ECONOMICS AND CORPORATE SOCIAL RESPONSIBILITY: SOME
PERSONAL REFLECTIONS

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I am going to take the opportunity, while I have undisputed occupation of the podium, to engage in some reflections on our economics discipline which have a personal flavour.

On the one hand, in economics, there is a beautiful logic and simplicity in our approach to those workings of society which we consider are our domain. On the other hand (!) society ends up being messy and, relative to our assumptions and models, non-conformist in so many ways.

Consider human capital theory. It is set to explain so much (even marriage). How hard we have tried to use it to explain women’s work and wage experience. Yet society has other subjective positions, social norms and rules of the game which cannot be measured in our model and we are left to accept we have fallen short of an explanation.

Or again, marginal productivity in a competitive market does not provide a satisfactory explanation for the remuneration of some of our high flying CEOs. Thus we have overlaid other models such as tournament theory in an attempt to achieve some satisfactory explanation. Recent trends in executive salaries suggest to me that, despite all this, we really have no economic explanation. Is that because we have no way of explaining or measuring power and influence in our models?

We, as economists, are agnostic on social outcomes but not on process; thus if our championship of free trade ends up with clothing workers in Mauritius or Mexico losing their jobs; that is the market, and the
market is ‘good’ by definition. We do not take responsibility for solutions to
the distributional outcomes though we do claim responsibility for the ‘good’
product price outcomes.

While as an undergraduate I was steeped in the theory, I well remember my
enthusiastic discussion with my father being met with the sceptical response,
‘in the real world’! My first job after graduation from
Sydney University was with the Reserve Bank. It was there that I
met Austin Holmes, who at the time was creating a ‘Flow of Funds’
methodology and data for the Bank. Austin later became my boss as head of
the Research Department before he went to Canberra to head up Priority
Review for the Whitlam government. Austin was always economical with
words, maybe in keeping with his origins as a farmer’s son from wheatbelt
WA. I well remember an occasion when my expressed concerns about
distributional issues were somewhat deflated by Austin’s clear economic
thinking. When I commented on the, to me, obscenity of a $1m payment by
a private citizen for a ‘penny black’ stamp, Austin dryly retorted, ‘Why an
obscenity? There is no new resource use involved.’

However, I have continued to ponder the issues which our adherence to the
concepts of rationality, objective choice, and to the amorality of the market
outcome, throw up. In what follows I indulge in some speculative comments
on Economics and Corporate Social Responsibility.

At first blush economics would seem to have little to say about corporate
social responsibility. We are all familiar with Milton Friedman’s classic
comment: ‘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’. (Friedman, New York Times,

This quote has been used time and again in economics (and business) as the
excuse for non-engagement when questions of corporate responsibility and
society are raised. However, early in that same article Friedman opened the
door a little; he wrote that the executive ‘responsibility is to conduct the business in accordance with their (the employers/stockowners) desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom (my italics). This is the less frequently quoted version of Friedman’s statement on responsibility. The comment ‘generally’ and the acceptance that the basic rules of society include not only the law but also ethical custom, suggests we are not so far apart after all.

My exploration of economics and corporate social responsibility has taken me back to some interesting economists like Veblen and JM Clarke and to some thoughtful contemporaries such as Sen and Etzioni.

Friedman argued (in the 1970 article) that ‘only people can have responsibilities’ not business. However, he does admit that ‘a corporation is an artificial person and in this sense may have artificial responsibilities’.

What is the nature of the ‘artificial person’, the corporation? The corporation is a legal entity and can sue (individuals as well as corporations) and be sued. The corporation has reputation, which has value to it and can be destroyed. The corporation has been vested by society with the privilege of limited liability; this device has enabled many corporations to grow exponentially. Some now exceed, in assets and cash flow, the size of nation states. The corporation can wield considerable, even massive, power and influence. Corporate ‘actions’ can affect the economic and social wellbeing of individuals, community groups, communities and even entire nations. In this context, it does not seem to me that the responsibilities of the corporation are so artificial.

JM Clarke (1916), writing early in last century and reflecting on the power of corporations over the wellbeing of individuals, had argued ‘we have inherited an economics of irresponsibility…We need an economics of responsibility, developed and embodied in our working business ethics.’ (p. 210). He rejected the individualistic premises of the economic orthodoxy
as being, from ‘a broader social point of view…limited or warped, either by excluding certain values…or by accepting certain partial or imperfect judgments of value’. (1936, p 4.) He noted that the outcome of business actions, e.g. pollution, safety issues at work, unsafe products, are ‘things over which someone can exercise control and that means they are things for which someone is responsible’(1916, p. 213.). He would hold the ‘business’ responsible since the actions which result in outcomes such as unsafe products and pollution are taken by businesses to further the business objectives.

Clarke argued that while specific regulation was able to handle issues as they are brought forward, the complexities of the financial and technological aspects of business lead to information asymmetry, with the citizen often unaware or unable to demonstrate how they are affected. Business, as the specialist, has the information and knowledge and hence the responsibility.

Consumers, for example, may have a normative position that they do not wish to use products produced by ‘slave’ labour; however, the consumer is unlikely to have the information in the case of each product choice, to discriminate in this respect. In Clarke’s ‘economics of responsibility’ business recognises and accepts its responsibility to operate according to social norms (such as the use of free labour) and the public interest (for example environmental protection). Clarke considered that, for economists, ‘the crucial task of theory is to unify, to reveal those causes and consequences of things men do which transcend the scope of free exchange’ (1916, p. 219).

Clarke would observe to-day that:
  i) advocacy for the primacy of the market is alive and well in the economics profession, the think tanks and in business;
  ii) government regulation to soften or eliminate the problems he highlighted has grown sporadically, but nevertheless in great volume. However, such regulation is an imperfect mechanism and many of the problems nevertheless remain or have increased in intensity;
iii) regulation is often resisted, using the arguments that not only is it not good for business, but that it is in some way not good for the public interest which is best served through business pursuit of unfettered profit maximisation;

iv) nevertheless, elements within business and government do discuss, advocate and report on corporate social responsibility initiatives with the caveat that these must be ‘good for business’ and consistent with profit maximisation.

The economics profession, however, has only recently and in small, though notable pockets, struck out to consider ‘theory to unify’ and to bring a ‘broader social point of view’. Galbraith (American Capitalism, 1956) proposed a theory of ‘countervailing forces’, where government regulation would moderate the unfettered pursuit of self-interest by private individuals and corporations. However, as public choice theory has highlighted, in practice an alternative outcome is the ‘capture’ of regulatory authorities in the service of private interests rather than the broader public interest. We have seen many high profile examples of this, from marketing boards and licensing authorities, to the ongoing management of the Murray-Darling basin.

In 1997 Epstein (1997; 4) noted ‘the subject of social norms is once again hot’. At issue are conceptions of a social order more complex than that which would be the outcome of individualistic rational economic man pursuing self-interest. It is interesting to note that even Friedman had envisaged economic activity of the corporation (and individual) as being answerable to ‘the basic rules of the society, both those embodied in law and those embodied in ethical custom.’

Elster (1989) noted that the most persistent cleavage in the social sciences has been that between ‘homo economicus’, whose behaviour is guided by instrumental rationality, and ‘homo sociologicus’, whose behaviour is dictated by social norms that have force even in the face of what may seem like superior options from the perspective of self-interest. While it is second
nature to the economist to argue that social norms may have functions related to self-interest or alternatively rational collective outcomes, Elster is able to demonstrate that this is not supported by the analysis.

Some economists (e.g. Posner, Lessig) have approached the question of social norms as part of homo economicus’s environment, which result in costs and constraints on rational choice. However, Etzioni makes the case for treating them as internalised predispositions to which humans adhere not because of social constraint, but as a source of intrinsic affirmation.

Social norms are not immutable; they are changeable through social and historical factors and processes of which the actors are neither aware, nor can individually control. This may include education, identification with authority figures, and generation of group enthusiasm through rituals, even the media. Some interesting contemporary examples of authority figures seeking influence in the development of social norms include the focus on the approach to teaching history in Australian schools and the debate on Australian values and the citizenship test. Advertising, which in most of its forms seeks to persuade and thus influence preferences may also, over time, influence social norms.

The discussion of social norms has taken place against the backdrop of social research, which found strong notions of ‘fairness’ can be counterpoised against the ‘selfish’ rational ‘homo economicus’. Sen (1977, p. 327) put forward concepts of sympathy and commitment as motivations which intervene in relation to ‘revealed’ individual preferences. According to Sen, commitment is demonstrated where an individual will choose to act in a way which will yield a lower level of anticipated personal welfare than an alternative available. As illustrative of the notion of commitment, Sen put forward attitudes towards work. He suggested ‘social conditioning’ and ethics play an important role here. He made the perceptive comment that ‘to run an organisation entirely on incentives to personal gain is pretty much a hopeless task.’ (p.335).
Research using laboratory experiments (surveyed by Fehr and Schmidt, 2000) has highlighted that social preferences for reciprocal fairness, inequity aversion and altruism can have a big impact on the aggregate outcomes for markets and organisations (Fehr and Fischbacher, 2002). Etzioni argued that social norms and the law both serve as foundations of social order, from caring for your children to paying taxes. Furthermore, he suggested ‘laws supported by social norms are likely to be significantly more enforceable’ (Etzioni, 2000, p.159).

Does this discussion allow us to take a ‘broader social point of view’, if not perhaps providing ‘theory to unify’? What do we have?

We have the proposition that ‘homo economicus” and ‘homo sociologicus’ cannot be consigned to separate realms of human endeavour; something, which we can call ‘social norms’ or ‘the basic rules of society’, may be the unifying concept, to be accounted in the discussion of preferences and behaviour.

Actions informed by social norms do not necessarily contribute towards outcomes which conform to those predicted for the economist’s rational (and selfish) consumer. Indeed, Sen’s concept of commitment, or the now well documented preferences for reciprocal fairness and inequity aversion, can be demonstrated to lead to observable preferences and outcomes which are counterintuitive to the economist.

Social norms are slow to change but they are not immutable. There exists a range of powerful agents within society capable of influencing social norms over time. We have to include such corporate activities as advertising, product design as well as business interaction with the media in this. Some of the exercise of that influence is self-regarding rather than ethically or socially based. A very interesting current example relates to the sexualisation of images of, and products for, young girls. Another example is the encouragement and support given by some corporations and the media to climate change sceptics.
What I believe we are left with is a very much more complex set of issues relating to consumer sovereignty, business responsibility and the outcome of the ‘invisible hand’ than my professors had me accepting as an undergraduate. While I understand the appeal of the objective position for the economist, the human as a social being holds to normative positions that affect their preferences, actions and thus the outcomes in what we call the economic sphere. I do not consider that the economist can claim for their profession or for business that these normative positions do not apply in their realms within society.

The ‘Business Case’ for adhering to Corporate Social Responsibility policies and reporting is the ‘good for profit’ case; considering the long-term, developing reputation. However, I propose the foundation for CSR must be laid on an ethical base and take into account social norms and societal outcomes. While there will be the well worn refrain ‘how can business set its priorities when outcomes other than profit are to be considered’, in practice, in business some high performance organisations do recognise and take into account the influence of social norms in relation to elements of product marketing, employee incentives and behaviour and firm reputation. In other words, there are some in business who accept that their operational environment is inhabited not by the one dimensional ‘homo-economicus’ but by the more complex ‘homo-sociologicus’ and that this is a much more ‘messy’ world with multiple elements entering the decision making framework. On one point, however, I totally agree with Friedman. Corporate Social Responsibility is not, and should not be, about corporate philanthropy.

For the economist there are some interesting implications for research inquiry. There is already a growing volume of ‘experimental’ work on preferences and behaviour. Maybe the qualitative research paradigm will also gain more currency than it currently has as a tool to explore the social realm, preferences and behaviour.

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References:


