The Tragedy of the Stakes: Business Ethics Without Zero-Sum Thinking

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John Rawls famously described society as a cooperative venture for mutual advantage. Living together with others in a way that respects the moral status and needs of those others as you can expect them to respect yours, requires living with them on terms that serve your ends as well as theirs. Rawls' point, or at least one of his points, was that people's material gains should be the result of actions that improve the situation of others. By contrast, "is not just that some should have less in order that others may prosper." (13)

This is not an essay in Rawlsian political philosophy. This is an essay about business ethics, and stakeholder theory in particular. But Rawls' formulation expresses a general idea of justice or morality that we can, and I believe should, treat as a fixed point in our ethical thinking. My main point, then, is that stakeholder theory fails in light of this fixed point. In fact, it encapsulates quite an opposite view of justice.

1. The division of responsibility

We live in a society of divided labor. We do not expect our electricians to fix our plumbing. We do not expect our school teachers to raise our children. We do not expect a sales person to install our new DVR. Being familiar with the benefits of the division of labor, we know *not* to expect these things. We know that, if we start expecting our electricians, teachers, and sales people to do everything, we cannot expect them to do anything well.

Companies are possible only within a society characterized by a division of labor. It's what gives them their point. There is no advantage in working together if everyone is doing everything all the time. Subject to the division of labor, companies can be more than we could ever be separately. Just as we can ask too much of our electricians, teachers, and sales people, we can ask too much of our companies too. And when we do, we erode the possibility of companies adding the kind of value to our lives that we want – the kind of value that gives them their point.

Good moral theories, too, accept a division of labor. They accept it in their content, by allowing a theory of business ethics to be a theory of *business* ethics, and not a theory of everything. And they accept it in their prescriptions, by reflecting that we cannot expect people to be responsible for the fate of everybody else. Good moral theories recognize that we all have lives to live, jobs to do, and limited time, knowledge, and abilities. And they encourage us to do our parts well, while trusting that others will take their responsibilities in turn. Good moral theories know that dividing the work is necessary if we are to be benefits to the people around us and the societies in which we live.

The point, here, is not that we can't reasonably expect more of our people or our theory-building capacities. This is not a point about "merely" empirical facts versus "pure" moral principles, or the nature of human motivation posing limits to the content of human duty. Of course, we *can* expect more. The point is, rather, that to expect so much more will predictably lead to people producing less.

There is a flip-side to Rawls' remarks about justice, then. The best way to make sure everyone is served by living in society is to protect people from becoming responsible for everything. Just like it's okay for the electrician to fix your wiring, and then go home to take care of her family, so too it's okay for a company to fulfil its own responsibilities, such as serving its customers, doing right by its employees, while refraining from harming third parties in the process. Companies do not have to implement the difference principle, or whatever else the full content of justice might be.

We can formulate a kind of consistency test for a good theory of business ethics or corporate social responsibility, then. Such a theory must be at least consistent with the overall aim of society as a cooperative venture for mutual advantage. It must, that is, put economic agents in a position to further their own ends through the furthering of others. This is true of economic agents in general, and companies in particular. Ethical companies do not seek to prosper through making others have less.

Of course the same is true of those who surround our companies. While ethical companies do their business in ways that benefit others, it's not their job to make sure society prospers as a whole. To demand that would be to ask too much, put them out of business, and make those who rely on them much worse off. Living justly in a society that contains ethical businesses, then, means not looking to those companies for everything. We respect them, as we demand they do of us, by taking our own responsibility.

2. Collective responsibility problems

When David Hume offered a speculative account of the origins of justice,[1] he saw the point of justice along very much the same lines. Justice, for Hume, allows human beings to overcome two important problems. On the one hand, we naturally find ourselves in a condition of scarcity. Since we are all separate people living lives that contain separate ends, there simply are not enough goods or resources naturally available to satisfy us all. On the other hand, we can overcome this problem of scarcity through using our productive abilities. When we apply our work to resources, we can transform a situation of scarcity into one of untold abundance.

This transformation involves hard work, often really hard work. And humans being humans, they cannot be expected to do this hard work merely for the sake of others, and at the expense of themselves. We might lack the requisite motivation. Or we might lack the requisite knowledge. Most likely, we lack both. And why would it the job of those workers to sacrifice themselves for the rest of us anyway? It's the job of justice, then, to pose rules for interaction that make it in our own interest to do this hard work in ways that also benefits others. Justice, again, makes our interactions be for mutual advantage.

Suppose things were otherwise, and we lived under rules that encourage a different way of bettering ourselves. Suppose, in other words, that one party getting ahead means another being set back. Apparently, this would be unjust. So what's the problem?

Imagine you run a fishing company, selling groupers you catch in the sea. You know, of course, that you're not alone catching grouper. There are many competitors out there, also trying to make a living this way. You cannot prevent them from doing so – you don't own the sea, no one does. So every fish they catch is one you've missed out on. And since you cannot control how much they catch, there is little point in restricting how much you catch. No matter what you do, the others might catch too many fish anyway.

Of course, there's nothing special about you. In fact, your competitors are in the very same position. Since they cannot exclude you, every fish you catch is one they're missing out on. And since they cannot control how you fish, they see little point in limiting how much they catch. You might realize this. As might they. And you might anticipate the problems this creates by fishing as much as you can, before all the groupers are gone. As might they.

Let's make this more precise. Think about your options as the owner of the fishing company. One option, call it Option A, is to restrict your fishing to the level that, if everyone were to adopt it, would sustain the grouper population. Doing so is clearly in your interest since if the grouper goes extinct, you will have lost your livelihood. Of course this means forgoing some benefit now, but if the grouper survives it will have been well worth it. But this option is risky since your competitors will likely not similarly restrict their use, leading to the groupers going extinct anyway. So Option A is not very attractive, as it involves losing *both* future earning *and* the current earnings you could make by fishing more.

Option B, then, is to catch more, perhaps as many as you can. Of course this may not feel great, as you are catching at a level that, if everyone were to do it, would harm the grouper population. But then again, you don't know whether others will do this, too. If they do, the grouper will go extinct anyway. If they don't, you can't catch them all.

The choice is clear – no matter what your competitors do, you should use as much of the resource as possible. Given the situation, there is no self-interested reason for you to restrict your fishing to levels that would be, if everyone adopted them, sustainable. And there likely is no moral reason either. Little is gained by insisting on the kind of moral purity that comes with doing what would be one's fair share in one situation while being in another. Given the situation, it's not your responsibility – or that of your competitors – to maintain the resource. You probably couldn't do it if you tried, and if you did try it would become impossible for you to make a living. It is precisely because the survival of the grouper population has become everybody's business that it ceases to be anybody's business.[2]

Garrett Harden famously called this the "tragedy of the commons." The tragedy is that, while each person has reason to keep the commonly held resource intact, each has an incentive to overuse the resource. Our combined actions thus predictably lead to the destruction of the resource. The logic of the problem is similar to that of a prisoners' dilemma. Because no individual has the ability to exclude others from the resource, no individual has control over how the resource is used overall. The resulting uncertainty about the total use of the resource creates incentives for each individual user that together predictably lead to the resource – and the livelihoods it represents – to be depleted, mismanaged, or destroyed.

The resulting situation we might call one of economic conflict. The economic conflict lies in the zero-sum nature of our interactions. It's not hard to see that situations of economic conflict might shade into situations of conflict, period. Ship captains might cut each other off. One might try to misdirect the other. If one boat breaks down others with empty bowels might rejoice instead of help. Is there an oceanic equivalent to road rage?

The fishery situation thus is very different from the vision of justice sketched by Rawls and Hume, as the way for one fishing company to prosper is to make its competitors have less. In this sense, your gain comes at the expense of others. And given that this is the same for each of the companies involved, everyone's ability to make a living involves depriving others of their ability to do the same. The value of one's business is necessarily subtracted from what's available to others.

3. Justice, ethics, and stakes

One of the most popular suggestions about how companies should limit their behavior, in order to comport with the demands of justice or ethics more generally, comes in the form of stakeholder theory. At its most general level, this theory, socially responsible corporations, and ethically run businesses in general, must act in the interests of all the parties that have a stake in the decisions that they make. The idea, very roughly, is that to act morally or responsibly, the company must do more than serve its customers or increase shareholder value.

There are, of course, many different kinds of stakeholder theory. Some claim that the theory's conclusions follow from the *nature* or *purpose* of the firm (as a social entity or vehicle through which various stakeholders pursue their interests), (Boatright 2000; Evan and Freeman 1988). Others recommend it for strategic reasons, as a managerial tool (Donaldson and Preston 1995). Yet others see the theory as delineating appropriate regulatory concerns, the proper scope of corporate law, a theory of corporate governance, and so on.[3]

Despite all these differences, there are some common or recurring features between the different versions of stakeholder theory. The one on which I focus here holds that companies' decisions morally ought to take into consideration the interests of all who have a stake in how they act. The idea is "to broaden management's vision of its roles and responsibilities to include interests and claims of non-stockholding groups". (Mitchell et al. 1997: 855). In short, the company must serve the interests of everyone around it.

This theory has some undeniably attractive features. It expresses that companies, like people, are socially embedded, and that we cannot run roughshod over the valid claims and rights of others in pursuit of profit.

Freeman first introduced the term "stakeholders" to refer to "groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions" (Freeman 1998: 129). The suggestion is that managers have moral obligations take into account the interests of a variety of groups. The moral aim of business, in a phrase, is to serve the interests of those who are relevantly affected.

Much of the practical upshot of the theory, of course, will depend on how one identifies the "relevantly affected" class. And much has been written about this "identification problem" (e.g. Mitchell, Agle, and Wood 1997: 856–858). Freeman distinguishes between a "narrow definition" of the term (Freeman 1998: 129), which refers to groups that are "vital to the success and survival of the firm," and a "wide definition," (Freeman 1984: 46) which refers to any group "who can affect or is affected by the achievement of the organization's objectives."

The former group plainly includes the employees, customers, and suppliers of a firm. On most on most versions, it includes the local community as well. The wide definition, on the other hand, includes all who are affected by the business' activities. This would include much of the larger society, and perhaps even the world, in which businesses operate. Of course finding the correct balance between all these interests will not be easy. Since the aim is to "keep the relationships among stakeholders in balance", managers find themselves in a position that is "akin to that of King Solomon." (Freeman 1998: 132)

We can set aside this issues for present purposes. For whichever way we conceive of the relevant class of stakeholders, the problems below will very likely arise. The problem is due to the fact that if businesses really were required to take into consideration the interests of all stakeholders, a number of highly pernicious incentives follow.

To see this, consider first the following four incentives:

(a) An incentive to be *among* those who have a stake in how the firm acts,
(b) An incentive to *maximize* the extent of one's stake,
(c) An incentive to *prevent others* from having or developing a stake in how the firm acts, and
(d) An incentive to *minimize* the extent of the stakes of others.

The rationale behind these incentives is the same throughout. The extent to which one stands to gain from the way businesses operate depends on the size of one's proportional stake. One gains more, that is, the larger the numerator and the smaller the denominator of one's share of the total stake in the business's operations. At the limit, the point at which one's interests are served *best*, the proportional size of one's stake will be 1.

The incentives above are ways to move in this direction. One can increase the numerator by, first, making sure one is counted among the stakeholders. Once you are counted, the business in question will have to serve your interests. Second, one can increase this by maximizing the interests one has in how the business operates. The larger your stake, the more you stand to gain from the business' decisions. One can decrease the denominator in two analogous ways. First, one can limit the ability of others to become among the stakeholders. Fewer stakeholders means fewer claimants to the business' pie. And second, one can work to make others' stakes as small as possible. With others' receiving smaller slices, more of the pie is left for one to gain.

The dynamic created here of course precisely reproduces the tragedy of the commons-situation discussed above. Let us call this, then, the *tragedy of the stakes*. The result is to encourage behavior in the economy that renders our ends zero-sum or rival once again. Your gain comes at my expense, and my gain means you must lose. The more a business' decisions become a matter of weighing the interests of various stakeholders, adopting the role of King Solomon, the more those holders' stakes come to stand in conflict.

Stakeholder theory thus makes everybody's business become everybody's business. And when everybody's business is everybody's business, tragedies occur. As we have seen, such incentives are utterly destructive. They prohibit productive activities, savings, and investments. They encourage short-term thinking and indeed conflict. As Freeman puts it, "there will surely be times when one group will benefit at the expense of others." (Freeman 1998: 132)

At times, Freeman has asserted that the claims that stakeholders can make on on businesses are limited by the stakes of others, and thus that businesses cannot be required to trade them off against each other. (Freeman, 2009, p. 66) But even if trade-offs between these demands are prohibited, the tragedy does not disappear. The effect is only to change the point at which the tragedy of the stakes plays out. If stakes cannot be traded off against each other, potential stakeholders find themselves facing a kind of arms race. They will want to get their stake as large as possible as quickly as possible, thereby precluding others from raising theirs. The result is the same: wastefully maximized demands, dependencies, and zero-sum interaction.

This alone would be enough for stakeholder theory to violate Hume's challenges. But things are worse. The four incentives above describe the effects that stakeholder theory will have on those who are relevantly affected by a business. But this is only one side of the coin. Just as stakeholder theory will have incentive-effects on those outside of a company, it will also have effects on the inside.

Here things are no better. A fifth incentive – really a collection of incentives – is for companies to minimize the social good they actually do and potentially might do. After all, the larger the actual or potential good impact of a company on society, the greater the incentives will be for those around it to ratchet up their proportional stakes. The greater the social benefit a company produces, the more mouths it has to feed, in other words. This may be the most tragic part of the tragedy of the stakes. What started out as a theory of corporate social responsibility or ethical business has become a recipe for exactly the opposite.

None of this is to say, of course, that it is *wrong* for businesses to take the interests of stakeholders into account. A system can avoid these kinds of tragedies only by empowering owners to decide how they want to use their possessions, including their businesses. And so they can – and clearly at times should – exercise their rights for the benefit of others. There is a place in our lives for rights and duties, and there is a place for virtue and plain old decency. But we must not lose sight of the *place* of these demands. The ethics of business cannot override or undercut the central motivation of the kind of property rights on which companies, exchange, and productivity are based in the first place.

4. Some objections considered

The argument above holds that stakeholder theory is unacceptable because its implementation would create incentives that are incompatible with a society in which productive activity is encouraged. Indeed, stakeholder theory encourages exactly the opposite. A society organized around the principles of stakeholding will encourage *extractive* behavior, it encourages people to seek their own gain at the expense of others. As we saw, this is incompatible with justice. And so stakeholder theory fails the consistency test we spelled out above.

One possible objection to this argument is that it assumes that stakeholders will be unscrupulously trying to serve their own interests. Perhaps in *practice* stakeholding will be socially destructive, but this does not disprove that *in principle* it is still the right thing to do. The objection fails because the theory argues precisely *against* such unscrupulously selfish activity. At most, then, it might be thought that I have shown only that in practice managers ought to be careful. Perhaps they should incorporate the ideas of stakeholder theory only to the extent that doing so will not be too destructive, say.

This is a mistaken objection, for two reasons. First, stakeholder theory tells us something about the moral responsibilities of companies, not of those who have a stake in their decisions. As such, it is perfectly silent on what those stakeholders may or may not do in good conscience. If the theory is to prohibit the increasing of one's relative stake, it needs to provide a much larger, and holistic account of how people's stakes and interests are supposed to be balanced against each other. This would require a complete theory of distributive justice, and thus puts the theory well beyond the confines of corporate social responsibility.

Second, while the objection does refer to the incentives it creates, it cannot reasonably neglect those incentives. Perhaps there is a place for a kind of utopian theory in philosophical ethical theory, where we can ignore how people will actually act in the real world. But for a theory of corporate social responsibility, this will not do. These are theories that must be applied within real-world contexts, and as such must take seriously the kind of incentives they create.[4]

When social relations become zero-sum, real conflict looms. Not mean only in the practical sense of fighting (although, at the limit, fighting does loom), but in a more philosophical sense of conflict that threatens the very possibility of justice). When we interact in mutually beneficial ways, we can see each other as people who have something *to add* to society, people whom we should welcome as valuable contributors. Stakeholder theory pushes us in quite the opposite direction. It makes the people with whom we seek good and just relations into negatives or threats to our own well-being, people to be avoided or ignored. This is a much deeper and disturbing kind of conflict. It does not require fighting, it disturbs the very possibility of harmony among people with different goals, desires, and lives.

- In this new setup: what if the constraints themselves are unjust? My answer: we ought to approximate what would be just. Approximate is not mimic, though, for reasons of second best.

5. Limiting corporate social responsibility

The viability of a theory (and, of course, the practice) of corporate social responsibility depends on our account of the *content* of what corporations are responsible for. Stakeholder theory is perhaps the dominant proposal of how to understand this responsibility. But, as we have seen, however, this theory fails as it recreates a tragedy of the commons.

The problem in these cases is that parties have at the same time too much and too little responsibility. They have too much responsibility because the fates of those around them come to depend on their actions. They have too little responsibility because the behavior of those others effectively determines the terms on which they can run their own affairs. In the case of stakeholder theory, the imposition on a business of a duty to care for the stakes of those around it creates the incentive not to start a business at all.

The typical solution to these types of commons problems is to grant parties private property rights that enable them to exclude others from their possessions. By excluding the claims of others on a resource, we simultaneously limit and expand the responsibilities of each. We limit their responsibility by preventing others from relying on them for their wellbeing. We expand their responsibility by making them fully responsible for what they own. As a result, it becomes in the owner's interest to have the resource survive. Fishing companies will cease overfishing because they can reasonably anticipate that limiting their catch will help maintain the stock over time. They will aim to make a living tomorrow as well. In this way, exclusionary rights sever the ties that otherwise drag a business down to the point of dysfunction or non-existence.

It is no surprise, then, that societies containing well-functioning and widespread systems of private property contain far greater economic promise than their rivals. They promise, that is, to do more than just maintain the stock of resources. Because owners know that they will be able to reap the full benefits of their lot, ownership incentivizes them to invest time and money and increase the resource's total productivity, for example by removing the underbrush, fighting common diseases, protecting the lot against potential poachers who might cut trees at unsustainable rates, and so on. Life under an economic system characterized by property thus promises standards of living that are vastly superior to life under non-propertied systems.[5]

Of course, sometimes such a solution is not possible. While groupers typically do not swim large distances, other fish do. And we cannot fence off the ocean. In those cases, the best we can do is for our governments to try and impose fishing restrictions. But either way, the solution remains the same in spirit. We save ourselves from the tragedy of the commons by limiting what we expect of the companies involved. We do not tell them to save the world. We tell them to make a living, within the limits of justice.

Stakeholder theory does not propose to *abolish* the system of private property. But in imposing its supposedly ethical demands on companies that are supposed to function within such a property system, it threatens to undo the very dynamic those systems are supposed to create. This is the sense in which stakeholder theory is unacceptable. In light of its problems, stakeholder theory is less an account of how firms and corporations can act in socially responsible ways within an economic system like ours, and more an attack on that system at large.

The task of a theory of business ethics, then, is to formulate norms for running an ethically acceptable business that pass the consistency test developed above. Such theories must be at least consistent with, and perhaps hopefully strengthen, the positive-sum nature of the interactions between businesses and their communities.

The upshot, then, is not that companies ought to simply maximize profits or maximize profits within the constraints of the law. A theory proposing this would allow businesses to engage in many forms of extractive and zero-sum behavior. It allows for rent-seeking behavior, such as lobbying efforts that aim to change the legal landscape in ways that move away from positive-sum terms. It allows them to take full advantage of sub-competitive market circumstances, for instance by setting excessively low wages as a monopsonist in the labor market. It allows them to impose externalities on non-consenting but legally unprotected parties. And so on.

We can summarize the point, then, by saying that companies ought to operate in ways that approach, as much as can be reasonably expected, their conduct under conditions of robust competition. Under such conditions, parties will have low barriers to entry into the market, leading to the presence of many buyers and sellers. There will be no unwanted externalities, no significant information disparities, and so on. For a market to be robustly competitive, it need not to display these features *fully*, as would be true of a textbook case of perfect competition. Perfect competition likely never exists. In any case, it is not necessary for satisfying the consistency test.

When a company acts in ways that reasonably approach these conditions, it satisfies the consistency test. It will be interacting with others as if they are consenting and well-informed. It will thus refrain from taking advantage of radical information disparities and, *a fortiori*, refrain from creating them. And it will refrain from imposing unwanted or unconsented to effects (negative externalities) on others. Businesses that act in this way aim to maximize community surplus (the sum of consumer and producer surplus), by seeking to make a profit through offering their customers the best deal they can find. And they will do so in all markets in which they operate – whether they be sellers of products, buyers of labor, buyers of materials and resources, or whatever.[6]

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[1] Treatise: ""if every man had a tender regard for another, or if nature supplied abundantly all our wants and desires, that the jealousy of interest, which justice supposes, could no longer have place; nor would there be any occasion for those distinctions and limits of property and possession, which at present are in use among mankind. Encrease to a sufficient degree the benevolence of men, or the bounty of nature, and you render justice useless, by supplying its place with much nobler virtues, and more valuable blessings. The selfishness of men is animated by the few possessions we have, in proportion to our wants; and it is to restrain this selfishness, that men have been obliged to separate themselves from the community, and to distinguish betwixt their own goods and those of others."

See also David Hume, *An Enquiry Concerning the Principles of Morals*, Section III, Part 1 (Oxford University Press, 1998).

[2] The game theoretic model is as follows:

Option B is a dominant strategy – it is in each party's interest to choose B no matter what the other does. Despite being terrible, the outcome is stable, or in equilibrium, because no individual has an interest to deviate from their course of action and choose A.

[3] There are relevant differences between versions of the theory that see corporations, companies, or economic agents in general as its addressee. Nothing in what follows turns on the selection of any of these, however.

[4] I have set aside questions about corporate governance or law. To the extent that these conclusions are true, incorporating stakeholder theory into the law will be all the more damaging, of course.

[5] Thus Hume emphasized that even though property rights mean that I cannot just take what I want or need, "it will be for my interest to leave another in the possession of his goods, provided he will act in the same manner with regard to me" (ToHN, sec. II: "Of the Origin of Justice and Property")

[6] Naturally, being committed to avoid taking advantage of an extractive playing field, they will refuse to invest resources in manipulate the playing field to allow for such extractive behavior.