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Author(s): Thomas Mulligan
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Thomas Mulligan

ABSTRACT. The main arguments of Milton Friedman's famous and influential essay are unsuccessful: He fails to prove that the exercise of social responsibility in business is by nature an unfair and socialist practice.

Much of Friedman's case is based on a questionable paradigm; a key premise is false; and logical cogency is sometimes missing.

The author proposes a different paradigm for socially responsible action in business and argues that a commitment to social responsibility can be an integral element in strategic and operational business management without producing any of the objectionable results claimed by Friedman.

In his famous essay, Milton Friedman argues that people responsible for decisions and action in business should not exercise social responsibility in their capacity as company executives. Instead, they should concentrate on increasing the profits of their companies.[1]

In the course of the essay, he also argues that the doctrine of social responsibility is a socialist doctrine.

The purpose of this paper is to assess the merit of Friedman's arguments. I shall summarize his main arguments, examine some of his premises and lines of inference, and propose a counter-argument.

Thomas Mulligan is an Assistant Professor at The Fuqua School of Business, Duke University, in the areas of Manufacturing Management Systems and Business Ethics. He has a Ph.D. from Northwestern University in the field of Philosophy and has worked as an educator, manager, and consultant in the manufacturing and software industries.

Friedman's argument: Corporate executives should not exercise social responsibility

Friedman argues that the exercise of social responsibility by a corporate executive is:

(a) unfair, because it constitutes taxation without representation;
(b) undemocratic, because it invests governmental power in a person who has no general mandate to govern;
(c) unwise, because there are no checks and balances in the broad range of governmental power thereby turned over to his discretion;
(d) a violation of trust, because the executive is employed by the owners "as an agent serving the interests of his principal";
(e) futile, both because the executive is unlikely to be able to anticipate the social consequences of his actions and because, as he imposes costs on his stockholders, customers, or employees, he is likely to lose their support and thereby lose his power.

These conclusions are related.

Points (b) and (c) depend on (a), on the ground that "the imposition of taxes and the expenditure of tax proceeds are governmental functions". Point (d) also depends on (a), because it is precisely in imposing a tax on his principal that this executive fails to serve the interests of that principal. Point (e) depends, in part, on (d), since it is the executive's failure to serve the interests of his principal which results in the withdrawal of that principal's support.

Point (a) is thus at the foundation of the argument. If (a) is false, then Friedman's demonstration of the subsequent conclusions almost completely collapses.

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Is it true, then, that the executive who performs socially responsible action "is in effect imposing taxes ... and deciding how the tax proceeds shall be spent"?

To make this case, Friedman argues by depicting how a company executive would perform such action.

He first introduces examples to illustrate that exercising social responsibility in business typically costs money. He mentions refraining from a price increase to help prevent inflation, reducing pollution "beyond the amount that is in the best interests of the corporation" to help improve the environment, and "at the expense of corporate profits" hiring 'hardcore' unemployed.

To establish that such costs are in effect taxes, he argues:

1. In taking such action, the executive expends "someone else's money" – the stockholders', the customers', or the employees'.
2. The money is spent "for a general social interest".
3. "Rather than serving as an agent of the stockholders or the customers or the employees ... he spends the money in a different way than they would have spent it".

The first two premises suggest a similarity between this money and tax revenues, with respect to their sources and to the purposes for which they are used. However, an expense is not yet a tax unless it is *imposed* on the contributor, irrespective of his desire to pay. Only Friedman's third premise includes this crucial element of imposition.

This third premise reveals the essential character of the paradigm on which Friedman bases his whole case.

Friedman's paradigm

In the above examples of socially responsible action and throughout his essay, Friedman depicts the corporate executive who performs such action as a sort of Lone Ranger, deciding entirely by himself what good deeds to do, when to act, how much to spend:

> Here, the businessman – self-selected or appointed directly or indirectly by the stockholders – is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose.

On this paradigm, the corporate executive does not act with the counsel and participation of the other stakeholders in the business. This is the basis of Friedman's claim that the executive is *imposing* something on those other stakeholders – unfairly, undemocratically, unwisely, and in violation of a trust.

But does Friedman's paradigm accurately depict the socially responsible executive? Does it capture the essential nature of socially responsible action in business? Or has he drawn a caricature, wrongly construed it as accurate, and used it to discredit the doctrine it purportedly illustrates?

A counter-paradigm

Friedman's paradigm is valid in the sense that it is certainly possible for a corporate executive to try to exercise social responsibility without the counsel or participation of the other stakeholders in the business.

Friedman is also correct in characterizing such conduct as unfair and as likely to result in the withdrawal of the support of those other stakeholders.

Yet Friedman insists, at least with respect to the executive's employers, that the socially responsible executive "must" do it alone, must act in opposition to the interests of the other stakeholders:

> What does it mean to say that the corporate executive has a "social responsibility" in his capacity as a businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers.

There is no good reason why this remarkable claim must be true. The exercise of social responsibility in business suffers no diminishment in meaning or merit if the executive and his employers both understand their mutual interest to include a proactive social role and cooperate in undertaking that role.

I propose a different paradigm for the exercise of social responsibility in business – one very much in keeping with sound management practice.

A business normally defines its course and commits itself to action by conceiving a mission, then proceeding to a set of objectives, then determining quantified and time-bound goals, and then developing a full strategic plan which is implemented by appropriate top-level staffing, operating procedures, budgeted expenditures, and daily management control.

Many stakeholders in the business participate in this far-reaching process.

Founders, board members, major stockholders, and senior executives may all participate in defining a mission and in setting objectives based on that mission. In so doing, these people serve as "legislators" for the company.

Top management's translation of these broad directions into goals, strategic plans, operating procedures, budgets, and daily work direction brings middle management, first-line management and, in some companies, employee representatives into the process. This is the "executive branch" of the business.

When the time comes to judge progress and success, the board members and stockholders serve as "jurists" at the highest level, and when necessary can take decisive, sometimes dramatic, corrective measures. However, the grass-roots judgment of the court of employee opinion can also be a powerful force. More than one company has failed or faltered because it did not keep a course which inspired and held its talented people.

In sum, a business is a collaborative enterprise among the stakeholders, with some checks and balances. In general, this system allows to any one stakeholder a degree of participation commensurate with the size of his or her stake.

For a business to define a socially responsible course and commit to socially responsible action, it needs to follow no other process than the familiar one described in the preceding paragraphs.

On this paradigm, if socially responsible action is on the corporate executive's agenda, then it is there because the company's mission, objectives, and goals – developed collaboratively by the major stakeholders – gave him license to put it there and provided parameters for his program. Lone Ranger executives are no more necessary and no more welcome in a socially responsible business than in one devoted exclusively to the maximization of profit.

This paradigm conforms more accurately than Friedman's to the reality of how action programs – socially responsible ones or otherwise – are conceived and enacted in a strategically managed business. The corporate executive in this process, in contradistinction to Friedman's corporate executive, does not impose unauthorized costs, or "taxes", on anyone. On this account, he usurps no governmental function, violates no trust, and runs no special risk of losing the support of the other stakeholders.

The problem of knowing future consequences

The preceding argument addresses most of Friedman's objections to a corporate executive's attempts to exercise social responsibility.

Friedman, however, provides one objection which does not rest on his paradigm of the Lone Ranger executive. This is the objection that it is futile to attempt socially responsible action because the future social consequences of today's actions are very difficult to know.

Suppose, he writes, that the executive decides to fight inflation:

> How is he to know what action of his will contribute to that end? He is presumably an expert in running his company – in producing a product or selling it or financing it. But nothing about his selection makes him an expert on inflation. Will holding down the price of his product reduce inflationary pressure? Or, by leaving more spending power in the hands of his customers, simply divert it elsewhere? Or by forcing him to produce less because of the lower price, will it simply contribute to shortages?

The difficulty of determining the future consequences of one's intended good acts has received attention in the literature of philosophical ethics. G. E. Moore, in his early twentieth century classic *Principia Ethica*, writes of "the hopeless task of finding duties"[2] since, to act with perfect certainty, we would need to know "all the events which will be in any way affected by our action throughout an infinite future".[3]

Human life, however, requires action in the absence of certainty, and business people in particular have a bias toward action. They do not wait for perfect foreknowledge of consequences, but instead set a decision date, gather the best information available, contemplate alternatives, assess risks, and then decide what to do.

Decisions about socially responsible actions, no less than decisions about new products or marketing campaigns, can be made using this "business-like" approach. The business person, therefore, has even less cause than most moral agents to abstain from social responsibility out of a sense of the futility of knowing consequences, since he is more practiced than most in the techniques for making action decisions in the absence of certainty.

Social responsibility and socialism

Some of Friedman's most emphatic language is devoted to his position that the advocates of social responsibility in a free-enterprise system are "preaching pure and unadulterated socialism".

He asserts this view in the first and last paragraphs of the essay, and concludes:

> The doctrine of "social responsibility" ... does not differ in philosophy from the most explicitly collectivist doctrine.

Friedman's argument for this conclusion is located roughly midway through his essay, and it too rests on his paradigm of the socially responsible executive "imposing taxes" on others and thereby assuming governmental functions:

> He becomes in effect a public employee, a civil servant .... It is intolerable that such civil servants ... should be selected as they are now. If they are to be civil servants, then they must be elected through a political process. If they are to impose taxes and make expenditures to foster "social" objectives, then political machinery must be set up to make the assessment of taxes and to determine through a political process the objectives to be served.
>
> This is the basic reason why the doctrine of "social responsibility" involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.

I shall raise three objections to this line of reasoning.

First, this argument rests on the paradigm which has already been called into question. If we accept the counter-paradigm proposed above as truer to the nature of a socially responsible corporate executive, then there is no basis for saying that such an individual "imposes taxes", becoming "in effect" a civil servant.

Second, it is not apparent how the propositions that, under the doctrine of social reponsibility, a corporate executive is "in effect" imposing taxes and "in effect" a civil servant logically imply that this doctrine upholds the view that political mechanisms should determine the allocation of scarce resources.

To the contrary, as Friedman points out, his paradigmatic executive is not a true political entity, since he is not elected and since his program of "taxation" and social expenditure is not implemented through a political process. Paradoxically, it is Friedman who finds it "intolerable" that this agent who allocates scarce resources is not part of a political mechanism. Nowhere, however, does he show that acceptance of such a political mechanism is intrinsic to the view of his opponent, the advocate of social responsibility.

Third, in order to show that the doctrine of social responsibility is a socialist doctrine, Friedman must invoke a criterion for what constitutes socialism. As we have seen, his criterion is "acceptance of the ... view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses".

The doctrine of social responsibility, he holds, does accept this view. Therefore the doctrine is a socialist doctrine.[4]

However, this criterion is hardly definitive of socialism. The criterion is so broad that it holds for virtually any politically totalitarian or authoritarian system – including feudal monarchies and dictatorships of the political right.

Further, depending on the nature of a resource and the degree of its scarcity, the political leadership in any system, including American democracy, is liable to assert its right to determine the allocation of that resource. Who doubts that it is appropriate for our political institutions, rather than market mechanisms, to ensure the equitable availability of breathable air and drinkable water, or to allocate food and fuel in times of war and critical shortage?

Therefore, Friedman has not provided a necessary element for his argument – a definitive criterion for what constitutes socialism.

In summary, Friedman's argument is unsound: first, because it rests on an arbitrary and suspect paradigm; second, because certain of his premises do not imply their stated conclusion; and, third, because a crucial premise, his criterion for what constitutes socialism, is not true.

Although he complains of the "analytical looseness" and "lack of rigor" of his opponents, Friedman's argument has on close examination betrayed its own instances of looseness and lack of rigor.

Conclusion

I have considered Friedman's principal objections to socially responsible action in business and argued that at the bottom of most of his objections is an inaccurate paradigm. In response, I have given an account of a more appropriate paradigm to show how business can exercise social responsibility.

Friedman is right in pointing out that exercising social responsibility costs money. If nothing else, a company incurs expense when it invests the manhours needed to contemplate the possible social consequences of alternative actions and to consider the merit or demerit of each set of consequences.

But Friedman is wrong in holding that such costs must be imposed by one business stakeholder on the others, outside of the whole collaborative process of strategic and operational business management. He presumes too much in intimating through his imagined examples that the business person who pursues a socially responsible course inevitably acts without due attention to return on investment, budgetary limitations, reasonable employee remuneration, or competitive pricing.

My purpose has been to provide a critique of the major lines of argument presented in a famous and influential essay. The thrust has been to show that Friedman misrepresents the nature of social responsibility in business and that business people *can* pursue a socially responsible course without the objectionable results claimed by Friedman. It would be another step to produce positive arguments to demonstrate why business people *should* pursue such a course. That is an undertaking for another occasion.

For now, I shall only observe that Friedman's own concluding statement contains a moral exhortation to business people. Business, he says, should engage in "open and free competition without deception or fraud". If Friedman does not recognize that even these restrained words lay open a broad range of moral obligation and social responsibility for business, which is after all one of the largest areas of human interaction in our society, then the oversight is his.

Notes

[1] Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits', *New York Times Magazine*, 13 September 1970, 32 ff. Unless otherwise noted, all quotations are from this essay.

[2] G. E. Moore, *Principia Ethica*, Cambridge, 1971, p. 150.

[3] *Ibid.*, p. 149.

[4] In the concluding paragraph of his essay, Friedman states, "The doctrine of 'social responsibility' taken seriously would extend the scope of the political mechanism to every human activity". "Every human activity" certainly seems at least one extra step beyond the set of activities involved in "the allocation of scarce resources to alternative uses". Unfortunately, Friedman's essay contains no explication of the reasoning he used to make the transition from the language of his argument midway through the essay to the grander claim of this concluding paragraph.

The Fuqua School of Business,
Duke University,
Durham, NC 27706,
U.S.A.