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CORPORATE SOCIAL RESPONSIBILITY: AN ECONOMIC PERSPECTIVE ON AN "ETHICAL" ISSUE

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Hell is paved with good intentions.[1]

Whether American business is or should be "socially responsible" is a question that has received some attention from economists for quite a long time. The issue has gained currency in recent years in light of such unhappy events as the risky positioning of gas tanks in Ford Pinto automobiles, the prevalence of pulmonary disease among long-term asbestos workers, and the Bhopal tragedy. The purpose of this brief essay is to point out that what may appear the obvious ethical response to questions about the desirability of corporate social responsibility is far from obvious to economists. By a somewhat similar token, the "cold hearted" economic response to such questions may, upon reflection, turn out to be appropriate.

The Morality of the Marketplace

To assess the argument that corporate responsibility is a useful check on the undesirable results of unfettered markets requires an understanding of what we mean by "good" economic performance, and how "good" behavior by individual managers contributes to it. In other words, we want to be able to make evaluative, or normative, statements about what constitutes appropriate behavior of managers, and then see under what conditions such "good behavior," in the context of freely functioning markets, will lead to "good" economic performance.

At the level of the individual manager, one might say that good behavior is that which conforms to the accepted moral standards of society. Such behavior goes beyond simply obeying the law, and addresses the many situations of moral

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1. J. RAY, ENGLISH PROVERBS (1670).

conflict which all individuals are called upon to resolve in the course of everyday life.

How each person deals with such problems depends not only on the values she has learned, but on the institutional environment in which she finds herself. Thus one might expect an individual working for a large corporation with a distinct managerial hierarchy to resolve a conflict between two employees differently than would an individual working in a university with its rather more fluid structure. Moreover, the nature of the moral dilemma is likely to be different for different institutions. The manager of a chemical company may face a decision about whether to undertake the development of a new product for which waste byproducts have unknown but suspected toxic qualities, whereas a physician may have to decide whether or not to remove a patient from life support systems. Nevertheless, in spite of the differences between institutions, and in spite of the fact that it is clearly possible for equally responsible individuals to disagree over the appropriate course of action, there is, as Peter Drucker has argued, no reason to suggest that business managers should or do conform to radically different standards of behavior than anyone else.[2] Society expects all its members to approach the problems of the workplace with integrity and to eschew immoral behavior in all spheres of activity.

Even if everyone in a market-oriented society (and business managers in particular) were to behave impeccably well, the question remains whether such behavior would result in "desirable" economic performance.[3] This question opens a Pandora's box whose contents are addressed by a vast economic and philosophical literature.[4] Several issues predominate. One is the definition of "good" or "desirable" economic performance, a matter that is usually discussed in

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2. Drucker, *What is "business ethics"?*, 63 PUB. INTEREST 18 (1981).

3. Oliver E. Williamson identifies three types of self-interest seeking behavior in contractual relationships: opportunism, which refers to self-interest seeking with guile; simple self-interest seeking, in which the individual fully discloses her self-interest; and finally obedience, in which the individual subordinates her self-interest. Williamson argues that obedience is an inappropriate form of activity in the economic sphere, and that while simple self-interest seeking is the basis for neo-classical economic theory, the prevalence of opportunistic behavior should make such behavior an element to be considered in the development of institutions. O. WILLIAMSON, THE ECONOMIC INSTITUTION OF CAPITALISM 43-63 (1985).

4. Amartya Sen is one of the major contributors to this literature. *See generally* Sen, *The Moral Standing of the Market*, in ETHICS AND ECONOMICS 1-19 (E.F. Paul, J. Paul, and F.D. Miller eds. 1985).

terms of justice in the distribution of society's income and efficiency in the allocation of scarce resources.[5] A second major issue is the role of individual rights and entitlements in economic processes, as opposed to the fairness of the distributional outcome. A third issue is the role of government as a protector of rights or a guarantor of "good" market performance, or both.

The historic connections between markets, justice, and efficiency are well known. Modern inheritors of the ideas of Adam Smith,[6] John Locke,[7] and the Utilitarians[8] now tend to fall into two camps. Followers of the libertarian philosopher Robert Nozick[9] argue that markets, and only markets, protect fundamental moral rights. Those who follow the philosopher John Rawls[10] believe that individual rights can be understood only in the context of a just social constitution that would be agreed to by moral individuals ignorant of their ultimate position in the social order. Such a constitution would weight most heavily the interests of the most disadvantaged members of society; the market is manifestly an inadequate protector in the Rawlsian view.

American economists, while harboring some pro-market sentiments, do not usually go so far as Nozick.[11] They are nevertheless accused with some frequency of wholly uncritical acceptance of market outcomes.

Without exploring the philosophical or economic underpinnings in great depth, it should suffice to note that, whatever one's personal beliefs, almost all societies—including the most vigorously individualistic—have chosen to intervene pervasively in the marketplace. There are all sorts of market results—ranging from the distribution of income to the quantity of air pollution to the menu of

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5. Justice and efficiency, however, are intertwined to the extent that an independent definition of each may prove impossible.

6. A. SMITH, THE WEALTH OF NATIONS (1776).

7. J. LOCKE, SECOND TREATISE OF CIVIL GOVERNMENT, (1690).

8. Modern utilitarianism springs from the work of John Stuart Mill, *e.g.*, UTILITARIANISM (1861), and Jeremy Bentham, THE WORKS OF JEREMY BENTHAM (1837). *See generally* UTILITARIANISM AND BEYOND (A. Sen and B. Williams eds. 1982).

9. R. NOZICK, ANARCHY, STATE, AND UTOPIA, (1974).

10. J. RAWLS, A THEORY OF JUSTICE (1971).

11. This is true even of "Chicago School" enthusiasts. Milton Friedman, for example, is about as vigorous a defender of the free market as American economics has produced. Yet even he concedes a need for collective (governmental) intervention, although within very narrow limits to be sure. *See* M. FRIEDMAN, CAPITALISM AND FREEDOM (1962).

safety devices on our automobiles—that we alter *via* government mandate. Unless one contends that political/legal choices in these matters have been massively distorted, the judgment has already been rendered: markets do indeed produce some outcomes that society considers unacceptable.

Corporate Social Responsibility: Pro and Con

Once the reality of undesirable market outcomes is acknowledged, the argument for corporate responsibility may appear self-evident. Many business decisions carry the potential for enormous social good or ill, perhaps more so now than in times past. Who could possibly hope that our captains of industry would ignore the commonweal in narrow-minded pursuit of the "bottom line?" Surely it is preferable that companies build safer rather than more dangerous cars, limit their air pollution, and avoid committing environmental atrocities. If corporate managements are willing to do these things in the name of a broadly construed social interest, will anyone—save perhaps Milton Friedman—really object?[12]

It turns out that the "self evident" proposition is not really obvious. There are, in fact, at least two fundamental difficulties with the idea that corporate social responsibility will solve the problems associated with the market system. The first difficulty has to do with "externalities"[13] or third-party effects; the second with the accountability of public as compared with private institutions.

Consider the management of a pollution-creating factory that aspires to corporate statesmanship, and suppose that no anti-pollution laws exist. What is the "responsible" course of action for this management? Should the company voluntarily reduce its pollution? By a "little bit?" By a "moderate"

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12. Consider Friedman's well-known statement: "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine." *Id.*, at 133.

13. "Externalities" refers to the frequently unpleasant, or even dangerous, impact of activities upon nonparticipants: for example, the cost imposed by a chemical manufacturer's pollution upon nearby residents who neither work for nor purchase the products of the company.

The increased importance of pollution in a nation such as the United States is tied to the growth of income and to population density. In a frontier society, how one disposed of one's garbage was a matter of no concern to (distant) neighbors. In a modern urban setting there is a great deal more garbage and one's neighbors are both close and numerous.

amount? By enough to drive the firm out of business? This last alternative points out a fundamental reality. Pollution abatement is costly in two ways. To install the necessary equipment must raise both production costs and product prices (if it were not costly in this sense, even the non-responsible firm would install it). But if the added cost forces the firm to reduce its output—in the extreme, to leave the market—then consumers lose access to the goods produced by the polluter: automobiles, heat and electricity, convenient food packages, and medicaments to ease our discomforts, among them. What, then, *is* the "responsible" choice of such a company's management?

The hard fact is that even if the polluting firm voluntarily reduces its activities, its own restrictions will have a negligible effect on the environment unless other firms follow suit. If they do not follow suit, moreover, our "responsible" management will also have damaged its competitive position in the bargain. Hence, there is absolutely no incentive for a firm to reduce its pollution in the absence of a law. Quite the contrary, any company that acts "irresponsibly" will benefit if all other firms are "well behaved."

This is precisely the scenario that illustrates the impotence of the market in dealing with environmental degradation. Markets do not do an effective job of providing a "public good" such as pollution control. And, when appropriate resources are not allocated to such tasks, the case for laws that require all firms to shoulder the burden is clear-cut.

A major task of the market, its *raison d'être*, is precisely the balancing of the myriad costs and benefits that every economic activity creates. The central virtue of competitive markets is that they allocate resources efficiently, meaning that resources flow to the uses in which they are valued most highly.[14] When the market fails, as in the case of pollution control, various forms of government intervention can in principle correct the failure by requiring appropriate action. By contrast, exhortations to corporate management to "act responsibly" convey not the slightest guidance about how to proceed.[15] Once antipollution laws are in place, society ex-

14. The equivalent Pareto notion of efficiency is a situation in which the welfare of one or more members of society can be improved only by harming the welfare of another or others. Economists have long demonstrated that a system of perfectly competitive markets implies such "Pareto optimality".

15. Milton Friedman has asked: "If businessmen do have a social responsibility other than making maximum profits for stockholders, how are

pects from business managers the same integrity in compliance as it does from businesses and individuals in, say, paying income taxes.

The second objection to reliance on corporate conscience is at least equally compelling. Let us suppose that our polluting firm's management can somehow define what it means by a socially responsible policy, and limits its activities accordingly. Is this an ethically satisfactory result? The answer would seem to be no, although it may not be the worst conceivable result.

Air pollution presents serious and complex societal problems, the "appropriate" treatment of which is often not obvious. The best we can strive for in these circumstances may well be reasonable *procedures* for seeking appropriate, nonobvious resolutions. Here our options are limited. The most effective solution mechanism is ordinarily the market, but markets do not deal well with pollution problems because of the heavy external component in pollution costs.

If we abandon the market, at least partially, the choices that remain are: the government agency and the corporate conscience. The problems that accompany government regulation are both familiar and real.[16] Public agencies have one critical virtue, however: they *are* accountable to the public, even though the accounting system tends to work imperfectly.

We ordinarily permit private executives to make our economizing decisions because we believe that these decisions are appropriately controlled by the market. Where market discipline is eroded, as in the pollution case, an alternative type of control—governmental—is appropriately substituted. In either event, society holds sway. Unacceptable economic

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they to know what it is?" M. FRIEDMAN, *supra* note 11, at 133.

In a similar vein, Ben W. Lewis, an economist with very different views from Friedman's, has observed: "[corporate conscience] may assure us that the men who make the decisions will be well intentioned and good, but it tells neither them nor us anything about the shape of goodness; it tells no one what society wants done and, hence, what to do." Lewis, *Power Blocs and the Operation of Economic Forces: Economics by Admonition,* 49 AM. ECON. REV. 384, 395-96 (1959).

16. These range from specific distortions in the use of factors of production, such as in the overinvestment in capital that is termed the Averch-Johnson effect, *see* Averch and Johnson, *Behavior of the Firm under Regulatory Control,* 52 AM. ECON. REV. 1053 (1962), to the possibility that captured regulators will act as a cartel to advance the interests of the "regulated" firms, *see e.g.*, Stigler, *The theory of economic regulation,* 2 BELL J. OF ECON. & MGMT. SCI. 3 (1971).

choicès will be penalized, either by market forces or by public agency regulators.

To rely to any important extent on managerial discretion (corporate conscience) when the market breaks down, seems an odd way to go. Society has, by assumption, lost market-type control over its choices; yet no other mechanism to enforce social accountability is in place. This is an inauspicious scenario, even though our business leaders may be well intentioned and capable.

The pollution example that we have been discussing represents a clear market failure; the chemical manufacturer, ignoring the external costs of its activities, produces a result that is "incorrect" in terms of efficiency. It is quite apparent, however, that even a properly functioning (efficient) market can yield arguably unethical outcomes.

Consider a company whose product occasionally injures its users, and suppose that it is technically possible to make the product safer. The company's decision not to increase its product's safety is, by assumption, efficient: to make a safer product would be so costly that it would outweigh any conceivable gains (such as improved reputation and fewer lawsuits by injured consumers).

Would a "socially responsible" management move to improve product safety? Once again, the answer is not obvious. Greater safety is good but costly, and we have assumed that the costs in this instance outweigh the gains. One *might* decide that additional safety is the "responsible" course, but the criterion for this decision is obscure. Surely there is no general basis for arguing that morality requires the expenditure of *any* quantity of resources, however large, in order to obtain *any* increment in safety, however small.

At a more mundane level, the management that decides to pursue additional safety incurs potentially heavy penalties. Since the extra safety increases costs (by more than compensatory benefits), a reasonably efficient market will not reward such statesmanlike conduct. Indeed, in a vigorously competitive environment, the highly responsible firm might not survive.[17]

We thus see precisely the same difficulties with social responsibility in an efficient market setting as in the market fail-

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17. Even if the firm's market is not highly competitive, there may exist an efficient market in "corporate control." If so, the company that acts "responsibly," thereby reducing its profits, is likely to become a target for takeover by a more traditional, profit-oriented group.

ure case: the meaning of responsible behavior is unclear, and if only one company acts responsibly (having managed to define what responsibly means) it suffers a competitive disadvantage. Moreover, if the "responsible," competitively disadvantaged firm is able to survive, society may yet be ill served. For we are then subject to the non-accountable whims of a corporate leadership that has somehow managed to decide for us what is to be considered "responsible" behavior.

Conclusion

Corporate responsibility, like motherhood, is a difficult thing to criticize, and we should no doubt hope that if our business managers possess broad discretion to affect society they will exercise this power benevolently. The real question is whether we should rely on such judgment in lieu of government intervention. In both economic and ethical terms, the answer is no.

Lee Iacocca is an estimable gentleman, but we do not want him deciding what amount of smoke in the air is best for us—at least not unless and until he is elected to public office. This should be our decision and our neighbors' decision; or, if the market does not permit that, then the decision of someone who is accountable to all of us. Social responsibility is a desirable personal trait, not only in a business executive but in all citizens (this statement is an uninteresting truism!). Social responsibility is not, however, a rational mechanism for important social and economic choices in a democratic society.