

1, both of

Series bridges the
of religion. Business
et despite the many
nters on the many
ess throughout the
id to publish books
well as be useful as
ourses.

Religious Perspectives on Business Ethics

An Anthology

Edited by
Thomas O'Brien and Scott Paeth

With a Foreword by
Patricia Werhane

ROWMAN & LITTLEFIELD PUBLISHERS, INC.
Lanham • Boulder • New York • Toronto • Plymouth, UK

ROWMAN & LITTLEFIELD PUBLISHERS, INC.

Published in the United States of America
by Rowman & Littlefield Publishers, Inc.
A wholly owned subsidiary of The Rowman & Littlefield Publishing Group, Inc.
4501 Forbes Boulevard, Suite 200, Lanham, Maryland 20706
www.rowmanlittlefield.com

Estover Road
Plymouth PL6 7PY
United Kingdom

Copyright © 2007 by Rowman & Littlefield Publishers, Inc.

All rights reserved. No part of this publication may be reproduced,
stored in a retrieval system, or transmitted in any form or by any
means, electronic, mechanical, photocopying, recording, or otherwise,
without the prior permission of the publisher.

British Library Cataloguing in Publication Information Available

Library of Congress Cataloging-in-Publication Data

Religious perspectives on business ethics / edited by Thomas O'Brien and Scott Paeth.

p. cm. — (Religion and business ethics)

Includes bibliographical references and index.

ISBN-13: 978-0-7425-5010-0 (cloth : alk. paper)

ISBN-10: 0-7425-5010-9 (cloth : alk. paper)

ISBN-13: 978-0-7425-5011-7 (pbk : alk. paper)

ISBN-10: 0-7425-5011-7 (pbk : alk. paper)


1. Religious ethics. 2. Business ethics. 3. Business—Religious aspects. I. O'Brien,
Thomas, 1961– II. Paeth, Scott. III. Series.

BJ1188.R43 2006

205'.64—dc22

2006017737

Printed in the United States of America

™ The paper used in this publication meets the minimum requirements of American
National Standard for Information Sciences—Permanence of Paper for Printed Library
Materials, ANSI/NISO Z39.48-1992.

Smith, Friedman, and Self-Interest in Ethical Society

Harvey S. James Jr. and Farhad Rassekh

In this article, Harvey S. James and Farhad Rassekh examine the writings of Adam Smith and Milton Friedman regarding their interpretation and use of the concept of self-interest. They argue that neither Smith nor Friedman considers self-interest to be synonymous with selfishness and thus devoid of ethical considerations. Rather, for both writers self-interest embodies an other-regarding aspect that requires individuals to moderate their actions when others are adversely affected. The overriding virtue for Smith in governing individual actions is justice; for Friedman it is noncoercion.

Suppose a company president comes to the realization that the firm's manufacturing operations, and those of competitors, discharge a harmful pollutant, and the pollutant is not subject to the country's environmental regulations. What should the company president do? Suppose the company president wanted to make the decision in accordance with the doctrines of Adam Smith and Milton Friedman as presented in a typical business ethics textbook. What would the action be? The most likely answer is that the doctrines of self-interest and profit seeking would advise the president to conceal the information and continue with business as usual. Is this an accurate assessment of Smith and Friedman?

Adam Smith maintains that market participants, in pursuit of their self-interests, are guided by an "invisible hand" and thus unknowingly benefit society. Closely related to Smith's doctrine is a thesis put forth by Milton Friedman that the "social responsibility of business is to increase its profits."¹ Implicit in Friedman's thesis is the Smithian doctrine that the pursuit of profit is beneficial to society. It is common in many business ethics textbooks to find Smith and Friedman interpreted as follows: People *should*

pursue their self-interests; businesses should do whatever improves their financial position, even if others are harmed; and in some way the "invisible hand" ultimately makes the effects of such actions right for society. Is this interpretation correct?

In this chapter we examine both Smith's doctrine and Friedman's thesis, particularly as they relate to the role of self-interest and to the modern notion of business ethics. We are motivated by the fact that virtually every textbook in business ethics devotes at least a section to Smith in connection with the role of self-interest in capitalism and a section to Friedman in relation to the social responsibility of corporations. However, many of these presentations are often a confusing explanation of self-interest and how Smith and Friedman interpret and use that concept. Many textbooks at best make an incomplete presentation of Smith and Friedman; at worst, they misrepresent them. We find this curious. Modern scholarship on Smith acknowledges his belief that self-interest must be tempered by virtues such as justice. And Friedman at least on one occasion has expressed his unhappiness regarding the interpretation of his position on social responsibility.

We intend to present Smith and Friedman based on their writings and to show that self-interest, as expounded by Smith and Friedman, is not the same as selfishness but rather has a moral and other-regarding component. To be clear, we argue that both Smith and Friedman would agree that the company president, when faced with the environmental problem outlined above, ought to inform the public and accept the consequences. And this course of action would be consistent with both Smith's and Friedman's interpretation of self-interest and its role in a market economy.³

Why is an accurate interpretation of Smith and Friedman important? The Smithian analysis of the pursuit of self-interest represents one of the most influential doctrines in the history of ideas, forming the foundation of the market system. Similarly, Friedman's analysis of corporate social responsibility represents one of the most controversial ideas in modern business ethics. Consequently, it behooves all individuals—particularly textbook writers and instructors who teach and critique—to understand Smith and Friedman accurately and completely regarding their interpretation of the nature and role of self-interest in society. Only then is it fair to conduct a normative evaluation of Smith's and Friedman's arguments.

This chapter is organized as follows: It presents a textbook treatment of Smith and Friedman; examines the concept of self-interest in Smith's writings; analyzes Friedman's thesis on social responsibility, particularly as an application of Smith's advocacy of self-interested behavior; and offers a concluding note.

Cor
and
inte
publ
with
expl
purs

suit o
strict
busin
egoist
produ
the g
ment
encor
in the
Rose
interf
of pe

TEXTBOOK TREATMENT OF
ADAM SMITH AND MILTON FRIEDMAN

Consider two quotes from Smith and two from Friedman that are well known and form the basis for the popular characterizations of how they view self-interest. In *An Inquiry into the Nature and Causes of the Wealth Nations* (WN), published in 1776 [1981], Smith outlines how markets operate, particularly with respect to the role of self-interest in society. In the first quote, Smith explains why self-interest is necessary, and in the second he shows how the pursuit of self-interest, via the invisible hand, benefits society:

It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their own interest.⁴

As every individual, therefore, endeavors as much as he can to employ his capital in the support of domestick industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it. By preferring the support of domestick to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was not part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the publick good. It is an affectation, indeed, not very common among merchants and very few words need be employed in dissuading them from it.⁵

What does Smith mean by regard to one's own interest? Why is the pursuit of self-interest necessary in a market economy? Does Smith place any restriction on the pursuit of self-interest? Typical answers to these questions from business ethics textbooks are as follows: "Smith believed that only through egoistic pursuits could the greatest economic good for the whole society be produced."⁶ Later in their text, Shaw and Berry explain, "Smith reasoned that the greatest utility will result from *unfettered pursuit of self-interest*. . . . Government interference in private enterprise should be eliminated, free competition encouraged, and *economic self-interest made the rule of the day*," which "results in the greatest benefit to society"⁷ [emphasis added]. Similarly, Buchholz and Rosenthal state that the "pursuit of one's own *selfish ends*, without outside interference, is believed to result in the greatest good for the greatest number of people"⁸ [emphasis added]. Velasquez remarks that Smith's definition of self-

interest fails to recognize that "human beings regularly show a concern for the good of others and constrain their self-interest for the sake of the rights of others."⁹ The idea is that nothing more than the pursuit of one's self-interest, with self-interest defined in narrowly egoistic terms, is necessary for a market economy to function well, since an invisible hand will guide such actions so as to produce positive effects for society.¹⁰

Now consider Friedman's application of Smith's principle of self-interest to the issue of corporate social responsibility. In the first quote, which comes from *Capitalism and Freedom*, Friedman defines the social responsibility of business. In the second, from an article entitled "The Social Responsibility of Business Is to Increase Its Profits," he gives his reason.

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.¹¹

In a free-enterprise, private property system, a corporate executive is an employee of the owners of the business. He has a direct responsibility to his employers. That responsibility is to conduct the business in accordance with their 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.¹²

Friedman also says that a social responsibility other than to generate as much profit as possible for business owners is a "fundamentally subversive doctrine."¹³ What does Friedman mean when he says the pursuit of profits is the only responsibility of business? Textbook answers to this question vary, but generally reflect the idea that Friedman's argument "attempts to ground business ethics . . . in the profit element only"¹⁴ and is a "declaration of *profits over ethics*"¹⁵ [emphasis added]. Primeaux states that "Friedman's ethical imperative . . . is too myopic, too *focused on bottom-line accounting profits alone*"¹⁶ [emphasis added]. And Buchholz states that

the social and ethical responsibilities of business are exhausted in terms of marketplace performance. As long as business performs its economizing functions well, it has fulfilled its social and ethical responsibilities and nothing more need be said. Thus [this] view of ethics . . . *does not necessitate any conscious ethical considerations* of business's responsibilities to society or to the environment other than successful economic performance. Ethics is totally captured by the notion of economizing.¹⁷ [emphasis added]

Similarly, Velasquez says that Friedman's position on profit and ethics "can be . . . used to justify a manager's *unethical or illegal conduct*"¹⁸ [emphasis added].

Hay
ing 1
or w
Acco
to pu
gene
the ii

devoi
ever,
and F
that t
and d
indivi
includ
analys

Smith
to unc
book,
sidered
philoso
devote
design
he des
To un
phy, or
misun

In
writin
nomic
Brown
1993 a
moral
not ye
presen

S
includ

Hay and Gray equate Friedman with the dictum "let the buyer beware," meaning managers "are not necessarily concerned with product quality or safety, or with sufficient and/or truthful information about products and services."¹⁹ According to these authors, Friedman says that it is justifiable for businesses to pursue any actions that increase profits since businesses' only function is to generate profits for stockholders. Any consideration other than profits is against the interests of business owners.

Popular interpretations of Smith and Friedman suggest that self-interest is devoid of ethical and other-regarding considerations. As we show below, however, these interpretations reflect a widespread misconception of what Smith and Friedman actually say.²⁰ A careful reading of Smith and Friedman will show that their use of the principle of self-interest is consistent with ethical conduct and that they never advocated the pursuit of one's interest to the detriment of individuals and society. Below we present a brief analysis of the Smithian system, including what Smith considered to be the proper behavior in business. This analysis leads us to Friedman's thesis on corporate social responsibility.

ADAM SMITH'S ANALYSIS OF SELF-INTEREST

Smith is generally known for his economic treatise *The Wealth of Nations*. But to understand Smith's social design, one would have to begin with his earlier book, *The Theory of Moral Sentiments* (TMS), published in 1759, which he considered to be a superior work to WN.²¹ Although TMS is a work on moral philosophy, it lays down the foundation for a social system to which Smith devoted his entire intellectual energy. An important element of Smith's social design is a proper political-economic system, which he analyzes in WN where he describes, inter alia, the operation of markets and the role of government. To understand Smith's political economy, one must study his moral philosophy, otherwise his overall social system will be incomplete, misinterpreted, and misunderstood.²²

In recent years, numerous books and articles have carefully delved into all writings of Smith and, as a result, accurately present Smith's ethical and economic systems. A sample of such scholarship on Smith includes Werhane, Muller, Brown, and Young, as well as many papers by Evensky that are referenced in his 1993 article.²³ In spite of the extensive contemporary examinations of Smith's moral philosophy and economics, many of the insights these scholars provide are not yet fully incorporated into mainstream business ethics literature. Hence, we present some essential points that are indispensable in understanding Smith.²⁴

Smith accepts as a matter of fact that we are endowed with many impulses, including self-love. But he maintains that we are also endowed with the capacity

to exercise self-command to contain our passions when the pursuit of self-love injures other people. Self-command plays a central role in Smith's ethical system, and it is a key to understanding his interpretation of self-interest as a proper motive for individual behavior.²⁵ "Self-command is not only itself a great virtue, but from it all other virtues seem to derive their principal luster."²⁶

While the virtue of self-command moderates one's actions, the approval of an action, according to Smith, depends on the judgment of an imaginary figure, the "impartial spectator." The following excerpt from TMS illustrates Smith's application of the impartial spectator in his ethical system.

There can be no proper motive for hurting our neighbor. . . . To disturb his happiness merely because it stands in the way of our own, to take from him what is of real use to him merely because it may be of equal or of more use to us, is what no impartial spectator can go along with. . . . *In the race for wealth, honors, and preferments, he may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should jostle, or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of.*²⁷ [emphasis added]

Clearly, Smith disapproves of actions that injure other people. An individual motivated by self-love "to outstrip all his competitors" in the pursuit of "wealth, honor, and preferment" ought not to "jostle, or throw down any of them." This principle permeates Smith's entire social and ethical systems, including his economics.

Smith expounds the doctrine that market transactions motivated by individual interests can benefit others. Although this doctrine figures prominently in WN, the genesis of the idea that self-interest drives market transactions is introduced in TMS.²⁸ The reason Smith appeals to self-interested motives in the market, according to Jacob Viner, is that Smith considers market exchanges to be mechanical and generally anonymous in comparison with social relations within families and between friends.²⁹ Sentiments such as sympathy and benevolence, which are prevalent in social behavior and familial relationships, are "insufficiently strong as a disciplinary force, and self-interest, moderated by an inner sense of justice as well as by politically enforced justice, would be the dominant psychological force" in market exchanges.³⁰

Two crucial points about self-interest emerge in Smith's writings. The first is that the pursuit of self-interest is bound by the laws of justice:

All systems either of preferences or restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring

both his i
order of m

Viner no
fraining from
another what
be the necessa
the expense of
est of one ord
other, is eviden
sovereign owe

The seco
tween selfish
recognizes a v
virtuous actio
teenth-century
fore in WN. S
pejorative sens
In fact, Smith
to restrain our
perfection of l
of sentiments an
[emphasis add
and that socia
benevolence.

The app
regarding acti
injuring other
fraud, or polit
cessions). The
the expense c

As an e
national trad
expense of c
thereby redu
ers because
of domestic
markets. Mo
and fewer cl
businesses b
amounts to
"outstrip" d

both his industry and capital into competition with those of any man, or order of men.³¹ [emphasis added]

Viner notes that to Smith "justice is a negative virtue; it consists of refraining from injury to another person and from taking or withholding from another what belongs to him. . . . Smith considered justice, so understood, to be the necessary foundation of a viable society."³² Advancing one's interest at the expense of others is unacceptable because to "hurt in any degree the interest of one order of citizens for no other purpose but to promote that of some other, is evidently contrary to that justice and equality of treatment which the sovereign owes to all different orders of his subjects."³³

The second point is that in Smith's mind there is a sharp distinction between selfishness and self-interest. Raphael and Macfie point out that "Smith recognizes a variety of motives, not only for actions in general but also for virtuous action."³⁴ These motives include self-interest or, to use the eighteenth-century term, self-love. It is this, not "selfishness," that comes to the fore in WN. Smith distinguished the two expressions, using "selfishness" in a pejorative sense for such self-love as issues in harm or neglect of other people. In fact, Smith believes "that to feel much for others and little for ourselves, that to restrain our selfish, and to indulge our benevolent affections, constitutes the perfection of human nature; and *can alone produce among mankind that harmony of sentiments and passions in which consists their whole grace and propriety*"³⁵ [emphasis added]. In short, Smith believes that selfishness is a vice to be avoided and that social harmony depends upon restraining selfishness and indulging benevolence.

The application of the foregoing argument in business is that for self-regarding actions to promote society's interest, businesspeople must refrain from injuring others, in the sense that business must be conducted without deception, fraud, or political rent-seeking (i.e., lobbying the government for favors and concessions). These actions violate the laws of justice and benefit one group only at the expense of another group—society's interest will not be advanced.³⁶

As an example of political rent-seeking, consider restrictions on international trade. These restrictions benefit import-competing industries at the expense of consumers and export industries. Tariffs often provoke retaliation thereby reducing exports. Even in the absence of retaliation, tariffs hurt exporters because they generally reduce import payments, causing an appreciation of domestic currency, thereby making exporters less competitive on world markets. Moreover, restrictions on international trade will lead to higher prices and fewer choices for consumers. Smith condemned political rent-seeking by businesses because of the harm it inflicts on others.³⁷ Political rent-seeking amounts to "justling" or "throwing down" competitors rather than trying to "outstrip" them by improving quality and lowering prices.

In business, the invisible hand leads every individual who wishes to generate the greatest value for himself to adhere to the desires of consumers, producing what society values the most. Thus businesspeople attempting to generate profit (or to avoid losses) unintentionally maximize the economic interests of society.³⁸ Moreover, competitive behavior, driven by self-interest, results in lower prices or higher quality, as well as the introduction of new products in the market. This process, however, often harms those who are outcompeted because consumers prefer efficient producers to the inefficient ones in the market.

Smith resolves this conflict of interest between buyers and inefficient producers by siding with "the great body of the people to buy whatever they want of those who sell it cheapest" as opposed to the interests of "merchants and manufacturers."³⁹ To elaborate, suppose firm A figures out a way to produce less expensively what firm B is producing. If A does not enter this market because B will be (likely) hurt, then society will be deprived of lower prices or higher-quality products. In the Smithian system, self-interest motivates A to enter the market, which advances consumers', and thus society's, interests. Smith, however, makes it clear that the competitive process must not involve unethical behavior such as deception and political rent-seeking. These actions not only redistribute benefits, they actually reduce them because time and talent that were spent on devising a scheme could have been spent on some other (beneficial) activity.

In summary, Smith presents a social paradigm whose harmony depends on benevolence (i.e., disposition to do good) and whose survival depends on justice (i.e., refraining from injuring others). He regards the pursuit of self-interest as an efficient way of organizing economic activities, which benefit the society provided that it is restrained by self-command and moderated by inner justice as well as by administratively enforced justice. Thus, "Smith's ideal economic actor is a person of goodwill, prudence, and self-restraint who operates both cooperatively and competitively in a social and economic milieu based on a foundation of morality, law, and justice."⁴⁰ Market mechanisms can effectively transform self-interested actions into socially beneficial outcomes if selfishness is avoided and justice is observed.

MILTON FRIEDMAN'S ANALYSIS OF SOCIAL RESPONSIBILITY

A careful reading of Milton Friedman regarding self-interest and the social responsibility of business shows that his philosophy is grounded in the writings of Adam Smith. In particular, Friedman's interpretation and application of self-interest to profit seeking also embodies restrictions that individuals are ethically required to observe. To understand Friedman's views on self-interest

and the pursuit of profit, one must understand his philosophy as detailed in many of his writings.

Friedman believes the political-economic problem involves designing a social system that effectively coordinates the activities of people. "The basic problem of social organization," explains Friedman, "is how to co-ordinate the economic activities of large numbers of people."⁴¹ He then explains the two fundamental approaches—central planning and market processes. He rejects central planning because it necessarily involves some degree of coercion by the state.

Friedman takes the "freedom of the individual, or perhaps the family, as [the] ultimate goal of judging social arrangements."⁴² For him, social processes that increase individual freedom should be encouraged while those that are restrictive or coercive should be avoided. Thus, freedom is the fundamental criterion by which one should judge individual actions. Freedom also forms the basis for Friedman's interpretation of self-interest as a motivation for human action.⁴³

Because Friedman values individual freedom so highly, he strongly advocates market mechanisms characterized by voluntary exchanges between individuals. The "key insight of Adam Smith's *Wealth of Nations*," according to Friedman, is "if an exchange between two parties is voluntary, it will not take place unless both believe they will benefit."⁴⁴ Voluntary exchange means "individuals are effectively free to enter or not to enter into any particular exchange."⁴⁵ This is important because "voluntary exchange is a necessary condition for both prosperity and freedom."⁴⁶ The result of such voluntary exchanges, however, goes far beyond the creation of economic wealth. There are many complex and sophisticated areas of human life that arise out of voluntary interactions among individuals, such as language, scientific knowledge, culture, and social conventions.⁴⁷

Friedman makes it clear that self-interest, motivating individuals to enter into exchange relationships, should not be interpreted narrowly given the pervasiveness of the economic and social effects of voluntary exchanges. There is a

broad meaning that must be attached to the concept of "self-interest." Narrow preoccupation with the economic market has led to a narrow interpretation of self-interest as myopic selfishness, as exclusive concern with immediate material rewards. Economics has been berated for allegedly drawing far-reaching conclusions from a wholly unrealistic "economic man" who is little more than a calculating machine, responding only to monetary stimuli. That is a great mistake. Self-interest is not myopic selfishness. It is whatever it is that interests the participants, whatever they value, whatever goals they pursue.⁴⁸ [emphasis added]

Because Friedman does not equate self-interest with selfishness, his interpretation is consistent with Adam Smith's on the other-regarding nature of self-interested behavior. But Friedman goes beyond the recognition that self-interest does not imply selfishness. He also recognizes the ethical and other-regarding dimension of decision making.

[In] a society freedom has nothing to say about what an individual does with his freedom; it is not an all-embracing ethic. Indeed, a major aim . . . is to leave the ethical problem for the individual to wrestle with. The "really" important ethical problems are those that face an individual in a free society—what he should do with his freedom. There are thus two sets of values . . . the values that are relevant to relations among people, which is the context in which he assigns first priority to freedom; and the values that are relevant to the individual in the exercise of his freedom, which is the realm of individual ethics and philosophy.⁴⁹

Friedman maintains that a balance between individual freedom and individual moral responsibility is necessary in any free society. The freedom that Friedman advocates is not "all-embracing." Rather, individuals have a moral obligation to "wrestle with" the ethical implications of their decisions and to exercise self-restraint when necessary. For this reason, Friedman states, "freedom is a tenable objective only for responsible individuals."⁵⁰ Furthermore, "absolute freedom is impossible. However attractive anarchy may be as a philosophy, it is not feasible in a world of imperfect men. Men's freedoms can conflict, and when they do, one man's freedom must be limited to preserve another's."⁵¹ He then cites a statement by an unnamed Supreme Court Justice who said that "my freedom to move my fist must be limited by the proximity of your chin."⁵² On another occasion, Friedman reiterates his belief that "freedom cannot be absolute. We do live in an interdependent society. Some restrictions on our freedom are necessary to avoid other, still worse, restrictions."⁵³

Friedman believes that the ethical responsibility of individuals in the exercise of their freedoms requires that they take into consideration the involuntary costs or harms they impose on others. He calls these costs "neighborhood" or "external" effects, and he defines them as "arbitrary obstacles" that prevent others "from using [their] capacities to pursue [their] own objectives."⁵⁴ He also argues that external effects should be avoided because "it is difficult to identify the effects on third parties and to measure their magnitude."⁵⁵

External effects can be allowed only if those adversely affected by them allow such actions, which they might under two conditions. First, they must be informed about the nature of the external effects; second, they must be adequately compensated or able to avoid the effects at relatively low cost. As an example, Friedman tells of a polluter of a stream. He explains that "the man who pollutes

a stream
ers might
them, ac
pensation
which h
when th
a free so
while th
any occ
parties t
succeed
Therefo
risks an
says that
part the
And win
chance."
tion is n
that ind
Otherw
of contr
rights, [
prevent

Th
responsi
others a
whether
by the c
must ta
require
the acti
some o
tion tha
majorit
to attain
procedu

Al
profit m
cial ret
Busines
tion or

a stream is in effect forcing others to exchange good water for bad. These others might be willing to make the exchange at a price. But it is not feasible for them, acting individually, to avoid the exchange or to enforce appropriate compensation."⁵⁶ Friedman distinguishes between harm caused by "external effects," which he opposes, and the personal consequences of decisions individuals make when they freely enter into risky transactions, which he accepts as necessary in a free society. According to Friedman, the former reduces individual freedoms while the latter does not. Thus, "everyone [is] free to go into any business, follow any occupation, buy any property, subject only to the agreement of the other parties to the transaction. Each [has] the opportunity to reap the benefits if he succeeded, to suffer the costs if he failed. There [are] no arbitrary obstacles."⁵⁷ Therefore, in the absence of external effects, individuals voluntarily accept the risks and consequences of the decisions *they* rather than others make. Friedman says that there are "probably more losers than winners. . . . But for the most part they went in with their eyes open. They knew they were taking chances. And win or lose, society as a whole benefited from their willingness to take a chance."⁵⁸ Friedman argues that when actions involve external effects, the question is not *whether* but *how* such actions should be restrained. He believes strongly that individuals should limit their conduct with self-restraint when possible. Otherwise, it is the duty of government to intervene through "the enforcement of contracts voluntarily entered into, the definition of the meaning of property rights, [and] the interpretation and enforcement of such rights" in order "to prevent coercion of one individual by another."⁵⁹

The foregoing analysis leads us to Friedman's discussion of the "social responsibility of business." Since actions that impose involuntary harm on others are unacceptable, business actions must be examined in the context of whether they are voluntary and compatible with the freedom of those affected by the decisions. In other words, if social responsibility means that businesses must take actions to positively affect society in some way, such actions must require the consent of all affected parties. And if some people are harmed by the actions, then they must agree to be affected (through compensation or some other process, for instance). Otherwise, "what it amounts to is an assertion that those who favor the [action] in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot obtain by democratic procedures."⁶⁰

Although Friedman argues that business executives should focus on profit maximization, he does not condone all behaviors that increase financial returns.⁶¹ Quite explicitly, he places four restrictions on profit seeking: Businesspeople must obey the law, follow ethical customs, commit no deception or fraud, and engage in open and free competition.⁶² The last restriction

means political rent-seeking and anticompetitive behavior in any form must be avoided. For Friedman, social responsibility means pursuing one's interests (such as making a profit) without adversely interfering with the freedom of others, so that everyone can freely enter into agreements "with their eyes open." These individuals would be fully aware of the risks and consequences of their actions.

Indeed, Friedman has both teleological and deontological reasons for advancing the thesis that business executives should pursue only profit and stay away from actions that purport to promote society's interests. On teleological grounds, he argues that it may not be possible for businesspeople to know what constitutes society's interests. Thus he asks, "[C]an self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest?"⁶³ Therefore, Friedman is skeptical of the *net* social benefits resulting from businesspeople intentionally seeking to promote society's interests.

On deontological grounds, Friedman believes that business actions, justified as "socially responsible," violate specific duties of those pursuing the actions. For example, unless businesspeople obtain the consent of those affected, they violate the duty not to coerce others. Similarly, business executives have a duty to act in the interest of those who hire and pay them (the stockholders). If executives do not act in the interest of their employer, then they are coercing them into financing a project that the owners do not want. "He [the business executive] has a direct responsibility to his employers," with the duty to act in their interests.⁶⁴ This does not mean, as some have argued, "Friedman is in error when he maintains that a business can ignore its other commitments," such as obligations to employees or suppliers.⁶⁵ Rather, it means that executives must recognize to whom their "primary responsibility" is directed. Those affected by the business action should give their consent. Otherwise,

the corporate executive would be spending someone else's money for a general social interest. Insofar as his actions in accord with his "social responsibility" reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customer's money. Insofar as his actions lower the wages of some employees, he is spending their money.⁶⁶

Moreover, Friedman disapproves of the motives of businesspeople who pursue actions under the "cloak of social responsibility," even though the actions may be in the corporation's interest, for example, when they "generate goodwill as a by-product of expenditures."⁶⁷ He denounces such actions as "hypocritical window-dressing" and as "approaching fraud," although he ac-

knowledges that "the attitudes of the public [may] make it in their interest to cloak their actions in this way."⁶⁸

Friedman makes it clear that this argument applies only to companies in which the decision makers are not the owners of the company. He distinguishes between the "social responsibilities of individuals" and the "social responsibilities of business."⁶⁹ The former requires individuals to examine and mitigate the extent to which their actions harm others, while the latter necessarily involves more explicit duties by executives to specific individuals or groups, such as stockholders. Thus, individual business owners and executives may voluntarily donate their own money to charity or other philanthropic causes. "The situation of the individual proprietor is somewhat different. If he acts to reduce the returns of his enterprise in order to exercise his 'social responsibility,' he is spending his own money, not someone else's."⁷⁰ Indeed, this is the great advantage of a free-market economy, according to Friedman, because "it forces people to be responsible for their own actions and makes it difficult for them to 'exploit' other people for either selfish or unselfish purposes. They can do good—but only at their own expense."⁷¹

In summary, Friedman believes that social benefits are achieved when individuals exercise their freedom without limiting the freedom of other people. Thus, individuals have an ethical obligation to conduct their actions without coercion, which requires the exercise of self-restraint. The principle of freedom implies that if business owners want profits, they are entitled to earn them, or to have employees they hire (and who agree to work for them) generate those profits. Executives who use the firm's resources to pursue any goal other than profit will necessarily coerce some people (stockholders, workers, or consumers) in the process, and it is coercion that Friedman objects to. Pursuit of profit and only profit is entirely ethical as long as business owners or their managers do not engage in illegal, deceptive, or fraudulent practices.

A FINAL NOTE

Adam Smith and Milton Friedman argue that the benefits to society are enhanced when individuals pursue their own interests. "But isn't concern for one's self-interest the very heart of behavior that conflicts with ethical behavior?" ask Bowie and Duska.⁷² The answer to this question is in the affirmative when self-interest is narrowly interpreted to mean selfishness. However, a careful reading of Smith and Friedman reveal that they do not use the concept of self-interest in this narrow sense. For Smith the overriding principle governing his interpretation of self-interest is justice, while for Friedman the principle is freedom (i.e., absence of coercion). For both writers, self-interest embodies an

other-regarding aspect that requires individuals to moderate their actions when others are adversely affected. It is this concept of self-interest that Smith and Friedman advocate.⁷³

QUESTIONS FOR DISCUSSION

1. According to the authors, how are Adam Smith's and Milton Friedman's conceptions of self-interest ordinarily treated? What conception of self-interest does this lead to? Do the authors view this conception as adequate?
2. Is there a difference between self-interest on the one hand and selfishness on the other? What is that difference?
3. What is the relationship between self-interest and justice for Adam Smith? What is the nature of justice? In what way is it a "negative virtue"?
4. What is the relationship between self-interest and freedom for Milton Friedman? What role does social responsibility play in this? Does respect for freedom of others constrain us morally? In what ways?
5. Is there a place for external compulsion in Friedman's worldview? May freedom be restricted for the good of society? How does self-restraint factor into his analysis?
6. How does Friedman argue that profit seeking should be restricted?
7. What are the moral arguments offered by Friedman as to why business executives should pursue only profit?

NOTES

1. Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," *New York Times Magazine*, September 13, 1970, 32.
2. Upon reading an earlier draft of this chapter, Friedman wrote to the authors (December 1, 1998): "As you recognize, I have been very unhappy about some of the interpretations that have been placed on my position."
3. In a private correspondence, one of the authors asked Friedman what his advice would be to the company president. Friedman replied (May 23, 1996) if he were the president, he "would be very unwilling to continue running that enterprise as [he] had before without that information being made available. . . . [The] appropriate course of action is to make publicly available the information." This is in contrast to the conclusion reached by T. Carson, "Friedman's Theory of Corporate Social Responsibility," *Business and Professional Ethics Journal* 12, no. 1 (1993): 3-32—that Friedman's statements on corporate social responsibility "imply that corporations have no duty to

warn the public about the hazards which they create" (18, emphasis in original). For an example of a similar conclusion from a business ethics textbook, see R. A. Buchholz and S. B. Rosenthal, *Business Ethics: The Pragmatic Path beyond Principles to Process* (Upper Saddle River, NJ: Prentice-Hall, 1998), 49.

4. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Indianapolis, IN: Liberty Classics, 1981), 27. Hereafter WN.

5. WN, 456.

6. W. H. Shaw and V. Barry, *Moral Issues in Business*, 7th ed. (Belmont, CA: Wadsworth, 1998), 60.

7. Shaw and Barry, *Moral Issues in Business*, 147.

8. Buchholz and Rosenthal, 106.

9. M. G. Velasquez, *Business Ethics: Concepts and Cases*, 4th ed. (Upper Saddle River, NJ: Prentice-Hall), 181.

10. Adams and Maine offer the following "economic" definition of self-interest. "Human beings . . . are motivated to do whatever it takes to satisfy their individual desires. Further, human beings are relatively indifferent about how their actions affect others. This does not imply that they are mean or spiteful, just that they tend to be disinterested about those effects." Although they do not directly attribute this definition to Adam Smith, they imply it by describing it as a basic tenant of neoclassical economics, with "a long and distinguished pedigree, going back to the philosopher Thomas Hobbes." D. M. Adams and E. W. Maine, *Business Ethics for the 21st Century* (Mountain View, CA: Mayfield, 1998), 29. However, as Werhane has argued, Smith was not a Hobbesian. See P. H. Werhane, *Adam Smith and His Legacy for Modern Capitalism* (New York: Oxford University Press, 1991).

11. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), 133.

12. Milton Friedman, "Social Responsibility," 33.

13. Milton Friedman, *Capitalism and Freedom*, 133.

14. Paul Camenisch, "Business Ethics: On Getting to the Heart of the Matter," in *Moral Issues in Business*, ed. Shaw and Berry, 242.

15. E. E. Englehardt and D. D. Schmeltkopf, *Ethics & Life: An Interdisciplinary Approach to Moral Problems* (Dubuque, IA: Wm. C. Brown, 1992), 313.

16. P. Primeaux, "Maximizing Ethics and Profits," in *Perspectives in Business Ethics*, ed. L. P. Hartman (Chicago: Irwin-McGraw-Hill, 1998), 259.

17. R. A. Buchholz, *Principles of Environmental Management: The Greening of Business* (Upper Saddle River, NJ: Prentice-Hall, 1998), 49.

18. Velasquez, *Business Ethics: Concepts and Cases*, 36.

19. R. D. Hay and E. R. Gray, "Introduction to Social Responsibility," in *Business and Society: Cases and Text*, 2nd ed. (Cincinnati, OH: South Western Publishing, 1980), 341, 345.

20. There are some exceptions, such as A. A. Marcus, *Business and Society: Strategy, Ethics, and the Global Economy* (Chicago: Irwin, 1996), 50-57, which treats both Smith and Friedman accurately. A. A. Goldsmith, *Business, Government, Society* (Chicago: Irwin, 1996) presents Smith accurately (62-64), but the analysis of Friedman although not wrong is incomplete (70).

21. T. D. Campbell, *Adam Smith's Science of Morals* (London: George Allen & Unwin Ltd., 1971), 16. In the introduction to TMS, Smith's foremost scholars note that "the two books complement each other and that the understanding of either is helped by studying both." D. D. Raphael and A. L. Macfie, "Introduction," in Smith, *An Inquiry into the Nature and Causes of the Wealth Nations* (Indianapolis, IN: Liberty Classics, 1984), 21.

22. Sen notes the following as an example of misinterpreting Smith. "Smith was often cited by imperial administration for justification of refusing to intervene in famines in such diverse places as Ireland, India, and China." A. Sen, *On Ethics & Economics* (New York: Basil Blackwell, 1987), 27.

23. Smith has been subjected to intense scholarship for over two hundred years. During this time some scholars have debated whether Smith's writings in TMS are inconsistent or even contradictory with his writings in WN, an issue known as "the Adam Smith Problem." However, the examples of recent scholarship we cite examine Smith's collective work and generally conclude that "the so-called 'Adam Smith Problem' was a pseudo-problem based on ignorance and misunderstanding" (Raphael and Macfie, "Introduction," 20).

24. Readers who wish to grasp Smith's philosophy on a deeper level than presented in this chapter should consult our citations on Smith.

25. For an elaboration, see Raphael and Macfie, "Introduction."

26. Adam Smith, *The Theory of Moral Sentiments* (Indianapolis, IN: Liberty Classics, 1984), 241. Hereafter TMS.

27. TMS, 82-83.

28. TMS, 304.

29. Viner is generally regarded as "[t]he greatest historian of economic thought that ever lived." D. A. Irwin, *Jacob Viner, Essays on the Intellectual History of Economics* (Princeton, NJ: Princeton University Press, 1991), 3.

30. Jacob Viner, "The 'Economic Man', or the Place of Self-Interest in a 'Good Society,'" in *Jacob Viner, Essays on the Intellectual History of Economics*, ed. D. A. Irwin (Princeton, NJ: Princeton University Press, 1991), 74.

31. WN, 687.

32. Jacob Viner, "Adam Smith," in *Jacob Viner, Essays on the Intellectual History of Economics*, ed. D. A. Irwin (Princeton, NJ: Princeton University Press, 1991), 252.

33. WN, 654.

34. Raphael and Macfie, "Introduction," 22.

35. TMS, 25.

36. Cavanagh correctly notes that Smith's position is "when morally conscientious individuals follow their own self-interest, it works to the benefit of society as a whole." G. F. Cavanagh, *American Business Values with International Perspectives* (Upper Saddle River, NJ: Prentice-Hall, 1998), 120.

37. For an analysis of Smith's views on rent-seeking, see, J. Evensky, "Retrospectives: Ethics and the Invisible Hand," *Journal of Economic Perspectives* 7, no. 2 (Spring 1993): 197-205; and J. D. Bishop, "Adam Smith's Invisible Hand Argument," *Journal of Business Ethics* 14 (March 1995): 165-80.

38. Baumol comments that, to Smith, the market system is "as an instrument of Deity designed to curb the frailty of humanity. . . . It is a device adopted by a very practical

Provid
Baum
Smith
Color
Smith
hand"
39.
40.
41.
42.
43.
[Fried
mizin
44.
York:
45.
46.
47.
48.
49.
50.
51.
52.
53.
54.
55.
56.
57.
58.
59.
60.
61.
to ac
ness,
62.
man
and
busin
socia
comp
Busin
1995
C.
latio
cond

Providence to deal with the unfortunate but very weakness of human character." W. J. Baumol, "Smith versus Marx on Business Morality and the Social Interest," in *Adam Smith and the Wealth of Nations 1776-1976 Bicentennial Essay*, ed. E. Glahe (Boulder: Colorado Associated University Press, 1978), 117. For this reason, observes Baumol, Smith says that individuals in the pursuit of their self-interests are "led by an invisible hand" not "led as though by an invisible hand" to promote society's interest (121).

39. WN, 493-94.

40. Werhane, 180.

41. Friedman, *Capitalism and Freedom*, 12.

42. Friedman, *Capitalism and Freedom*, 12.

43. Thus, we disagree with Primeaux's conclusion that "it is evident that the values [Friedman] wants to encourage are focused exclusively on utility." Primeaux, "Maximizing Ethics and Profits," 259.

44. Milton Friedman and R. Friedman, *Free to Choose: A Personal Statement* (New York: Avon Books, 1980), 5.

45. Friedman, *Capitalism and Freedom*, 14.

46. Friedman and Friedman, *Free to Choose*, 3.

47. Friedman and Friedman, *Free to Choose*, 3.

48. Friedman and Friedman, *Free to Choose*, 18-19.

49. Friedman, *Capitalism and Freedom*, 12.

50. Friedman, *Capitalism and Freedom*, 33.

51. Friedman, *Capitalism and Freedom*, 25-26.

52. Friedman, *Capitalism and Freedom*, 26.

53. Friedman and Friedman, *Free to Choose*, 61.

54. Friedman and Friedman, *Free to Choose*, 119.

55. Friedman, *Capitalism and Freedom*, 31-32.

56. Friedman, *Capitalism and Freedom*, 30.

57. Friedman and Friedman, *Free to Choose*, 124.

58. Friedman and Friedman, *Free to Choose*, 129.

59. Friedman, *Capitalism and Freedom*, 27.

60. Friedman, "Social Responsibility," 124.

61. Hence Boatright states that Friedman's argument "does not permit corporations to act in a socially irresponsible manner." J. R. Boatright, *Ethics and the Conduct of Business*, 2nd ed. (Upper Saddle River, NJ: Prentice-Hall, 1997), 352.

62. Novak comments that these restrictions require "a high level of moral performance." Michael Novak, *Business as a Calling* (New York: Free Press, 1996), 141. Trevino and Nelson concur by noting that Friedman's statement on the social responsibility of business "tacitly embraces two of the three additional components of the corporate social responsibility pyramid: legal and ethical responsibilities." (The third additional component is philanthropic responsibilities.) L. K. Trevino and K. A. Nelson. *Managing Business Ethics: Straight Talk about How to Do It Right* (New York: John Wiley & Sons, 1995), 29.

Carson argues that the first two conditions, which he labels the "second formulation," derived from Friedman's 1970 article, are inconsistent with the final two conditions, which Carson calls the "first formulation" from Friedman's 1962 book, a

criticism we can perhaps call "the Milton Friedman Problem." T. Carson, "Friedman's Theory of Corporate Social Responsibility," *Business and Professional Ethics Journal* 12, no. 1 (1993): 3-32. In a critique similar to "the Milton Friedman Problem," Mulligan states that Friedman's reference to "open and free competition without deception or fraud" in *Capitalism and Freedom* shows that he "does not recognize that even these restrained words lay open a broad range of moral obligation and social responsibility for business." T. Mulligan, "A Critique of Milton Friedman's Essay 'The Social Responsibility of Business Is to Increase Its Profits,'" *Journal of Business Ethics* 5, no. 4 (1986): 269. We see no contradiction in Friedman's writings. Rather, we suggest that his conditions of obeying the law, following ethical custom, committing no deception and fraud, and engaging in free and open competition are complementary and consistent with all of his writings.

63. Friedman, *Capitalism and Freedom*, 133-34. In an interview with *Business and Society Review*, Friedman gives the following example: "During the 1930s, German businessmen used some corporate money to support Hitler and the Nazis. Was that a proper exercise of social responsibility?" Friedman, "Social Responsibility," 6.

64. Friedman, "Social Responsibility," 33.

65. D. Stewart, *Business Ethics* (New York: McGraw-Hill, 1996), 56.

66. Friedman, "Social Responsibility," 33.

67. Friedman, "Social Responsibility," 124.

68. Friedman, "Social Responsibility," 124. L'Etang also rejects business actions promoting social good on Kantian grounds because "beneficiaries can be used as a means to the end of improving the company's image." J. L'Etang, "Ethical Corporate Social Responsibility: A Framework for Managers," *Journal of Business Ethics* 14 (February 1995): 126.

69. Friedman, "Social Responsibility," 33.

70. Friedman, "Social Responsibility," 124.

71. Friedman, "Social Responsibility," 124.

72. N. E. Bowie and R. F. Duska, *Business Ethics*, 2nd ed. (Englewood Cliffs, NJ: Prentice-Hall, 1990), 25.

73. We wish to thank William Baumol, Milton Friedman, and Glen Moots for helpful comments on an earlier draft of this chapter. The usual disclaimer applies.