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Friedman's Theory of Corporate Social Responsibility*

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Milton Friedman's theory about the social responsibilities of business is an extremely important and influential position. Almost everyone who writes on the topic writes at least partly in reaction to Friedman. Friedman's position was first stated in *Capitalism and Freedom*[1] A substantially different version is presented in his later essay "Social Responsibility of Business."[2] The first formulation (which I will refer to as F1) says that the one and only obligation of business is to maximize its profits while engaging in "open and free competition without deception or fraud."[3] The second formulation (which I will refer to as F2) says that business executives[4] are obligated to follow the wishes of shareholders (which will generally be to make as much money as possible) while obeying the laws and the "ethical customs" of the society.

Maximizing profits while engaging in "open and free competition without deception or fraud" is not the same as maximizing profits while obeying the laws and ethical customs of one's society. Acts which involve fraud or deception or which do not constitute open and free competition are not necessarily contrary to a society's laws or ethical customs. Further, the laws or ethical customs of a society might prohibit certain actions which are permitted by the injunction to engage in "open and free competition without deception or fraud." Certain corporate actions permitted by F1 are not permitted by F2 and vice versa.

"Social Responsibility of Business" was written seven years after *Capitalism and Freedom*. It might be suggested that we should accept the position formulated in "Social Responsibility of Business" as the final statement of Friedman's views. We shouldn't accuse Friedman of inconsistency simply because he has modified his views. But this simple solution to the problem of inconsistency does not work. The problem is that Friedman concludes "Social Responsibility of Business" by quoting and *endorsing* the passage from *Capitalism and Freedom* in which he first formulates his theory. He does not seem to be aware of the inconsistency in the two formulations of his position.

In Part I, I will present Friedman's two formulations of his position, explain how they differ, and illustrate the differences by presenting examples in which the two formulations yield different results. These examples reveal that both formulations have consequences which are seriously at odds with Friedman's intentions and stated views about specific issues. The problem of inconsistency can be resolved by opting for one or the other of the two formulations. But Friedman's intentions are not fully served by either formulation. In part II, I examine two modified versions of Friedman's theory and argue that it is doubtful that any defensible reformulation of the theory is fully consistent with all of Friedman's views about particular issues.

Friedman presents two different arguments in defense of his theory. The first argument appeals to the rights of the shareholders and the duties incumbent upon business executives who act as their agents. The second argument is a utilitarian argument which invokes the felicific tendencies of the free market. Friedman's very strong position against reducing profits in order to support charities and other social causes creates special problems. I shall argue that the first type of argument cannot support a view as strong as Friedman's. Whether utilitarian considerations support Friedman's position raises extremely complex empirical questions–e.g., "does maximizing profits (within certain rules) promote the general welfare?"–which I cannot even begin to resolve here. In the final section of the paper, I raise what I take to be a very serious objection to Friedman's theory and formulate a revised version of the theory which avoids the objection. I believe that this modified theory is preferable to Friedman's own theory; it is also consistent with the libertarian spirit of Friedman's view.

I

Friedman first states his theory about the social (moral)[5] responsibilities of business (business executives) in the following passage from *Capitalism and Freedom:*

> [F1] In such an economy ["a free economy"], there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.[6]

In a free economy the only moral obligation of business (or business people) is to maximize profits while engaging in "open and free competition without deception or fraud." The rules which require open and free competition and prohibit fraud and deception are constraints within which profit-seeking behavior must be limited. Businesses are not permitted to violate these constraints, even if doing so would increase their profits. In Nozick's parlance, the rules which require open and free competition and prohibit fraud and deception are "side constraints" on the pursuit of profits.

In "Social Responsibility of Business" Friedman formulates his view as follows:

> [F2] In a free-enterprise, private property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which will generally be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and in ethical custom. Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose–for example, a hospital or a school. The manager of such a corporation will not have money or profit as his objective but the rendering of certain services.[7]

Friedman concludes this essay by quoting and re-endorsing the earlier formulation (F1) of his position from *Capitalism and Freedom*. Speaking with reference to what he calls the "doctrine of 'social responsibility,'" he writes the following:

> It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why in my book *Capitalism and Freedom*, I have called it a "fundamentally subversive doctrine" in a free society, and have said that in such a society, "there is one and only one social responsibility of business–to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."[8]

These two formulations differ in a number of significant respects. 1) F1 is apparently intended to be a theory about the duties of profit-making companies (or the executives of such companies). F2 is broader in scope. It describes the obligations of executives or officers of both for-profit and not-for-profit corporations. 2) F2 leaves open the possibility that if the owners of a for-profit company wanted the company to serve any aims other than that of making money, then it would be permissible for the managers of the company to sacrifice profits in pursuit of those other aims. (This possibility is ruled out by F1.) 3) F1 says that the sole responsibility of businesspeople is to maximize profits while "staying within the rules of the game." F2 says that the responsibility of a business executive is to conduct the business in accordance with the desires of the owners while "conforming to the basic rules of the society." In both formulations Friedman refers to "rules" which are supposed to constrain businesspeople in their pursuit of profit (or other objectives of the shareholders). According to F1, businesspeople must constrain their pursuit of profits by engaging in open and free competition and refraining from fraud and deception. According to F2, businesspeople must constrain their conduct in accordance with the "basic rules of the society, both those embodied in law and those embodied in ethical custom." In other words, businesspeople must constrain their pursuit of profits by obeying the law and by obeying the rules embodied in the ethical traditions of their societies.[9] F1 says nothing about the duty to obey the law and nothing about any general obligation to obey (all of) the rules embodied in the "ethical customs" of one's own society. F2 says nothing about a duty to engage in open and free competition and refrain from fraud and deception. It implies that any of these would be permissible if they increased profits and were permitted by the laws and ethical customs of one's society. This is not a moot point, since the moral and legal codes of many countries permit practices which are contrary to Friedman's requirement of free and open competition; some societies permit practices which are considered fraudulent or deceptive in the U.S.

I will now describe five cases in which the two formulations of Friedman's theory will yield different results in practice.

Case 1–The duty to obey pointless laws.

Suppose that the building code of a city requires that all electrical cable for residential use must have insulation at least 1/4 inch thick. In the past this law significantly enhanced the safety of residential wiring. But the materials used to make insulation are now much better than those used earlier, and cable with 1/8 inch insulation is just as safe as cable which satisfies the requirements of the law. It adds substantially to the cost of houses and apartments to make them so that they meet these standards. Let us assume for the sake of argument that it is extremely unlikely that the government (or anyone else) would find out that the contractor's wiring does not meet the city's building code, and that even if it did find out, it is very unlikely that the city would prosecute the company. Do the executives of the building company have a moral responsibility to make sure that their company uses cable with 1/4 inch insulation? F1 implies that the executives are not obligated to ensure that the company complies with the law. In fact, inasmuch as ignoring the law would maximize profits without constituting fraud, deception, or a departure from open and free competition, F1 implies that the executives are *obligated to break the law*. On the other hand, F2 implies that the executives must comply with the law.

Case 2–The obligation to obey desirable laws.

Company X manufactures product Y. The president of X has just learned that the production of Y creates and discharges into the air an extremely toxic by-product x3x. It is illegal to discharge x3x into the environment. But x3x is very difficult to detect and no one else is aware of any connection between the manufacture of Y and x3x. Even in the unlikely event that its discharge of x3x were detected, the company would not be subject to any significant punitive measures or unfavorable publicity. (No one would suspect the company of having knowingly produced and discharged x3x.) It would be very costly for the company to prevent the discharge of x3x into the environment. It might be impossible for the company to do so without sacrificing all of its profits. Should the president attempt to remedy the problem or should she just ignore it and allow the company to continue to discharge the poison? F1 would require the president to *ignore the problem*. F2 would require her to *comply with the law* and cease discharging x3x into the environment.

Case 3–Acting contrary to the ethical customs of a society.

Suppose that the ethical customs of a particular society (S) strictly prohibit employers from dismissing long-term employees except when doing so is necessary in order to avert bankruptcy. But dismissing long-term employees in order to increase profits is not prohibited by the laws of S. X is a large company which operates in society S. X owns a small subsidiary company which runs a very unprofitable factory in a small town. X can easily continue to run the factory without going bankrupt, but closing the factory and dismissing the employees would increase its profits substantially. The workers at this factory do not have skills which would enable the company to transfer them to other facilities. Dismissing these workers is unlikely to gain much attention and this action is unlikely to be widely attributed to the parent company X or bring it much unfavorable publicity. Should the company dismiss the workers? F1 would require the company to close down the factory and dismiss the workers. F2 implies that it would be wrong for the company to do this.

Case 4–The ethical customs of a society permit practices which are inconsistent with open and free competition.

Imagine a society in which anti-competitive practices are permitted both by law and the conventional ethical code. Suppose that a company could enhance its profits by forming a cartel or lobbying for protective tariffs against foreign competitors and that such practices are in accordance with the wishes of the shareholders. Would it be permissible for the company to engage in these practices? F1 implies "no"; F2 implies "yes." Here, Friedman might reply that a society which permitted such practices couldn't be said to have a free economy and that therefore his theory does not apply to such cases. (The scope of Friedman's theory is limited to the social responsibilities of business in "free economies"–Friedman says nothing about the social responsibilities of business in socialist countries.) But, in that case, Friedman severely limits the applicability of his theory–on this reading it is questionable whether the U.S. is a "free economy." Friedman does not intend his theory to apply only to "pure" capitalist societies of the sort which do not exist. He uses his theory to criticize the conduct of businesspeople within the *existing* U.S. society and economic system. The laws and ethical customs of the United States permit U.S. companies to lobby against foreign competition.

Case 5–A case in which shareholders disagree about corporate aims.

The Bosco Company has never donated any money to charitable causes. The current members of the board of directors are all avid followers of Milton Friedman. They are opposed to the idea of donating any corporate profits to charities. But 70% of Bosco's stock is owned by people who want Bosco to donate a small percentage of its profits to local universities. A slate of candidates running for the board of directors endorses the idea of donating a small percentage of corporate profits to local universities and publicizes this policy among the shareholders. (Given current SEC regulations, this kind of action is difficult, but not impossible.) In the next election of board members, this slate receives 70% of the votes. The other 30% of the vote is for the current board of directors. The new board is installed and directs management to begin giving money to local universities. Would it be permissible for the company executives to donate corporate funds to universities? F1 implies that this would not be permissible.[10] (In *Capitalism and Freedom* Friedman explicitly labels corporate donations to universities as "inappropriate."[11]) F2 (which says that the primary responsibility of the executives is to act in accordance with the wishes of the shareholders) seems to imply that this would be permissible.

This result can be generalized. F1 and F2 will disagree in any case in which a majority of the shareholders want (and are known to want) management to pursue "social objectives" which have the effect of reducing profits. In "Social Responsibility of Business," Friedman discusses the movement in the late 1960s by certain General Motors stockholders to require the company to "exercise social responsibility." The apparent aim of this movement was to gain controlling interest in the company and then direct the executives to pursue "social ends," at the expense of profits. Friedman strongly objects to this.

> In most of these cases, what is in effect involved is some stockholders trying to get other stockholders [or customers or employees] to contribute against their will to "social" causes favored by the activists. Insofar as they succeed, they are again imposing taxes and spending the proceeds.[12]

Even if such a movement attracted the support of enough shareholders to acquire controlling interest in the company, there would still be shareholders who would be unwilling to sacrifice their profits for the sake of the social causes in question.[13] Friedman claims that it would be wrong for a group of shareholders to redefine corporate objectives in such cases.[14] It is important to ask why this should be so. Friedman does not object to allowing shareholders who have controlling interest in a corporation to override the wishes of other shareholders regarding matters such as long-range planning and plant expansion. No conceivable model of shareholder rights could possibly guarantee that corporations will never do things opposed to the wishes of some of the shareholders. Friedman needs to find a basis on which to distinguish cases like 5 from cases in which he would agree that management is permitted to follow the wishes of majority shareholders against the strong opposition of the minority.

A Further Complication

In an interview published in *Business and Society Review* in 1972, Friedman expounds yet another view about the social responsibilities of business. In this interview he says that the only obligation of business executives is to maximize profits while obeying the law:

> [F3] So the question is, do *corporate executives*, provided they stay within the law, have responsibilities in their business activities other than to make as much money for their stockholders as possible? And my answer to that is, no, they do not.[15]

The "third" formulation (F3) gives different results than F1 in cases 1 and 2. (The first and third formulations differ on the issue of the duty to obey the law.) F3 yields different consequences than F2 in case 3. (F3 does not require business executives to conform to the "ethical customs" of society.) F3 carries less textual weight than his other two statements of the theory. It is an answer to a question posed during an interview; it is not a statement which Friedman prepared (carefully) for publication. I will ignore F3 for the rest of the paper. If nothing else, F3 provides additional evidence for thinking that he is unaware of the significant differences between his various formulations.

II

As we have seen, Friedman's two formulations of his theory are inconsistent. The problem of inconsistency could be resolved by opting for one formulation or the other. However, we have no reason to think that one or the other is Friedman's preferred position. F1 is reaffirmed at the end of the very article in which F2 is presented and *neither formulation* is fully consistent with Friedman's intentions and stated positions on specific issues.

It falls to Friedman to clarify his own position. I cannot claim to speak for him. However, it is worth casting about for a single formulation which is consistent with Friedman's intentions. It is plausible to suppose the following:

i. Friedman thinks that businesspeople (at least those who are members of "free societies") have a duty to obey the law; his failure to mention this duty in the first formulation was an oversight.

ii. When Friedman talks about a duty to obey the ethical customs of one's own society, he only means the duty to obey certain minimal *prohibitions* long accepted in capitalist societies–rules against fraud, deception and departures from open and free competition.[16]

If we reformulate F1 in accordance with i) and ii), we obtain the following:

F1a. In a free capitalist economy, the only (moral) responsibility of business executives is to maximize profits so long as they obey the law, engage in open and free competition, and refrain from fraud and deception.

If we use i) and ii) to reformulate F2 we obtain the following:

F2a. In a free capitalist economy, the only (moral) responsibility of corporate executives is to conduct the business in accordance with the wishes of the owners *within the following constraints*: 1) they must obey the law, 2) they must engage in open and free competition, and 3) they must refrain from fraud and deception.

F1a and F2a yield the same consequences for cases 1 through 4. Both imply that the companies must obey the law in cases 1 and 2. F1a and F2a each imply that the company is not obligated to make sacrifices beyond those required by the law in order to retain long-term employees in case 3. They also both imply that the company would not be justified in engaging in the anti-competitive practices described in case 4. All of these results are consistent with Friedman's intentions. However, F1a and F2a are each inconsistent with Friedman's stated views about certain issues. F1a implies that managers of an individually owned business would not be justified in promoting "social causes" at the expense of profits, even if the owner so requested. (F2a, on the other hand, would permit executives to follow the owners' wishes in this case.[17]) F1a does not give sufficient weight to Friedman's view that an executive is an agent and servant of the owners or shareholders.[18] Given this, and given his view that individual proprietors are justified in pursuing social causes at the expense of their own profits, it seems that the favored formulation of Friedman's theory must make explicit mention of the executive's duty to act in accordance with the wishes of the owner(s).

Although F2 and F2a seem closer to Friedman's intentions than F1 and F1a, both F2 and F2a have consequences (for cases like 5) which Friedman would regard as unacceptable. For example, both F2 and F2a permit the kinds of charitable contributions described in case 5. I am unable to formulate a version of the theory that is fully consistent with Friedman's stated views about specific issues. I suspect that there may be no plausible formulation of the theory that says everything that Friedman wants to say about specific issues. In any case, this is a question that Friedman himself must address.

III

I now want to examine Friedman's main arguments for his theory. I will pay special attention to his defense of his very strong position against "socially responsible" actions taken at the expense of corporate profits.

Friedman claims that executives who limit profits in the pursuit of social objectives are "imposing taxes" on the shareholders.[19] Friedman is not opposed to all forms of taxation. He thinks that duly elected political representatives are justified in imposing taxes on the public, provided that they are subject to democratic controls and can be voted out of office. Friedman argues that it is wrong for business executives to promote social objectives at the expense of profits, because doing so constitutes "taxation without representation."[20] Here, Friedman makes a bad analogy. Executives *are* answerable to boards of directors elected by shareholders. Collectively, shareholders have the power to elect persons to the board of directors who will remove current management. Friedman's "taxation without representation" argument is particularly implausible in cases like 5 in which the executives act in accordance with the expressed wishes of majority shareholders.

Friedman also argues that the pursuit of social objectives imposes taxes on the employees and customers of a business (these parties are usually not represented on boards of directors).[21] This is an interesting argument which merits careful study. But it is not an argument that *Friedman* is entitled to make, since he does not recognize any special duties of executives to employees or customers.

According to Friedman, executives who sacrifice profits for the sake of social objectives are "spending someone else's money" to promote their own causes.[22] Friedman regards such actions as tantamount to theft.[23] But it is not plausible to view these actions as theft. At the present time, U.S. laws permit companies to sacrifice profits and returns to shareholders for the sake of social causes. In any corporation, it is possible for a group of shareholders to band together to try to force the company to pursue social objectives at the expense of profits. All investors are aware of these facts. Thus, all persons who buy stock in a company *consent* to a set of rules and procedures whose implementation may slightly reduce their return on their investment. In that case, reducing profits for the sake of social objectives would not constitute theft. Any use of my property in accordance with rules and procedures to which I freely consent cannot be a case of theft.[24]

Friedman thinks that the property rights of individuals entitle them to use their resources to create profit-making corporations. Individuals also have the right to create non-profit corporations. Friedman must also grant that individuals' property rights and right to liberty entitle them to create corporations which aim *both* to produce profit and to further charitable or social causes. Friedman should consider the fact that *a market* exists for investment in corporations which aim both at profit and the furtherance of social causes. The existence of self-described "ethical" or "environmentally conscious" investment funds demonstrates the existence of such a market.

Even if we were to accept Friedman's claim that reducing profits in the pursuit of social objectives constitutes theft or some other serious violation of the rights of the shareholders, this would not, by itself, show that it is *always* wrong for business executives to pursue social objectives at the expense of profits. The executive's obligation to maximize profits conflicts with other more important duties. For all that Friedman has shown, corporate executives might have duties to the general public which sometimes outweigh their duties to the shareholders.[25] For example, suppose that a corporation could maximize its profits by pursuing actions which expose the public to hazardous pollution. In such a case, the duty to act in the interests of the shareholders might be overridden by the duty not to harm others. (I will discuss cases of this sort in part IV.)

Friedman's arguments which appeal to the rights of shareholders do not (by themselves) adequately support all of his conclusions about the social responsibilities of business. However, Friedman presents other (broadly utilitarian) arguments in addition to his arguments about the rights of shareholders. If successful, Friedman's arguments about rights of the shareholders show that there is *some* moral presumption against reducing profits (doing so is theft and theft is *prima facie* wrong). If successful, his "utilitarian" arguments show that there are seldom cases in which this presumption against sacrificing profits is overridden by utilitarian considerations.

Friedman offers two distinct utilitarian arguments for his theory of corporate social responsibility. First, he questions the competence of business leaders (or any other individuals) to discern and directly promote the general good.[26] Second, he argues that the market itself is the best mechanism by which to promote the public good. Here, Friedman's views closely parallel those of Adam Smith. He thinks that economic agents best promote the general welfare, not by aiming at it directly, but by pursuing their own individual interests. His work as an economist makes a powerful case for this; much of *Capitalism and Freedom* and his later book *Free to Choose* is devoted to showing how laisser faire institutions would lead to desirable consequences.

It is far beyond the scope of this paper to assess these arguments. But I would like to observe that many critics have misunderstood Friedman's position and, as a result, have been too quick to dismiss his utilitarian arguments. Some take his theory to be a statement of a fundamental moral principle to the effect that the only moral duty of a business executive (*qua* executive) is to serve the interests of the shareholders (within certain rules). I think it unlikely that Friedman takes his principle–in whichever formulation–to be an exceptionless moral principle. Surely business executives have other basic moral duties. All human beings have a duty not to harm others; business executives acting *qua* executives are not exempted from this duty.

Friedman's view is most plausible if we take him to be claiming that his principle is the best *general policy* for businesspeople to follow in their everyday conduct.[27] Critics who attack Friedman by pointing to particular cases in which the policy of profit maximization leads to bad or even disastrous consequences fail to appreciate the status of his basic principle as *a general policy*. The claim that profit maximization (within the "rules of the game") is the best *policy* cannot be refuted by finding occasional cases in which adherence to this policy results in more bad than good. There is no reason to suppose that the best policy for fallible human beings to follow in the real world is an ideal policy which always results in the best consequences. We must assess the merits of his theory as a general policy for businesspeople to follow in their everyday actions.

IV

I will now present what I take to be a very serious objection to Friedman's theory. (This objection applies to both F1 and F2 and to my two reformulations of his theory–F1a and F2a.) I shall argue that there are cases in which the policy of maximizing profits within Friedman's rules is likely to have disastrous consequences. In certain cases, this policy would permit businesses to subject the public to serious hazards without providing any warning. Such cases are sufficiently common to cast serious doubt on the claim that Friedman's theory provides the best policy for executives to follow. Then I will try to show how this objection can be avoided by revising Friedman's theory and show why my modified version of the theory is preferable to Friedman's own formulation(s). [I do not claim that the modified theory is true or correct, I only claim that it is *more plausible* than Friedman's own formulation(s).] Some of the claims Friedman makes in *Capitalism and Freedom* provide a rationale for my modified version of his theory. It might even be suggested that my modified version of the theory is implicit in things that Friedman says in *Capitalism and Freedom* (this possibility is discussed in endnote 35).

Case A. The Bland Corporation produces a previously unknown chemical XYZ as a by-product of its manufacturing process. Bland discharges large quantities of XYZ into the environment. Internal company data on the health of workers and local residents indicates that exposure to XYZ greatly increases one's risk of cancer and birth defects. The company can continue using the process for many years without significant chance that the problem will become public knowledge (which in turn could cause adverse consequences to the company such as law suits or unfavorable publicity). The company cannot eliminate serious health risks for its workers and the general public without greatly increasing its costs and badly undermining its competitive position. Bland's competitors are also exposing the public to XYZ, but they are better equipped to solve the problem and would gain a competitive advantage over Bland should the problem become known and become the subject of legislation. Any government regulation of XYZ would be harmful to Bland's competitive position. Therefore, it would not be in Bland's interest to notify the public of the problem.

Case B. A company is marketing a very profitable product. The company has reason to believe that the product poses significant health risks to consumers. The product cannot be modified to substantially reduce these risks. The causal connection between the product and the health risks is clear only in the light of confidential information possessed by the company. The information is therefore unlikely to become known or cause problems for the company. (Since the risks are not generally known, no laws have been enacted to restrict or prohibit the marketing of the product.) The company stands to lose most of its profits from the product if these dangers are revealed.[28]

In both cases the company's actions expose the public to substantial risk of great harm. Friedman would argue that it is not desirable for any corporation to *unilaterally* go beyond what the law requires for the sake of the environment. Doing so will decrease that corporation's market share and will do nothing to eliminate the (*growing*) pollution caused by its competitors (who will thereby obtain a greater share of the market). According to Friedman, it is the government's responsibility to protect the environment; the government should pass environmental laws and regulations which apply to *all* companies.[29] In the case of potentially hazardous products such as breast implants, Friedman would argue that it is not desirable that manufacturers cease producing the products, since it is likely that some rational consumers would prefer to use the products even if they were fully informed of the risks associated with them. These arguments have considerable plausibility. Unilateral pollution control beyond what the law requires is likely to harm the company in question without doing much good for the public. Rational consumers who knowingly accept the risks posed by certain products should be presumed to be acting in their own self-interest. Friedman underscores this last point in the following passage from *Capitalism and Freedom*:

> The possibility of coordination through voluntary cooperation rests on the elementary–yet frequently denied–proposition that both parties to an economic transaction benefit from it, *provided the transac*tion *is bilaterally voluntary and informed* (p. 13).

Note that Friedman says that the mutual benefit afforded by voluntary market transactions is contingent on all parties being informed. This passage does not justify withholding information about hazards and could even be construed to imply that businesses are obligated to reveal all information about hazards they create.

F1 and F2 imply that corporations have no duty to stop creating hazards of these sorts; they also imply that corporations have no duty to *warn* the public about the hazards which they create (F1a and F2a also imply this). The latter consequence strikes me as very objectionable. There is no reason to suppose that one's own good is served if one chooses to use products which have dangers of which one is unaware. Similarly, there is no reason to think that one's own welfare is promoted if one chooses to work in a place of business where one is exposed to hazards without one's knowledge. A business is obligated to warn the public of any serious dangers to which it is exposing them.[30] If your actions or your products are likely to kill or injure me, then, at the very least, you are obligated to inform me of the risks to which you are exposing me. Government action and legislation are not a substitute for disclosure of hazards by business itself. Businesses are often the first to know about dangers which they create.[31]

Friedman might reply that his position does not have the counter-intuitive consequences which I am alleging here. Two replies (to my objection) suggest themselves:

> 1. Withholding information about the dangers of one's actions or products is tantamount to deceiving the public about those dangers. Thus, withholding such information is prohibited by Friedman's strictures against deception.
>
> 2. Failing to warn workers, customers, or the general public about hazards to which it is subjecting them is unlikely to be in a corporation's long-term interest. If the company learns of the dangers, then those dangers are almost certain to become public knowledge in the long run. Companies who hide such information are likely to suffer law suits, punitive legislation and unfavorable publicity.

My rejoinders: 1) Friedman never explains exactly what he means by "deception." Perhaps he would construe the term very broadly to include not only actively deceiving someone (causing her to have false beliefs) but also deception by omission (failing to provide someone with information). But this strains the ordinary meaning of the word "deception." In ordinary language we distinguish between deceiving someone (causing someone to have false beliefs) and withholding or failing to reveal information. 2) It is difficult to point to any actual cases in which corporations have profited by withholding information about hazards for which they are responsible.[32] In order to profit by withholding such information, it is almost always necessary that the information never become known. If a company successfully conceals information, the public cannot know that it is being concealed. In light of this, the fact that we can only point to a few examples of cases in which companies have profited by withholding information about hazards does not show that such cases are uncommon.

In the U.S., tort laws are governed by the principle of strict liability. Any company which exposes the public to serious hazards without warning runs the risk of being subjected to very costly law suits. Nonetheless, cases of the sort I describe in A and B are *possible*. Friedman might reply that such cases are very unlikely to occur and that, because they are so rare, they do not constitute evidence against the proposition that his theory sets out the best general policy for business executives to follow. (The fact that acting in accordance with a particular policy has bad consequences in very unusual circumstances does not show that the policy in question is bad or morally unacceptable.)

For the purposes of argument, let us grant that such cases are very uncommon in the U.S. However, cases like A and B are commonplace in "free economies" whose tort laws do not include a principle of strict liability. Cases like A and B would also be common in any society in which the legal system was (in practice) unsympathetic to the claims of people seeking compensation for harms suffered. For example, in a society whose tort laws include a principle of strict liability, the government or legal system might be controlled by people who are concerned with advancing the interests of multi-national corporations. No matter what kinds of laws are on the books, it might be nearly impossible for individuals to win law suits against corporations in those societies. In *Capitalism and Freedom* Friedman takes his theory of the social responsibilities of business to apply to businesses (or business executives) in *any* "free economy," not just those which, like that U.S., have very strict tort laws and legal systems sympathetic to the claims of people pressing law suits.[33] Cases like A and B are commonplace in at least some other "free economies."

Cases of the sort I am discussing here raise serious doubts about the merits of Friedman's theory as a general policy. I think that the following modified theory is more plausible than Friedman's own theory:

> M. The one and only social (moral) responsibility of corporate executives is to act in accordance with the wishes of the owners provided that they 1) obey the law, 2) engage in open and free competition, 3) refrain from fraud and deception, and 4) warn the public about all serious[34] hazards or dangers created by the firms which they represent.[35]

I do not take M to be a fundamental moral principle. I want M to be assessed in terms of its merits as a general policy. Since I have considered only a few of the many possible alternative policies (and since all those I have considered are libertarian/Friedmanesque policies), I am in no position to claim that M is the best possible policy. I only claim that M is a *better policy* than the one which Friedman recommends.

Cases of product and environmental hazards which are unknown to the public are quite common. It is almost always best if such hazards are brought to light as soon as possible. This is likely to help bring about (or speed-up) needed legislation. It will also permit employees, consumers, and local residents to make informed decisions about hazards of which they would otherwise be unaware. Many of these individuals are likely to change their place of employment, purchasing decisions, or place of residence in order to avoid these hazards.[36] Some of the most notorious cases in business ethics, including the Ford Pinto and the Johns Manville asbestos cases, are ones in which corporations knowingly withheld information about hazards created by their products or activities. Unlike any of Friedman's formulations of his theory, M has the virtue of clearly and unambiguously prohibiting such conduct.

My modified version of Friedman's theory is consistent with–arguably even required by–the libertarian spirit of his philosophy. Friedman attaches great value to individuals' freedom to choose what is best for them and adamantly opposes paternalistic treatment of competent adults. But free choices can be presumed to be beneficial to the choosers only when they are adequately informed. The libertarian ideal of human flourishing involves not only the freedom of individuals to choose what is best for them, but their possession of adequate information which enables them to make informed and rational choices.

Notes

* I am indebted to Milton Friedman for his extensive and extremely helpful comments on an earlier version of this paper. I would also like to thank Patricia Werhane and two anonymous referees of this journal.

1. University of Chicago Press, 1963.

2. *New York Times Magazine*, September 13, 1970, reprinted in *An Economist's Protest* (Thomas Horton, 1972), pp. 177-184. All references to this article are to the page numbers in the version reprinted in *An Economist's Protest*.

3. *Capitalism and Freedom*, p. 133.

4. In "Social Responsibility of Business" Friedman explicitly rejects the idea that corporations are moral persons which can have moral obligations, (pp. 177-178). He says that only individuals who work for companies can have moral duties. Friedman does not explicitly address the issue of corporate moral agency in *Capitalism and Freedom*. His wording of the relevant passage "there is one and only one social responsibility *of business* [my emphasis] . . . " leaves open the question of corporate moral agency. It is reasonable to suppose that Friedman would now want us to interpret the earlier theory in light of his later explicit rejection of corporate moral agency. Also see "Milton Friedman Responds," *Business and Society Review*, Spring 1972: "The only entities who can have responsibilities are individuals; a business cannot have responsibilities" (p. 6).

5. I take Friedman's talk about the "responsibilities" or "social responsibilities" of business/business executives to mean the *moral* responsibilities of business/business executives. The context of Friedman's work is his criticism of others who write about the "responsibilities" or "social responsibilities" of business. He is responding to *moral* or *ethical* criticisms of business and the policy maximizing profits. Friedman aims, among other things, to persuade us that businesspeople who maximize profits while adhering to "the rules of the game" should not be criticized on moral or ethical grounds. Unless we take Friedman's theory of social responsibility to be a moral theory, it is difficult to see the relevance of the theory for business *ethics*. Even if I am (badly) mistaken about the interpretation of Friedman, it is important to ask whether his theory can serve as a theory about the *moral responsibilities* of business. Many people appeal to profit maximizing (or profit maximizing within certain rules) as a moral principle and use it as a basis for defending various business actions and policies *on moral grounds*.

6. *Capitalism and Freedom*, p. 133.

7. "Social Responsibility of Business," p. 178.
8. "Social Responsibility of Business," p. 184.
9. It is unclear which ethical customs are supposed to constrain the behavior of executives. It is often uncertain how to identify *the* relevant society of an executive. Is an executive's society the nation in which she resides, or could it be some subgroup within that country? International trade raises serious difficulties here–what if a certain practice is forbidden by the moral code of one society, but required by the code of another society? Suppose that we identify the society (or societies) whose moral customs are binding on executives. There is still the problem of identifying the relevant ethical customs of the societies in question. This problem is particularly pressing in diverse pluralistic societies such as the United States. How are we to identify *the* "ethical customs" of the United States to which businesspeople in the U.S. must conform?
10. I am assuming that any benefits which redound *to the company* are not enough to make up for the amount of money which it contributed. Some argue that donating money to local universities benefits corporations by creating good will among the general public and enlarging the pool of well educated workers. This kind of argument was made by the A. P. Smith Company in the case of *A. P. Smith vs. Barlow* (New Jersey Supreme Court, 1950), reprinted in Beauchamp and Bowie, eds, *Ethical Theory and Business*, 4th ed. (Prentice Hall, 1993), pp. 96-98. The Smith Company had donated $1500 to Princeton University. A shareholder named Barlow sued the company. Smith maintained that the contribution benefited the company because it created good will in the local community and helped enlarge the pool of well-educated people who are potential employees of the company. The court ruled that the company's donations were permissible. The court accepted the company's arguments to the effect that it benefited from the contributions. The court did *not* rule that corporations are permitted to deliberately sacrifice their own interests in order to pursue social objectives.

The claim that corporations generally benefit from such donations is extremely implausible. It is very unlikely that the benefits to corporate donors outweigh the costs. I teach in a large urban university. The majority of my students are local residents. When we discuss the case of Smith vs. Barlow in my business ethics classes I ask them the following questions:

> Do you know which companies do and do not donate money to this university?
>
> When applying for jobs do you try to determine which companies donated money to this university?
>
> Suppose you had to choose between the following job offers: Employers X and Y offer similar positions with similar responsibilities and working conditions. X offers a slightly higher salary, but Y (unlike X) donates money to this university. Which offer would you accept?

Almost none of my students know which corporations do and do not contribute to our university. It is fair to assume that the general public is even less well informed about these matters. Some students said that, as consumers, they would be willing to give some preference to businesses which contributed to the university, provided that the cost to them was nominal. Almost none of my students said that corporate donations would affect their choice of an employer. Most corporate donations to universities might just as well be anonymous for lack of attention and publicity which they receive. (I am excluding very large donations of the sort which prompt universities to name buildings after donors.) It is very difficult to see how donations which almost no one knows about could possibly create enough gratitude or goodwill so as to constitute a net benefit to a corporation.

Surely a company would be more likely to obtain better employees by offering higher wages or educational benefits to its own employees, rather than donating money to a university, most of whose students will never work for it. Corporate donations do a considerable amount of good for universities and their students. It is at least plausible to suppose that such donations often do more good for society than the company would do if it reinvested the money or distributed it to shareholders. However, the benefit of such donations is spread out or diffused among many different people. Only a small portion of the benefit redounds to the corporation itself. Even if we grant that corporate donations to charitable causes often have benefits (for society as a whole) which exceed the costs to the corporation, it will still rarely be in the corporation's *own interest* to make such contributions. It is very unlikely that enough of the society's benefit will redound to the corporation itself to make such contributions advantageous to the corporation.

I am not claiming that contributions to charities *never* benefit corporations or enhance their profits. I only claim that *sometimes* (often) they don't. Contributions which do not benefit corporations or enhance their long term profitability are permitted by law. The "business judgment rule" permits executives considerable discretion in their choice of means to achieving corporate ends. They are permitted to make small donations to charity as long as they *claim* that they are doing it for the benefit of the company. It is not necessary that the contributions actually benefit the corporations.

The purpose of this very long note is to show that there are (or could be) cases of the sort described in case 5, i.e. cases in which the majority shareholders favor actions which are contrary to the economic interests of the company but which are permitted by law. In such cases, Friedman's first formulation implies that it would be wrong for the company to act in accordance with those wishes. His second formulation implies that it would be permissible for the company to act in accordance with those wishes.

11. p. 135.

12. "Social Responsibility of Business," pp. 181-182.

13. In the unlikely event that *every* shareholder agreed to sacrifice profits for the sake of social causes, Friedman would not have any strong objection to the corporation sacrificing its profits. His primary objection to such actions is that they involve compelling individuals to contribute to social causes against their will. He has no objection to an individual proprietor managing her business so as to further "social objectives" ("Social Responsibility of Business," p. 182).

14. Note that Friedman has shifted from talking about the duties of executives to talking about the duties of shareholders.

15. "Milton Friedman Responds," p. 6. The "third" formulation is more similar to F1 than F2 in that it talks about the duty to maximize profits rather than the duty to follow the wishes of shareholders. However, on p. 7 Friedman writes the following:

> Question: Is there no way, then, that the corporate executive should spend money other than to maximize the stockholders' return on their invested capital?
>
> Friedman: Generally not. His job is to do whatever the shareholders would like to see done, and most of the time shareholders want only to make money.

In the context of the paper as a whole, the "third version" of the theory is most plausibly read as follows:

> (F3′) The sole obligation of business executives is to follow the wishes of shareholders (which will generally be to make as much money as possible) while obeying the law.

16. Even if the principle "businesses should donate money to charitable causes" became generally accepted in a society (perhaps this principle is already generally accepted in the United States), it is unlikely that Friedman would think that businesses are morally obligated to follow it. Friedman is sharply critical of many current business practices and received views about business ethics; he is also the author of a book entitled *The Tyranny of the Status Quo*. Clearly, Friedman does not want to say that the ethical customs of a society are morally binding just because they are the *customs* of a society. He *seems* to say this in his second statement of the theory ["while conforming to the basic rules of the society, both those embodied in law and ethical *custom*" (my emphasis)], but this is surely not what he intends to say.

17. Friedman says that individual proprietors are justified in sacrificing their profits in the pursuit of social objectives ("Social Responsibility of Business," p. 182). He would surely hold that executives employed by a company owned by a single individual would be justified in acting in accordance with the owner's wishes in such cases.

18. Cf. "Milton Friedman Responds," p. 7.

19. "Social Responsibility of Business," p. 179.

20. Ibid.

21. Ibid.

22. Ibid.

23. Friedman makes this explicit in his 1972 interview in *Business and Society Review*:

> Getting back to this question of corporate responsibility, let's say an executive could get away with donating half the company's income for social purposes? . . . He is in effect *stealing* [my emphasis] this money from shareholders and devoting it to purposes he regards as desirable (p. 8).

24. Richard Nunan makes a similar criticism of Friedman in "The Libertarian Conception of Corporate Property: A Critique of Milton Friedman's Views on the Social Responsibility of Business," *Journal of Business Ethics*, December 1988, pp. 891-906. Nunan argues that "socially responsible" actions taken at the expense of profits do not constitute theft, because in such cases there is no obvious victim of the theft. According to Friedman, customers, employees, and shareholders can all be harmed by "socially responsible" actions undertaken at the expense of profits. If the charge of theft is plausible, then at least one of these parties must be the victim of that theft. But Nunan argues that none of these parties can be said to be the victim of theft.

> Whose money has the executive stolen to pay for this social good? Surely not the customers' money, for they can always buy a cheaper product from a less socially aware manufacturer (pp. 894-5).
>
> . . . What about the employees? Is our executive stealing from them when he reduces their wages the next time their contract is negotiated? . . . On some views this would be the case, but it's hardly an argument to which Friedman might appeal. . . . On his view employers and employees bargain freely to arrive at a wage settlement. If the employees don't like the terms, they can leave the company (p. 895).

The shareholders are the parties most plausibly said to be the victims of theft. But Nunan argues that, given longstanding legal precedents (including what he calls "the business judgment rule"), corporations which engage in social action at the expense of profits are not violating any agreements with shareholders and therefore are not stealing from them.

> The business judgment rule effectively condones any altruistic behavior exercised by corporate managers so long as it is done, however tangentially, in the name of corporate welfare (p. 902).
>
> When corporate altruism is achieved at the expense of reduced dividends to shareholders, Friedman claims that corporate executives are now spending money which rightfully belongs to the stockholders. . . . I argue that stockholders are voluntarily entering into a contractual arrangement in which corporate executives have the explicit legal right to engage in corporate altruism to any extent which they perceive necessary to insure corporate survival (p. 904).

Nunan appeals to the Michigan Supreme Court Ruling in the case of Dodge vs. Ford Motor Company (1916). Henry Ford greatly reduced dividends to shareholders with the explicit aim of promoting the general welfare (Ford wanted to enable more people to purchase automobiles and to employ more workers in the auto industry). The court ruled against Ford and ordered the company to pay additional dividends to shareholders. Nunan attaches great significance to the following passage from the court's ruling:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

This ruling, Nunan contends, allows managers to have *complete discretion* in promoting the welfare of shareholders. They are permitted to do whatever they think is necessary in order to assure the well being and survival of the company. If an executive thinks that "socially responsible" actions will benefit shareholders, then those actions are permitted.

Nunan's arguments are fine as far as they go. He is correct to stress that since "socially responsible" actions at the expense of profits do not violate any implied or explicit contracts between the shareholders and executives, such actions cannot be described as theft. However, Nunan's argument concedes too much to Friedman. It permits Friedman to say that socially responsible actions are wrong in cases in which executives aim directly at the general good rather than the good of the firm. (As a legal matter, it will be very difficult to *prove* any contentions about someone's motives or intentions. If an executive claims that he donated corporate funds to a charity for the good of the firm, it will be difficult to disprove this claim.) Nonetheless, such cases (corporate donations motivated by a concern to promote charitable causes) frequently occur. My alternative criticism of Friedman's theft argument is as follows: *de facto* socially responsible action at the expense of profit is permitted and widely practiced. Everyone knows this. So, those who purchase stock of their own free will consent to this arrangement and cannot claim that they are the victims of theft.

25. Cf. Thomas Donaldson, *Corporations & Morality* (Prentice Hall, 1982), pp. 55-56. Donaldson grants that the property rights of the shareholders may give executives a *prima facie* duty to maximize profits. However, Donaldson claims that these rights and duties can sometimes be overridden by other rights and duties.

26. "Social Responsibility of Business," p. 180.

27. I am not certain exactly what criteria Friedman uses to assess policies. In particular, I am not sure whether he would want to judge policies solely in terms of their consequences. John Danley reads Friedman as a rule utilitarian ("Polestar Refined: Business Ethics and Political Economy," *Journal of Business Ethics*, 1991, pp. 915-933). On Danley's reading, Friedman holds that business executives are morally justified in following Friedman's principle "Maximize profits while adhering to rules x, y, and z" because this principle maximizes utility. Danley's paper is valuable in that it provides a careful formulation and powerful critique of rule utilitarian justifications of Friedman's theory. But, as an interpretation of Friedman, the paper leaves much to be

desired. As Danley observes, Friedman never explicitly states his fundamental moral principles. Danley's reasons for thinking that Friedman is a rule utilitarian are very speculative (see p. 920). Danley's interpretation ignores the fact that one of Friedman's central arguments (his appeal to the rights of shareholders) is difficult to reconcile with utilitarianism. At the very least, I think that Friedman would say that any duty we might have to promote the good or promote the general welfare is constrained by the duty to respect the rights of individuals, particularly their rights to liberty and property.

28. My case is similar to the current case of Dow Chemical breast implants, except that in the Dow case the dangers of the product became generally known. Now that the public is aware of health problems caused by the implants, Dow is likely to loose more money from law-suits and unfavorable publicity than it ever made from the product.

29. Friedman favors replacing the present set of environmental regulations with a tax on all pollution. See *Free to Choose*, with Rose Friedman (Avon, 1981), pp. 203-208.

30. Cf. Christopher McMahon, "Morality and the Invisible Hand," *Philosophy & Public Affairs*, Summer 1981,

> [I]f markets are to be efficient, there must be perfect information "with respect to the quality and nature of the product and prevailing price." In light of this assumption of perfect information, it appears that the implicit morality of the market will contain various requirements to facilitate the flow of information. . . . The implicit morality of the market, then, appears to rule out both deception and exploitation of the ignorance of those who are misinformed (or who lack relevant information). (pp. 256-257)

31. Cf. Christopher Stone, *Where The Law Ends* (Harper and Row, 1975), pp. 93-110. Stone argues that there is a "lag" between the time when corporations become aware of dangers or hazards and the time when government enacts laws to protect the public. Because of this time lag, corporations must do more than just obey the law.

32. The best case that I can think of is that of U.S. tobacco companies who withheld information about health risks of smoking for many years.

33. In the U.S., people pressing suits against corporations are entitled to obtain access to internal corporate records relevant to the case. In many other legal systems, e.g., Germany, it is extremely difficult, if not impossible, for litigants to obtain corporate documents. This makes it extremely difficult to succeed in law suits for damages.

34. This is a "weasel word" which I will not attempt to explicate here. Clearly M needs to be clarified much further in order to be a principle that can be applied to real cases. In particular, we need to ask how great and how likely the danger must be in order for corporations to have a duty to inform the public of potential dangers. My criticisms of Friedman show that some suitably refined version of M is more plausible than any of Friedman's formulations of his theory and more plausible than F1a or F2a.

35. It has been suggested to me that in light of the passage I cited earlier in which Friedman claims that economic transactions are beneficial to all parties provided that they voluntary and informed (*Capitalism and Freedom*, p. 13), M should be taken to be an interpretation of Friedman, rather than a modification of his views. On this reading, Friedman takes "informing the public about all hazards for which one is responsible" to be one of the "rules of the game" which constrains business in the pursuit of the aims of the shareholders. This is a possible reading of Friedman. Indeed I think that Friedman's more general libertarian principles provide a rationale for modifying his theory of corporate social responsibility along the lines of M. But since Friedman never says *anything* about the duty to inform the public of hazards in any of his three discussions of the social responsibilities of business, I think it unlikely that Friedman takes warning the public about hazards to be included in the "rules of the game" which constrain businesspeople in their pursuit of profits (or other objectives of the shareholders). This is a matter of interpretation which only Friedman himself can resolve definitively.

36. Suppose that a law were passed which required businesses to disclose all potential hazards which they create. In that case, Friedman's own preferred policy for executives (which includes a

requirement to obey the law) would also require businesses to reveal information about such hazards. If such a law were enacted, my and Friedman's views would not differ in practice. In support of M over Friedman's view, I would observe that it is highly desirable that information about hazards be made known; this is desirable independently of its being required by the law.