes this way. The socially responsible corporation becomes a quasi-political institution, levying quasi-taxes on stockholders, workers, and customers and making quasi-governmental expenditures on various social causes. This situation is tantamount to taxation imposed by private persons (corporate executives) instead of elected government officials; the setting of public expenditure guidelines by private, non-elected officers instead of civil servants; and occurs without the benefits and safeguards provided taxpayers through the checks-and-balances system of government. These procedures are similar to and will lead to collectivism because such a view favors the allocation of resources by a (quasi-) political mechanism rather than by means of the private market mechanism. Taken seriously, the social responsibility doctrine would "extend the scope of the political mechanism to every human activity." As such, it is a "fundamentally subversive doctrine."

Two corrective comments are in order. First, the corporation is a "political" institution though not a governmental one. The difference is very important. The corporation is political in the sense that it is a system of power, allocates power in a hierarchical manner, and has mechanisms through which various interest groups in the company accommodate to one another and mediate their respective differences. Any large scale organization is "political" in this meaning of the word.

But the corporation is not governmental -- it lacks the authority and organs of constituted governmental power, it operates in limited ways to achieve limited goals, it does not and cannot act in the interest of the "public at large" not only because it doesn't possess the requisite resources usually needed but because it has not been authorized to do so, and it is a profit-seeking institution based on private property. It is by no means "governmental" in the sense in which that term is normally used.

For this reason, it cannot be argued that private corporate spending programs lead directly into socialism or collectivism. The most that can be said is that, logically and hypothetically, they might lead to a form of <u>non-governmental</u> collectivism -- a kind of all-embracing corporate collective body. But quite obviously, this is not what Professor Friedman has in mind. He wants the reader to believe that state, governmental socialism will be the end result -- that socialized, nationalized property will replace private property. But he has not made his case. All he has hypothetically demonstrated is that the political processes by which power and resources are distributed inside the corporation are similar in form to some of those same allocative processes that are operative in government. He has not demonstrated that an extension of the former will grow into the latter. Nor has he demonstrated (nor even raised as an issue) that the private political allocative mechanism of the corporation (through which socially responsible executives make their decisions) is anything other than a variant of the market itself.

In fact, the corporation _is_ an extension of the private market mechanism. It may be political. It is not governmental. Decisions made through it are _private_ decisions, taken in pursuit of _private_ goals, inspired largely by the hope of gaining _private_ profits for distribution to _private_ owners and reinvested as _private_ capital. Just how this private process leads necessarily to socialism in the governmental sense has yet to be explained.

This raising of the specter of governmental socialism and collectivism as the logical outcome of corporate actions undertaken in the name of social responsibility is the most shameful and least defensible of all the interpretative errors made by Professor Friedman.

But is this not mere quibbling over terminology? If in fact corporations act like government, does it really matter that they aren't legitimately authorized to act that way? And isn't this the very danger that Professor Friedman is pointing out to us?

Well, Professor Friedman can't have it both ways. If he favors a private allocative mechanism (the market) and if the collective corporate community is such a private mechanism (the current variant, or at least a portion, of the market), then he has to be on the side of the private decision makers, i.e., the corporations and their managers. But since he quite clearly does not applaud public decision making by private parties, he has no choice but to turn to government for those decisions that cannot or will not be made through the private market. But in doing so, he abandons the market, which he prefers! Which will it be, Professor Friedman -- the market whose very core is composed of the collective corporate community that you enveigh against, or the government whose powers you also suspect? You say you prefer instead a simpler time when the competitive model more nearly approached reality? Ah, so do we all!

Suppose the choice would be government-sponsored social-action programs, in order to escape corporate take-over of legitimate government functions. Would there be safeguards against encroachment by the wielders of private corporate power, even if government had to seek the cooperation of the private business community in making such programs effective? Of course, there would be. A great and apparently powerful body of public opinion and public law, reinforced by judicial interpretations, stands as a bulwark between legitimate governmental power and properly circumscribed private corporate power. Few people today, in or out of government, favor total corporation take-over of social-action programs; and all can observe the often reluctant and sluggish moods of private corporations themselves in tackling such problem areas. Indeed, instead of a creeping corporate conspiracy to assume legitimate governmental functions, one sees just the opposite: a hesitant community of private corporations, prodded by the law and public opinion to become involved in social problems to a greater extent than their inclinations or skills impel them to. A strange kind of subversion, indeed!

Rampant Exploitation

A third interpretative error is found in Professor Friedman's comment that private competitive enterprise "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." The mind boggles at this assertion when it is considered in the context of American business history over the past century. Was it so difficult to exploit child labor, women workers, all factory workers prior to the 1930's, black people generally as workers and consumers, consumers in a variety of markets both before and after the passage of some of the anti-trust and consumer protection laws, and even other businessmen themselves, especially when the smaller ones were pitted against the larger? The great ease with which business exploitation was accomplished is a well known hallmark of the private competitive enterprise system in late 19th century America. The partial abatement of these exploitative tendencies into the latter part of the 20th century has been achieved, not by resort to greater doses of competitive private enterprise, but by government regulation in the form of anti-trust laws, safety standards, and government encouragement of competing power centers in labor, agriculture, and consumer groups. Call this an attempt by government to emulate the conditions that would normally be present in a textbook model of competition, if you will. But don't attribute the result to "private competitive enterprise," and don't maintain, as does Professor Friedman, that during the freebooting period when private enterprise was in its heyday and competition reigned supreme, naked exploitation of others was difficult. We must, after all, give Andrew Carnegie and Commodore Vanderbilt their historic due.

Waiting for Godot

A fourth interpretation with which it is easy to disagree is the Friedman contention that prompt, rapid action to solve social problems through the private sector is less important than preserving democratic principle and achieving general consensus even though the latter may be long in coming. Depending upon where one is located in the social system, it is possible for some to be willing and able to wait for solutions to be produced slowly. Such a person can even resort to the elevated rhetoric of fundamental principles, democracy, consensus, etc., favoring these over immediate action. All of this is understandable, and we should allow Professor Friedman such privilege. It is doubtful, though, if corporations and the general public can thus fiddle while their Rome burns: the air thickens, the streams choke, radical rhetoric is followed by homemade bombs, blacks revolt, women rebel, youths protest, the city rots.

Again, Professor Friedman has recommended to us an archaic institutional ideal -- this time, "democracy" -- at a time and under social circumstances where new and different institutions have not only supplanted those older ones but where still others are now needed. At a time when even Establishment Scholars question the efficacy of pluralism in generating workable alternatives for today's social problems, one marvels at this suggestion that we cling to "democracy," even if in so doing we suffer collective social paralysis.[3]

The machinery of pluralistic consensus includes the narrow vested interests, the corrupt politicians, the sluggish bureaucracies of both government and business, and the many other non-democratic elements of politics as fought out at local, state, and federal levels. Professor

Friedman's defense of these groups and practices -- whose very actions and values often block meaningful action to resolve social problems -- has a hollow ring when done in the name of democratic principle. What is in this case offered as "democratic" turns out to be nothing other than those interests who find themselves threatened by prospective change. Is it proper, under these circumstances, that society should work to preserve the machinery of assent when that machinery seems capable of producing nothing but vetoes?

Given the oft cited paralysis of liberal government as it faces today's social crises,[4] some fruitful new pathways of cooperation between public and private sectors may be the only means of meeting those social challenges. As the smoke trails into the sky from the burning city, should we cling, with Professor Friedman, to the pluralistic deadlock, arrived at "democratically"? Or should we push along, in characteristically pragmatic American fashion, to find workable solutions, even though they may fall short of an abstract and now somewhat suspect ideal?

Business Loves Coercion

Ah, if the world were just as simple and neatly categorized as Professor Friedman believes it to be! Now he tells us that "The political principle that underlies the market mechanism is unanimity," while "The political principle that underlies the political mechanism is conformity." Market decisions are voluntary. Political decisions are coercive. Has a nice ring, doesn't it? Unfortunately for his argument, such simple, ideal stereotypes of both the market and government, and the imagined actions they induce, have no real or actual existence. To the extent that business history may be brought to bear upon the question, the opposite conclusion seems to be true. Many businessmen who have operated in highly competitive markets have learned to their chagrin how powerfully coercive and unyielding the market can indeed be. In a perfectly competitive market, there is no recourse beyond the prevailing market price. You meet it or perish. This is conformity with a vengeance.

On the other hand, American business history is studded with instances of businessmen voluntarily flocking to government to achieve various economic privileges and benefits (capital for investment, tax write-offs, cash subsidies, favorable regulations, etc.) not attainable through the market mechanism. Careful historical research now establishes the widespread support among important businessmen at the time for the Clayton (Anti-trust) Act, the Federal Trade Commission, the Federal Reserve System, and other business regulatory acts formerly and popularly thought to have been opposed by business interests *per se*.[5] Professor Friedman's notion of all governmental actions as instances of coerced conformity simply is not borne out by these and similar cases taken from the history of American business.

Real Problems or Mere Catchwords?

There are a number of other errors of interpretation committed by Professor Friedman which could also be mentioned but these are perhaps less important than those already treated. He errs by over-simplifying when maintaining that "Society is a collection of individuals and of the various groups they voluntarily form" -- because society is more than just people and because involuntary social groupings are also a part of society. And it is difficult to believe that a man whose professional economic advice is sought by Presidents and Presidential aspirants actually believes that such societal problems as unemployment, discrimination, and pollution are little more than the "catchwords of the contemporary crop of reformers." That's what he says, but it is still difficult to believe that he means it. Perhaps it is only a Friedmanian put-on. If not, then he errs again.

A "Benign Neglect" of Central Issues?

What is it that Professor Friedman has left out of his discussion that is germane to the controversy? Five fundamental omissions can be identified. By not treating these points, or even suggesting to his readers that such matters are a part of the entire question, Professor Friedman commits what most scholars would consider an unpardonable and highly irresponsible act, not really worthy of one with such otherwise impeccable academic credentials and reputation.

He ignores the role that private business has played in bringing on some of today's social problems. A number of leading corporation executives now freely admit that business has indeed been one of the parties partly responsible for such conditions as widespread environmental pollution, racial discrimination in hiring, and lax safety standards in various consumer products. In the face of a rising tide of public opinion against private business for being involved in such abuses and shortcomings, how is it possible for one to maintain with such unconcerned equanimity that the sole responsibility of private businessmen is to tend their own profitable gardens, with no concern as businessmen for the quality of life around them? If the pursuit of profits has been partly responsible for our present social condition, are we simply to press on for more profits as a way out of present difficulties?

Professor Friedman also ignores the simple fact that much of the talent and many of the skills needed to be marshalled for an attack on society's problems lie within the private corporation. No one would wish to argue that all such skills are there, or that all persons in the corporation have such skills. But it would be foolhardy to ignore the vast pool of human talent and scientific resources and know-how that are available within the corporate sector of the society. Presently they are not focused on the solution of social problems, and perhaps they never will be. But it is not likely that such vast societal concerns and upheavals as we are witness to today will yield solutions without significant involvement of the private sector in one way or another.

Oddly enough, Professor Friedman -- that sturdy advocate of the private enterprise system -- fails to tell his readers just why it is important for businessmen to pursue profits as their sole aim and responsibility. To what rationale does he appeal? But, you may say, that is a self-evident matter and therefore it is not essential that he discuss it. Perhaps. Another explanation, though, might be that that traditional rationale -- profit as sole or central motivator, profit as reward for socially productive activity, profit as future payment for present sacrifice -- constitutes so incomplete and inadequate an explanation of business behavior that even its most staunch ideological defenders hesitate to put it forward unflinchingly. It is an odd omission.

Closely related to that failure is another. There is no acknowledgement of the social character of the business corporation. Students have long recognized the economic role of the corporation -- as producer, capital accumulator, investor, distributor, employer, seller, supplier. What is now evident -- and omitted completely in Professor Friedman's account -- is that the business corporation is preeminently a broad social institution, also. All of its acts have social consequences -- from production to pollution. Its routines effectively shape the social lives and many of the attitudes of its employees. Its products and services become its customers' standard of living. Its decisions to expand or contract, stay or move away, innovate or stagnate, directly and vitally influence the lives of all members of the community in which it resides and does business. Governments at all levels depend upon it for revenues, the arts thrive or not as corporate gifts ebb and flow, schools and universities base their continued efforts to achieve excellence on the generosity of their corporate donors. What is not made clear by Professor Friedman -- most likely because it cannot be made clear on logical grounds -- is why we should imagine the corporation's economic functions to be either superior to or separable from its social functions.[6]

Nowhere in the article does Professor Friedman offer clear approaches to pressing social problems. As noted earlier, in certain places he even seems to doubt that there are such problems, although this posture can perhaps be dismissed as a trivial error induced by stylistic expression. But one concludes the article wondering just where he has left us, as we contemplate the burgeoning list of social problems. About all we know is that he believes that businessmen are about to commit suicide by downgrading the profit motive and embracing the notion of social responsibility. What we don't know is: Where does that leave us with respect to the social problems themselves? That, after all, is the pressure that brought social responsibility as a doctrine to the fore. Does Professor Friedman have an alternative, especially one that is workably effective in the economic, social, and political conditions of our times?

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