THE LIMITS OF CORPORATE SOCIAL RESPONSIBILITY

(revised)

by

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Presented to

The Conference on the Impact of Corporate Social Responsibility

at

Wake Forest University
Winston-Salem, North Carolina, USA
14 April 2016

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Headline

There is a sense in which the common good is promoted by an ethic of corporate social responsibility, but it is not the sense in which the phrase is normally used.

Abstract

The doctrine of corporate social responsibility has passionate advocates and critics. I propose that the doctrine of corporate social responsibility has merit to the extent that it conveys a limited but important aspect of social responsibility. This sense of corporate social responsibility helps to insure that firms do that which clearly promotes the common good. But this sense is not what most advocates mean by the phrase. The commonly understood sense – that firms have a responsibility to promote social welfare through positive moral action apart from their core function in a free market society – is actually deleterious to social welfare.

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Introduction

Over the last half century it has become increasingly difficult to find someone who does not automatically agree with the doctrine of corporate social responsibility. To offer skepticism is to invite immediate *moral* disapproval. One would suspect that such a consistently fervent moral response would be well supported by compelling social, political, economic, or philosophical arguments, or perhaps by mountains of empirical evidence. Yet even among passionate advocates of corporate social responsibility it is difficult to find anyone who will even try to make a substantive case for how it actually helps to promote social welfare.

In this paper I argue that there are two very different senses of the concept of corporate social responsibility, one that is good for society and one that is not, but it is the latter that gets all of the attention. The socially beneficial sense conveys a limited but very important kind of corporate social responsibility, which is that those who own and work in firms should abide by an ethic of duty-based moral restraint. I explain how this sense of corporate social responsibility helps insure that firms do not reduce social welfare through negative moral actions while at the same time insures that firms behave in ways that most effectively *promote* the common good.

Unfortunately this is not the sense emphasized today. Today the doctrine has much more to do with encouraging positive moral action than discouraging negative moral action. I shall argue that this sense actually harms society. Among other problems, it obfuscates what would otherwise be a clear objective for firm behavior – an objective that is consistent with maximizing output per person, general prosperity, and therefore the common good. I then offer an explanation for why the socially harmful sense has come to dominate the socially beneficial sense.

Parsing the phrase

What, exactly, does the phrase “corporate social responsibility” mean? The word “corporate” is certainly well defined. The adjective “social” modifies the word “responsibility” presumably to draw contrast with the firm’s obvious responsibility of promoting the welfare of its shareholders. No one claims that corporations don’t have a responsibility to their shareholders. The adjective “social” exists to imply that a moral firm understands it has a responsibility to society that goes beyond its responsibility to its shareholders. This comports with another important concept in modern business ethics, stakeholder theory, which overlaps with the doctrine of corporate social responsibility.[1]

The adjective “social” also suggests that we can eliminate all justifications for the doctrine based on its creating value for the firm because it will engender approval from potential customers and thereby drive up demand for output. That would benefit shareholders, of course, but it would do so only by moving business from one firm to another. This will not produce a net benefit to society. The doctrine should therefore be evaluated from society’s point of view, not the firm’s.

The third word in the phrase, “responsibility,” suggests something more than mere desirability or laudability. It suggests that a corporate firm has some kind of moral duty to society that goes beyond its duty to promote the welfare of its shareholders. This word is trickier than it first appears. There are at least two senses of this word that imbue the doctrine with two different meanings. I shall argue that this has a great deal to do with determining whether the doctrine actually promotes or undermines social welfare. I propose that the concept of responsibility can be divided into two categories: *ex post* and *ex ante* responsibilities.

Ex post responsibility refers to being responsible for having done or not done something in the past. If one is responsible for having already done or not done something and a morally positive outcome results, then this is often rewarded. The reward can be external in the form of social approval (e.g., what Adam Smith called approbation), a medal, a plaque, a parade, and so forth. The reward can also be internal in the form of increased feelings of esteem.[23]

If one is responsible for having done or not done something in the past and this produces a morally negative outcome, then it often elicits some kind of punishment. The punishment can be external in the form of social disapproval (e.g., what Adam Smith called disapprobation), diminished status, a fine, jail time, and so forth. It can also be internal in the form of experiencing feelings of guilt.

Negative moral actions often harm others and when this happens, the responsible party often expected to rectify the harm by, at the very least, making the harmed parties whole.

Ex ante responsibility refers to being responsible for doing or not doing something in the future, such as our expectation that parents will continue to take care of their children or our expectation that drivers won't throw trash out their windows. Instead of rewards or punishments, ex post, ex ante responsibility engenders encouragement or discouragement, ex ante. This can be external (ad campaigns, the urgings of parents and teachers, etc.). It can also be internal in the sense that one has built up character that has produced what are now hardwired emotional triggers that makes one expect to experience feelings of esteem ex post, so one is thereby more likely to undertake actions that would produce such feelings.

It is common in modern business ethics to view different types of responsibilities as simply manifestations of competing moral values. The problem with such thinking is that it fails to recognize important differences in logical function. These differences have surprising implications for how firms behave and, in turn, the extent to which they promote the common good.

So the phrase "corporate social responsibility" means that corporations have a moral duty to do certain things and/or to not do certain things if they are to be good citizens of society. I shall argue that this is half right. In so doing, I hope to draw attention to the limits of the doctrine of corporate social responsibility.

Corporate Social Responsibility *Ex Post*

In various contexts some have argued that it is possible for everyone associated with an organization to be of good moral character and to always strive to behave in a good and honorable manner, but the organization is still inherently bad for society because the whole is not merely the sum of its parts.[4] Because of this, simply pointing to the ethical character and ethical conduct of the owner and every worker in a firm is not sufficient to assure that everything the firm does is ethical.

This is a fair point. So are firms – apart from the behavior of their owners and workers – typically responsible for having done something good for society or something bad for society? Put more directly: *are firms inherently good or inherently bad for society?* This is a crucial question for if it can be shown that firms are inherently good for society, then it follows that bad firms are not bad because they are firms, they are bad for some other reason. The most likely reason, of course, is that their owners and/or their workers do wrong.

I shall argue that what firms do in a free market society is inherently good. As such, unless shown to have been corrupted via the unethical behavior of owners or workers, firms should not be regarded as bad or even as necessary evils since they are clearly forces for good.

To reiterate, this does not mean firms cannot be bad. It only means that if firms are bad it is not because their essential nature fates them to be bad. I will show why their essential nature is good in that it automatically promotes the common good without harming anyone along the way as a means to that end. Bad firms that do exist are therefore bad because their owners or their workers do bad things. I shall therefore argue that firms only have something to make amends for if their owners or workers behave badly.

Juggernauts of cooperation

I submit that firms are, at their core, nodes of cooperation. To understand the essential nature of firms, then, one must begin with understanding the concept of cooperation. To that end, let us suppose that alone person *A* makes 10 and person *B* makes 10, but cooperating with one another they make 26. The difference between the whole and the sum of the parts is 6, and this is a most important difference indeed. If this difference is not expected to be positive, cooperation will not occur. This is because *A* and *B* will not work together unless coerced, which hardly seems an appropriate use of the word cooperation. We call this difference the *cooperative surplus*.[5]

The grand story of human advancement parallels the grand story of economic development, and the grand story of economic development is a story of humans figuring out how to cooperate ever better in ever larger groups. Over time an increasing proportion of such cooperation occurred outside of the household and within firms. As humans devised institutions that induced the subsequent evolution of firm governance structures, this facilitated ever more effective cooperation in ever larger groups, achieved through ever larger and more sophisticated firms.

Even before the emergence of anything we'd recognize as a firm today, cooperation often produced surpluses that led to more output than could be used by the cooperators involved. In the absence of exchange, the story would normally end there with greater productivity arising from cooperation simply affording more leisure. Exchange provided opportunities to trade surpluses for goods that were produced in other groups. So while cooperation is far older and more fundamentally important than exchange, it was exchange that was the real key to unleashing the full power of cooperation.

Many organisms cooperate, some very effectively, but none other than humans (and almost certainly some of our extinct cousins) engaged in more than trivial forms of exchange. So as is so often the case, Adam Smith was right. Dogs obviously cooperate in the wild, but "Nobody ever saw a dog make a fair and deliberate exchange of one bone for another with another dog."[6]

The human capacity for communication made exchange with strangers possible and allowed humans to cooperate more effectively at the same time. It also allowed them to *flexibly* cooperate in much larger groups than other organisms can.[7] Yet again Smith's wisdom is in evidence, for Smith did not merely argue that specialization dramatically increases productivity. Smith also argued that the increase in productivity arising from specialization rises dramatically with group size since this affords an ever finer division of labor.

An expanding scope of goods and services that could be acquired through exchange drove up the value of cooperative surpluses. As a result, the incentive to cooperate grew so cooperation occurred in ever large groups to achieve ever greater returns to specialization.

As the groups within which cooperation grew, the ability to make decisions through mutual consent gave way to informal voting. Voting, however, becomes increasingly inefficient with group size (the value of being able to vote falls with the likelihood of being the median voter) so increasingly those who were members of such nodes of cooperation found it in their best interest to abandon collective decision making through voting and to adopt hierarchical management and direction instead (Alchian and Demsetz 1972; Grossman and Hart 1986; Hart and Moore 1990; Hart 1995; Rose 2000).

So what started out as small group cooperation – not unlike wolves hunting caribou – slowly evolved into more formally structured forms of cooperation. At some point this transformed cooperative teams into what anyone would recognize today as a firm. A formal model that exemplifies a conjectural historical account of how this might have happened can be found in Rose (2000), but the main idea is not hard to grasp. Cooperation was, in the beginning, induced by the prospect of a cooperative surplus, and to enjoy the benefits of sharing surpluses people formed cooperative nodes. Whether we call them groups, or teams, or firms, these are all fundamentally cooperative nodes whose existence is ultimately derived from cooperative behavior animated by the expectation of a cooperative surplus that could make all parties better off at the same time.

Cooperative surpluses are a very important part of the story of how free market economies produce general prosperity. Simply exchanging things only moves resources around so the total output per person remains the same. Oh it might be more efficiently distributed so the utility value of output might rise per person, but the amount per person is still the same. The key to increasing social welfare over time is increasing output per person over time. Efficient distribution, while important, is obviously secondary to having more to distribute in the first place. The way a society gets more per person is to foster more cooperative behavior so it can pile up cooperative surpluses. The larger the sum of surpluses for a given group of people, the more output there will be per person. Given the definition of cooperation and the cooperative surplus, this is almost true by definition.

Profit maximization and cooperation

People cooperate because cooperating increases their welfare because they can share in the cooperative surplus. While it is true that most people enjoy the process of cooperation, I submit this is because the increase in welfare and survival rates arising from cooperation reinforced traits that support cooperation, traits like preferring working with others rather than alone. If cooperation did not improve welfare by increasing payoffs, such traits would either not exist or be significantly weaker.

Obviously the greater is the expected value of the cooperative surplus the stronger is the incentive to cooperate. The truer it is that membership in the group is voluntary (a very unlikely thing early in human history but a very likely thing today in modern free market economies), the truer it will be that competition for team members will drive surplus splitting to equal shares. This insures that one's opportunity cost plus an equal share of the surplus will be paid. This, by definition, insures an improvement in welfare at the margin.

In practice, profit is a very complex thing to compute. In principle, however, it should already be clear that, at its core, profit is cooperative surplus. Profit is, ultimately, the value of output minus the value of that which was given up to make it. All that is required to turn the cooperative surplus into a profit is to multiply the outputs and the inputs by the prices involved.

I submit that anyone who wishes to study or go into business, or presumes to regulate business activity with an aim toward improving social welfare, should recognize that profit is ultimately the measure of cooperation. This is a very important point. It means that maximizing profit effectively maximizes the value of cooperative surpluses out of which increasing output per person is made possible. In this way, the maximization of profit promotes the common good by increasing general prosperity because increasing general prosperity necessarily starts with having more per person.

Careful readers will wonder if this story might fail to satisfy the Pareto criterion for welfare maximization. According to the Pareto criterion, increasing the welfare of some by decreasing the welfare of others does not count as evidence of greater social welfare. Critics of capitalism often concede that Smith might be right that a free market system will dramatically increase total output and thereby output per person, and might even maximize it. But they go on to argue that this does not necessarily imply that everyone in the story will be made better off over time.

It is quite possible, therefore, that more output per person can result with some being made better off while others, perhaps even most, being made worse off over time. Such a position is far from fanciful. This story fits the facts well, perhaps because it was created to do so. But in any case nearly everyone knows the images of the late 19th century with its dramatic increase in total income and wealth evidenced by grand estates and parties, alongside extreme misery among those in the lowest classes who worked long hours in factories, some at a very young age.

This is an inadequate reading of Smith but I don't think this argument is entirely disingenuous. This objection can be addressed to the satisfaction of most people by pointing out that if, in a story of social, political, and economic development, each transaction involves some people who are either better off or unaffected, and none who are worse off, it is not the case that great improvements are springing from greater misery. As long as all transactions are voluntary, each of the thousands upon thousands of transactions upon which a free market society grinds forward through time improves the welfare of everyone involved. And to those who quibble that some are made better off to a greater extent than others, it is normally the case that it is the poor who have the greatest return on their sacrifice.[8]

In short, for the set of all voluntary transactions, it follows that social welfare is at worst unchanged and otherwise improved. Those who wish to get rich do so by engaging in high surplus producing transactions and as many of them as possible, but in doing so they quite automatically improve the welfare of everyone else involved be they bankers, investors, employees, contractors, retailers, or customers.

It should be noted that the argument above makes a heroic technical assumption (strictly interior solutions) that raises important side issues concerning the distribution of wealth. These are very serious issues indeed. One such issue is that the prices of things like real estate can rise faster than the returns to cooperation by the lower classes because the upper classes can spend much more on such things. They don't just spend more because they have more, they can also spend a greater proportion of what they have because one can only eat so much, as it were. This means at the margin of the transaction one is better off relative to not engaging in the transaction, but over time the real value of one's earnings falls because prices for things like land, especially, can increase faster than nominal earnings.

This is not a foolish story but it is an issue for another time. This is because this potential problem is not pertinent to what follows, for these effects are downstream of this analysis, which is aimed at explaining why the maximization of profit by firms is in fact a very good thing for society in general because it gives us more output per person. This is separate and primary to the issue of optimal distribution.

It should also be noted that nothing above implies that in a free market system everyone is becoming better off all the time. Changes in supply and demand occur constantly and the resulting changes in prices can wipe out individual firms and even entire industries. Those who worked in such firms or industries can find the value of their firm and/or industry specific human capital wiped out and therefore their welfare dramatically reduced. In a system where such fluctuations in supply and demand could be magically eliminated, these losses would never be suffered. But while this is a terrible cost of the free market system, it has nothing to do with whether it is better for firms to maximize profit from society's point of view. A firm that pursues multiple objectives and therefore does not maximize profit can be wiped out by a demand fluctuation, too.

If maximizing profit ultimately amounts to maximizing the value of cooperative surplus and therefore the value of output per person, then it follows that anything that impedes the maximization of profit ultimately impedes the maximization of the value of output per person. In so doing, it impedes the maximization of social welfare and therefore does not best promote the common good.

Bad versus inherently bad

Nothing above suggests that there are no bad firms. There are firms whose owners or workers do bad things in connection with the firm, in so doing making such firms bad firms. But from the discussion above it should be clear that what makes such firms bad is not their essential nature but the nature of those who comprise them. Profit maximizing firms are inherently good for society. So if a firm is a bad firm it is not because firms are inherently bad. It is because bad people have caused the firm to do things contrary to its inherently good nature.

In this, profit maximizing firms are hardly unique. Consider a charitable organization that everyone agrees is morally praiseworthy. If such an organization were to be led by unethical people and therefore run in an unethical way, it would not mean that the charitable organization is inherently unethical. It would simply mean that when unethical people use organizations to do their bidding, they can make otherwise inherently good organizations bad. This is very different from, say, an organization that was created to practice organized crime or to engage in racial hatred. In such cases the organizations involved are indeed inherently bad.

This suggests that it is generally mistaken to punish a firm – a mere legal fiction in the case of a corporate firm – for wrongful behavior that can be traced to it. But punishing a firm might be an efficient form of shorthand by which society punishes the firm's owners and, indirectly, even its workers, since often bad behavior is tolerated by owners intentionally or is the product of willful neglect because owners enjoy some of the benefits of such behavior.

Punishing firms, then, is not necessarily inconsistent with understanding that firms are inherently good so bad behavior emanating from them is necessarily rooted in individual persons. But it important that such punishment be understood as being in lieu of direct punishment to those individuals who were responsible for the misbehavior. Getting rid of the bad people involved or compelling them to change their ways is the real goal so the firm will get back to the business of unambiguously improving social welfare.

Viewed *ex post*, then, firms inherently bear *social responsibility* for having improved social welfare at the margin and thereby for having promoted the common good. Those who say firms are obliged to "give back" to society therefore leave a very misleading impression. Honestly run firms can't possibly give back what was never taken.

Does it then follow that honest firms deserve a reward? In a stroke of good luck for humanity the answer yes and no. They might deserve a reward for not being dishonest but most adults of high moral character do not remember a childhood of constant rewards for not disobeying their parents and teachers. In any case a reward turns out to be unnecessary. For firms, the profit seeking that leads them to automatically do that which best promotes social welfare is its own reward. No parades or medals are necessary to get them to do what we want them to do to, but a little respect might be nice.

Corporate Social Responsibility *Ex Ante*

From society's point of view, what should firms be trying to do in the future? What is their responsibility to society *ex ante*? Are there things that firms should be trying to do or trying to not do in order to be moral rather than immoral? It would seem obvious that, at the very least, firms should be responsible to society insofar as they strive not to behave immorally.[9,10]

Positive moral actions are actions that are generally considered good, right, or moral because they nearly always improve the welfare of other individuals, groups, or society as a whole. Negative moral actions are actions that are generally considered bad, wrong, or immoral because they nearly always reduce the welfare of other individuals, groups, or society as a whole. What I shall call moral exhortations are moral values that encourage undertaking positive moral actions. What I shall call moral prohibitions are moral values that discourage taking negative moral actions.

Positive moral action

In firms, do exhortations to take positive moral actions increase, decrease, or leave unchanged social welfare? At first the answer seems obvious – of course having firms possess moral values that exhort positive moral action increase social welfare because encouraging more of a good thing has to be a good thing, all else the same. But this is the obvious answer only if one adopts a *non-social* perspective. When one adopts a truly social perspective, it becomes clear that all else is not the same.

From the point of view of society it is necessary to account for all of the costs involved. Positive moral actions are actions and, as such, normally require resources. This leaves fewer resources with which to undertake other actions, including other positive moral actions. Although a given positive moral action may appear laudable at the margin, from society's point of view it is not desirable if the cost of taking it results in more worthwhile positive moral actions not being taken.

If a firm responds to an exhortation to take a positive moral action other than that of maximizing profit, then it follows that such an exhortation is either meaningless because it changes nothing or is meaningful but deleterious because it diverts resources from efforts to maximize profit. How can I make such a bold claim? The answer comes from understanding that profit is ultimately the measure of cooperation and cooperation is the ultimate key to maximizing general prosperity by increasing output per person.

Undertaking a positive moral action out of funds that would otherwise be distributed to firm owners as profit is certainly good for the recipient of those funds, but every dollar that goes to the recipient is a dollar that does not go to firm owners. Firm owners could have used that dollar for personal consumption, for saving, or for their own charitable giving. So dollars diverted from owners by firm managers so as to directly fund positive moral action reduces the firm owners' welfare dollar for dollar – a zero-sum game.

Advocates of corporate social responsibility might quibble by arguing that firm owners also take pleasure in the charitable giving undertaken by the firm. This is likely true for many to some extent, but such an argument is misguided. The firm owners can undertake such giving themselves and it would be remarkably unlikely that they would choose exactly the same charities in exactly the same proportions that firm managers choose. This mismatch is produces an efficiency loss that suggests that dollars diverted by managers to directly fund positive moral action produce a negative-sum outcome.[11]

Reallocation of resources from the owner to fund a charity directly through corporate giving produces a negatives-sum outcome for society as a whole for another reason. Such a dollar comes from what would have otherwise been a payoff arising from positive-sum activity. To the extent that the reduction in this payoff reduces the return to positive-sum activity it reduces the level of such activity and therefore reduces the realization of the cooperative surpluses that occasioned such activity in the first place.

This necessarily ends-up costing more than one dollar because one must also add to the dollar in question the expected loss in cooperative surplus that would have otherwise occurred but now won't. Since charity is not about cooperative production but is, instead, largely about providing resources for consumption to those who need it, most charity amounts to a redistribution of resources that is zero-sum in nature, where it produces at best one dollar of social benefit.[12]

If one were to argue that the above is untrue because charities can engage in cooperative production, then one has to make the case that they do this to greater effect than such production that is driven by the goal of profit maximization. Such an argument might exist but if it does it is not yet in evidence. It seems unlikely such an argument is likely to be crafted since if true, we would expect entrepreneurs to have seized such opportunities and rendered the issue moot.[13]

The big picture in the long-run

Out of cooperation comes a net increase in resources out of which more, not less, positive moral action can ultimately be funded by society as a whole. Consider a hunter-gatherer band in the Amazon jungle. In such a group there will be a great deal of positive moral action that effectively redistributes resources. You will see a great deal of cooperation, too, but not on a scale or on a level of sophistication we take for granted in an advanced free market society.

Any reader would, of course, rather be a low person in an advanced free market society than a low person in that hunter-gatherer band, even though there might be significantly more preoccupation in the hunter-gatherer band with positive moral action. The reason why is simple: positive moral action starts with resources and modest moral earnestness with a great many resources to work with beats great moral earnestness with only a few resources to work with. The ability to support the kind of cooperation we take for granted in our large firms is what ends up making the difference in this example.

But take away the returns to cooperation and you take away the cooperation. Take away the cooperation and you take away the cooperative surpluses. Take away the cooperative surpluses and you take away that which makes general prosperity possible. Pies get divided more equally, but they are much smaller pies.

In a nutshell, then, exhortations to take positive moral actions produce competing objectives to that of profit maximization. This either does nothing or it dilutes the effort put toward profit maximization and/or dilutes the returns that would otherwise flow to owners. Either weakens incentives for cooperation. This undermines the firm doing what it does uniquely well to promote the common good through increasing general prosperity. So if the money spent by corporate leaders on charity was instead spent by firm owners, it follows that there would be more of it, indeed very much more of it, that could be spent for such action.

Negative moral action

I have argued that if firm behavior is guided solely by the goal of honestly maximizing profit there is nothing more for firms to do with respect to positive moral actions. Indeed, additional positive moral action is demonstrably inefficient and therefore reduces social welfare. So other than honestly maximize profits, there is nothing more for the firm to do if it wants to best promote the common good. There is, however, something for firms not to do if they are to best promote the common good, which is the topic we turn to now.

In firms, do prohibitions against taking negative moral actions increase, decrease, or leave unchanged social welfare? Unlike positive moral actions, prohibitions are normally matters of inaction. As such they normally do not require additional resources at the margin. So in most cases to obey a moral prohibition does not leave one with fewer resources with which to undertake other actions.

Prohibitions against taking negative moral actions help firms positively contribute to social welfare in at least two ways. The first and most obvious way is that if a firm's owners and workers obey all prohibitions against negative moral actions, they will not use the firm to promote their welfare at the expense of society.

Note that this has nothing to do with taking it easy on profit maximization as an objective. In the mathematics of optimization, an objective function is maximized or minimized. If the objective function is a profit function, then it is obviously maximized. This amounts to finding the highest spot on plotted line. Doing everything one can to maximize profit amounts to doing everything one can to get to the highest spot.

In the real world, however, scarcity is everywhere, so there are constraints added to the problem of maximization. What constraints do is effectively redact the set over which maximization occurs. This redaction effectively removes parts of the objective function over which maximization occurs. But this does not mean that maximization does not occur or that it occurs but with restraint. It simply means that maximization occurs over the amended objective function.

My point here is that if firm owners, managers, and workers steadfastly obey prohibitions against negative moral actions – that is, if they act as though they possess an ethic of duty-based moral restraint – the net effect on society is quite positive, because this forecloses behaviors that might otherwise reduce social welfare in a completely unconstrained quest for profit.

Consider an individual who can make his division look better this quarter if he dumps untreated effluent into the river rather than pays to have it disposed of properly. This will benefit him, of course, and perhaps even benefit the firm owners, but it does so by imposing a cost on society in the form of a polluted river. There is no end to these kinds of examples and much of what irks citizens about the behavior of corporate firms comes down to these kinds of behaviors. But if firm owners and workers behave as though they possess an ethic of duty-based moral restraint then they will never lie, cheat, steal, or break laws to promote their own welfare or the welfare of firm owners.

The second way that prohibitions against negative moral actions help firms positively contribute to social welfare is indirect and hard to see, but is incredibly important nonetheless. Duty-based moral restraint is the key to having those in a firm refrain from opportunism at the expense of the firm itself. Remember, profit is the measure of cooperation and cooperation is the key to promoting the common good. Such opportunism can weaken the single objective of profit maximization. In so doing, it reduces the extent to which a firm contributes to the common good.

Consider top-level managers who might put together a merger that will reduce risk exposure to their firm-specific human capital. If such a merger reduces profit, even if only counterfactually, then undertaking such a merger is not consistent with maximizing profit so the firm will not be doing all that it can to maximize social welfare and thereby best promote the common good.

If, however, a firm's top-level managers possess an ethic of duty-based moral restraint, then they would abandon such a plan as soon as they concluded that it was not in the firm owners' best interest because upon being hired they effectively agreed to make decisions that are in the firm owners' best interest. Such a merger would benefit them at the margin but it would be wrong and, as such, the merger idea would be dropped.

Note that refraining from negative moral action in no way devalues positive moral action. On the contrary, since it results in greater output per person it provides more resources from which to undertake positive moral action from a social perspective.

Time Consistent Social Responsibility

Consider any firm that takes seriously its *ex ante* social responsibility to insist that all owners, managers, and workers always behave as though they possess an ethic of duty-based moral restraint. Such a firm won't cheat on laws or regulations, won't cheat its transaction partners (including its own workers), and won't induce, pressure, or manipulate workers into behaving as opportunists.

Now consider any firm that takes seriously its *ex ante* social responsibility to undertake positive moral action while not taking duty-based moral restraint seriously. Such a firm won't enjoy the advantages listed immediately above. In such a firm, the value of "doing good" is balanced against the value of "doing bad," through some mysterious casuistic calculation. And to the extent that emphasis on corporate social responsibility to undertake positive moral action crowds out emphasis on duty-based moral restraint, it does worse than fail to deliver the above – it undermines the ability of those who work in and transact with that firm to trust that firm.

So, *ex ante*, moral prohibitions trump moral exhortations. This raises the obvious question of which matters more, a firm's *ex ante* responsibility to teach and only tolerate duty-based moral restraint or a firm's *ex post* responsibility to rectify the harm it does to society? Recall that firms are inherently good for society because honest profit maximization has the effect of maximizing output per person. If firms have an *ex post* responsibility for having done harm, then, it is from harm that can be traced to the behavior of its owners or workers.

It turns out that we don't have to choose. The more fully a firm promotes an ethic of duty-based moral restraint among owners, managers, and workers as a matter of *ex ante* social responsibility, the less likely there will be anything for the firm to be responsible for, *ex post*, that requires making amends for.

So there is a sense in which corporate social responsibility is beneficial to society as a whole. That sense is that corporations contribute most to social welfare when everyone involved, all owners and all workers, abide by an ethic of duty-based moral restraint. Firm owners should teach duty-based moral restraint, demand it, and practice it. At the same time, those who teach business ethics will do the most to promote the common good by making this very argument, an argument that begins with understanding that the firm is, at its core, a cooperative node, and that honest profit maximization is therefore a very good thing for society.

But for this sense of corporate social responsibility to be fully manifested it must not be undermined by firms believing they must take positive moral actions. Corporations (owners and workers) should understand that as long as both owners and workers abide by an ethic of duty-based moral restraint, the corporation will inherently be a powerful force for the common good so there is nothing to make amends for, and taking further positive moral action ends up reducing, rather than increasing, social welfare, because it takes resources away from positive sum activity and directs them to zero-sum activity.

The doctrine of corporate social responsibility, to the extent that it stresses the need for positive moral action, derives its moral force from the claim that corporate firms must make amends because they are responsible for past actions that were not good for society but, rather, were in fact harmful. But if firms are inherently good in that what animates them inherently promotes the common good, then harmful actions are not the result of the firm's essential nature *per se* but of those who comprise it.

This means that if such firms teach and demand business ethics that stress the need for duty-based moral restraint over moral advocacy, the need for making amends disappears and with it, the need for positive moral action beyond maximizing profit.

Comparing corporations to sole proprietorships

One way to see the social cost of charitable giving promoted by the doctrine of corporate social responsibility is to compare large corporate firms to a single small sole proprietorship. Should a sole proprietor give some of his firm's profits to a given charity? The answer to this question is simple. Such a firm should do what its owner wants it to do. Society's only stake in this is to require that what he does is within legal, ethical, and moral constraints.

The answer to this question is simplified by the fact that we know precisely what the firm's objective function is in the case of a sole proprietorship: it is the owner's utility function. That's obvious. What is not obvious is that what really makes a difference is that this is but a single objective function, so maximization is a meaningful endeavor.

If the sole owner decides he wants to use some of his firm's profit to make a contribution to a charity, this is inherently efficient. He compares the marginal utility derived from making the gift to the marginal cost of giving up the money required and if for him the former minus the latter is positive, then the gift is perfectly rational for him and perfectly consistent with maximizing social welfare.

The question, then, is whether this scenario differs in an interesting way when we consider corporate firms. The answer is no. Divided shareholder ownership does not change the nature of the rational decision to give to charity. The (part) owner is, like the sole proprietor, confronted with the decision to give some his own profit to a charity. He compares the marginal utility derived from making the gift to the marginal cost of giving up the money required and if for him the former minus the latter is positive, then the gift is perfectly rational for him and perfectly consistent with maximizing social welfare. The effect of shareholder ownership is therefore not substantive unless one wishes to claim that sole proprietors are capable of rationally promoting their interests but individual shareholders are not.

This, however, does not mean there is no effect from shareholder ownership. As many have pointed out over the last half century – most clearly Harold Demsetz [Demsetz (1988), Demsetz and Lehn (1985)] – divided ownership introduces a wrinkle to the arithmetic involved, and this wrinkle introduces intrigue that is moot in sole proprietorships. This wrinkle is an example of a broader problem in economics: the problem of costs and benefits being realized over different sets of people.

Demsetz explained how increasing the number of owners can lead to an intensification of the problem of the separation of ownership and control. Consider a sole proprietor who hires a manager to do most of the day-to-day managing of the firm. Every dollar of profit that is not realized because the manager did not do his job well is one dollar less in the pocket of the sole proprietor. This does not make it rational for the sole proprietor to oversee every single decision, of course, but the marginal effect of mismanagement on a sole proprietors welfare is quite high so sole proprietors will closely monitor their managers.

Now consider *n* owners. Mismanagement that benefits the manager by one dollar and costs the firm one dollar in foregone profit costs the co-owners $1/n$ dollars each. Obviously, as $n \rightarrow \infty$, the cost to owners of harm arising from lack of monitoring vanishes, so careful monitoring also vanishes.

Something similar happens to the incentives that govern charitable giving when we consider ever larger numbers of owners. Imagine that some money might be given to a particular charity but the manager knows that not one owner would deem the charity worthy of the cost if confronted with the decision to contribute his own money directly. But suppose that the manager could arrange a gift for the charity and be rewarded with accolades for doing so.

If this were a sole proprietorship the manager would know that this would likely be noticed by the owner. But if there are a great many owners the marginal cost of the gift on any individual owner's portfolio of assets will be so small as to not be noticed. Such an owner would also likely have many other firms to monitor. While the substantive issues as they relate to social efficiency have not changed in this example – such a gift is not socially optimal in either case – the dilution of ownership changes monitoring incentives in a way that reduces *social* welfare.

Conclusion

In 1948 Richard Weaver wrote his masterpiece ***Ideas Have Consequences***. It is hard to imagine a better example of his point than the doctrine of corporate social responsibility. Like the phrase "I believe the children are our future," corporate social responsibility is a banal positive claim with a normative implication. And as we all know all too well, it is stated with such frequency and verve that one can't help but get the impression that is an immutable and self-evident fact of life.

Ideas have consequences in part because even simple phrases can function as socially harmful memes. Like a virus that doesn't just parasitize its host but also shuts down the host's immune system response to combat it, some ideas use mellifluous moral reasoning to shut down critical thinking. Since morality trumps everything else, moralizing is an excellent means by which to smuggle in self-serving ideas.

There is no shortage of critiques of the doctrine of corporate social responsibility and many are quite compelling (Hayek's (196) and Friedman's (1962, 1970) are the most famous). But they have also proven to be at best noble failures. I submit that the moral allure of the phrase is too strong for it to be toppled by theoretical or empirical criticism, no matter how well crafted. Almost by definition, morality trumps everything, so it won't do to hurl technical efficiency arguments and evidence against strident moral claims. This is why so many who know better have decided it is simply easier to jump onto the bandwagon with those with whom they disagree.

The better approach is to provide a positive case for the socially beneficial sense of the concept of corporate social responsibility and then, after having done so, explain why the currently popular sense is deleterious to the common good. This approach will give people something to be for rather than merely against, and hopefully their efforts will work to insure that the socially beneficial sense comes to displace the socially harmful sense over time.

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Endnotes

[1] R. Edward Freeman single handedly launched stakeholder theory with his book on the subject in 1984. The idea has since had an incredible influence on the world and has spawned a very large literature. For a review see Freeman *et al.* (2010).

[2] Smith, Adam. 1976 [1759]. *The Theory of Moral Sentiments.* Liberty Fund and Oxford University Press.

[3] In what follows I make a number of references to Adam Smith. For an excellent review of his work see Otteson (2002).

[4] This argument is frequently made with respect to institutional racism.

[5] This is laid out in more detail in Rose (2000, 2002).

[6] Smith, Adam. 1976 [1776]. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Volume 1, Book 1, Chapter 2, Liberty Fund and Oxford University Press, p. 26.

[7] "Flexibly" means cooperation via conscious rational decision making. Thousands of ants cooperate, of course, but their behavior is not flexible, it is written in their genes.

[8] This is not a vague empirical observation or argument. Alone *A* makes 10 and *B* makes 2, but together they make 14. In this case *A*'s payoff is the recovery of his opportunity cost of 10 plus his equal share of the surplus of 1, which equals 11. This is a return of 10% to what he brings to the table. On the other hand, *B*'s payoff 3, which is a 50% return. The intuition is that because competition drives surplus splitting to equality, it follows that individuals with the lowest opportunity costs will enjoy the highest return.

[9] Hayek (1960) was very critical of the doctrine of corporate social responsibility. He did, however, believe that corporate firms were not exempt from the kind of moral rules that society imposes upon individuals.

[10] Much of what follows in the next two sections is developed fully in Rose (2011).

[11] Another objection involves a private gain arising from tax law. But to the extent that tax law might subsidize charitable giving more if done by the firm directly than if done by firm owners is a matter of inefficient tax law and not the efficacy of the principle of corporate social responsibility *per se*.

[12] An important exception to this rule is public goods, for which the social benefit may far exceed the private benefits and therefore one dollar taken from the private sector may produce far more than one dollar of benefit to society if used to produce a public good. But this constitutes a compelling argument for how government might improve social welfare by using its power to provide public goods. There is no argument of which I am aware for why corporate firms are in a better position to provide public goods than government. More to the point, most charitable giving involves the provision of goods or services for which such provision is neither non-rival nor non-excludable. As such they are simply not public goods. And as such, from society's point of view, one dollar from one individual that goes to another changes nothing. If one argues that diminishing marginal utility makes this not so because a dollar taken from a rich person is worth less than a dollar given to a poor person, then one must go on to explain why the provision of social insurance is better conducted through the independent efforts of corporate firms than through government.

[13] If it is argued that this cannot happen because of market failure problems involved in doing so, then we are right back to the problem actually being a public good problem that is better solved by government than by firms.