INTRODUCTION TO ECONOMICS HONORS
Hopatcong High School Summer Reading 2017 - 2018

The purpose of a course in Economics is to give students a thorough understanding of the principles of economics that apply to the functions of individual decision makers, both consumers and producers, within the economic system. It places primary emphasis on the nature and functions of product markets, and includes the study of factor markets and the role of government in promoting greater efficiency and equity in the economy.

ASSIGNMENTS

Students will be responsible for completing the following assignments over the summer. Pay attention to the due dates which can be found at the end of this document.

All assignments should be completed using GOOGLE DOCS and should be shared with me on Google Classroom.

1.) Read Economics and Economists: The Basis for Controversy

   a. Read this introductory article before completing any of the other summer assignments.

2.) Read Issue I -- Are Profits the Only Business of Business:

   a. Read the article with opposing viewpoints on the issue before completing the written assignment in the summer assignment description.

After you read the opposing viewpoints on the profits of business, complete the summary and analysis.

- Type a 1 paragraph brief summary of each of the opposing viewpoints of the issue.
- Type a 1-2 paragraph analysis stating the viewpoint you agree with – complete with explanation.
- Share this typed assignment with me on Google Classroom with the document titled first initial, last name on google docs.

- **Due date: 1st Day Back to School - Thursday, 7 September 2017**

3.) ECONOMIC NEWS ARTICLES - Article Summaries

a. Follow the news on a weekly basis by reading economic articles online from any of the sources listed below. You should read at least 3 articles per week.

The Economist
The New York Times
The Washington Post
Newsweek
Time
Bloomberg.com
Money
The Atlantic Monthly

There are additional newspaper links on my web page.

b. You **must select one article per week and write a Weekly Article Analysis addressing the key economic concepts introduced in the articles.** These should be completed in the following format:

i. at least 1 page ii.
12 pt. font
iii. Times New Roman
iv. MLA style citation of article at the end of the paper

c. You are required to complete 10 total Article Analyses:

i. 1 for June (Due July 3, 2016)
ii. 4 for July (Due August 1, 2016)
iii. 5 for August (Due by 6 September 2016)

Your textbook for Economics Honors is an on-line textbook. Principles of Economics is accesses as follows - https://openstax.org/details/principles-economics.

Please read Chapter 1 – Welcome to Economics and complete the attached vocabulary. Due Thursday, 7 September 2017.

Name - ____ Date - ___________________________

Honors Principals of Economics
Principles of Economics - Chapter 1 – Welcome to Economics

Please read Chapter 1 – Welcome to Economics - https://www.openstaxcollege.org/files/textbook_version/low_res_pdf/21/principles-of-economics-LR.pdf

Define the following terms –

circular flow diagram

command economy

division of labor

economics

economies of scale

exports

fiscal policy

goods

services

goods and services market

gross domestic product (GDP)

imports

labor market

macroeconomics

market economy

market

microeconomics

model

monetary policy

private enterprise

scarcity

specialization

theory

traditional economy

underground economy

Needs

Wants

Shortage

Scarcity

Allocation of Resources

Opportunity Cost and Tradeoffs

Production Possibilities curve

Marginal benefits

marginal costs

Incentives

Economic Systems

Globalization

Consumer Economics

Economics and Economists:
The Basis for Controversy

Thomas R. Swartz and Frank J. Bonello

[The Introduction from the book T*aking Sides: Clashing Views on Controversial Economic Issues*, published by Dushkin/McGraw Hill, 1998]

Although more than 70 years have passed since Lord Keynes (1883-1946) penned these lines, many economists still struggle with the basic dilemma he outlined. The paradox rests in the fact that a free-market system is extremely efficient. It is purported to produce more at a lower cost than any other economic system. But in producing this wide array of low-cost goods and services, problems arise. These problems-most notably a lack of economic equity and economic stability - concern some economists.

If the problems raised and analyzed in this book were merely the product of intellectual gymnastics undertaken by egg-headed economists, we could sit back and enjoy these confrontations as theoretical exercises. The essays contained in this book, however, touch each and every one of us in tangible ways. Some focus upon macroeconomic topics, such as balancing the budget and the Federal Reserve's monetary policy. Another set of issues deals with microeconomic topics. We refer to these issues as micro problems not because they are small problems, but because they deal with small economic units, such as households, firms, or individual industries. A third set of issues deals with matters that do not fall neatly into the macroeconomic or microeconomic classifications. This set includes three issues relating to the international aspects of economic activity and two involving pollution.

The range of issues and disagreements raises a fundamental question: Why do economists disagree? One explanation is suggested by Lord Keynes's 1926 remark. How various economists will react to the strengths and weaknesses found in an economic system will depend upon how they view the relative importance of efficiency, equity, and stability. These are central terms, and we will define them in detail in the following pages. For now the important point is that some economists may view efficiency as overriding. In other cases, the same economists may be willing to sacrifice the efficiency generated by the market in order to ensure increased economic equity and/or increased economic stability.

Given the extent of conflict, controversy, and diversity, it may appear that economists rarely, if ever, agree on any economic issue. We would be most misleading if we left the reader with this impression. Economists rarely challenge the internal logic of the theoretical models that have been developed and articulated by their colleagues. Rather, they will challenge either the validity of the assumptions used in these models or the value of the ends these models seek to achieve. The challenges typically focus upon such issues as the assumption of functioning, competitive markets, and the desirability of perpetuating the existing distribution of income. In this case, those who support and those who challenge the operation of the market agree on a large number of issues. But they disagree most assuredly on a few issues that have dramatic implications.

This same phenomenon of agreeing more often than disagreeing is also true in the area of economic policy. In this area, where the public is most acutely aware of differences among economists, these differences are not generally over the kinds of changes that will be brought about by a particular policy. The differences more typically concern the timing of the change, the specific characteristics of the policy, and the size of the resulting effect or effects.

ECONOMISTS: WHAT DO THEY REPRESENT?

Newspaper, magazine, and TV commentators all use handy labels to describe certain members of the economics profession. What do the headlines mean when they refer to the Chicago School, the Keynesians, the institutional economists, or the radical economists? What do these individuals stand for? Since we too use our own labels throughout this book, we feel obliged to identify the principal groups or camps in our profession. Let us warn you that this can be a misleading venture. Some economists - perhaps most of them - defy classification. They drift from one camp to another, selecting a gem of wisdom here and another there. These are practical men and women who believe that no one camp has all the answers to all the economic problems confronting society.

Recognizing this limitation, four major groups of economists can be identified. These groups are differentiated on the basis of two basic criteria: how they view efficiency relative to equity and stability; and what significance they attach to imperfectly competitive market structures. Before describing various views on these criteria, it is essential to understand the meaning of certain terms to be used in this description.

Efficiency, equity, and stability represent goals for an economic system. An economy is efficient when it produces those goods and services that people want without wasting scarce resources. Equity in an economic sense has several dimensions. It means that income and wealth are distributed according to accepted principles of fairness, that those who are unable to care for themselves receive adequate care, and that mainstream economic activity is open to all persons. Stability is viewed as the absence of sharp ups and downs in business activity, in prices, and in employment. In other words, stability is marked by steady increases in output, little inflation, and low unemployment.

When the term market structures is used, it refers to the number of buyers and sellers in the market and the amount of control they exercise over price. At one extreme is a perfectly competitive market where there are so many buyers and sellers that no one has any ability to influence market price. One seller or buyer obviously could have great control over price. This extreme market structure, which we call pure monopoly, and other market structures that result in some control over price are grouped under the broad label of imperfectly competitive markets. With these terms in mind, we can begin to examine the various schools of economic thought.

Free-Market Economists

One of the most visible groups of economists and perhaps the easiest group to identify and classify is *the free-market economists*. These economists believe that the market, operating freely without interferences from government or labor unions, will generate the greatest amount of well-being for the greatest number of people.

Economic efficiency is one of the priorities for free-market economists. In their well-developed models, *consumer sovereignty* - consumer demand for goods and services - guides the system by directly influencing market prices. The distribution of economic resources caused by these market prices not only results in the production of an array of goods and services that are demanded by consumers, but this production is undertaken in the most cost-effective fashion. The free-market economists claim that, at any point, some individuals must earn incomes that are substantially greater than those of other individuals. They contend that these higher incomes are a reward for greater efficiency or productivity and that this reward-induced efficiency will result in rapid economic growth that will benefit all persons in the society. They might also admit that a system driven by these freely operating markets will be subject to occasional bouts of instability (slow growth, inflation, and unemployment). They maintain, however, that government action to eliminate or reduce this periodic instability will only make matters worse. Consequently, government, according to the free-market economist, should play a minor role in the economic affairs of society.

Although the models of free-market economists are dependent upon functioning, competitive markets, the lack of such markets in the real world does not seriously jeopardize their position. First, they assert that large-size firms are necessary to achieve low per-unit costs; that is, a single large firm may be able to produce a given level of output with fewer scarce resources than a large number of small firms. Second, they suggest that the benefits associated with the free operation of markets are so great compared to government intervention that even a second-best solution of imperfectly competitive markets still yields benefits far in excess of government intervention.

These advocates of the free market have been given various labels over time. The oldest and most persistent label is *classical economists*. This is because the classical economists of the eighteenth century, particularly Adam Smith, were the first to point out the virtues of the market. In *The Wealth of Nations* (1776), Smith captured the essence of the system with the following words:

Every individual endeavors to employ his capital so that its produce may be of greatest value. He generally neither intends to promote the public interest nor knows how much he is promoting it He intends only his own security, only his own gain. And he is in this led by an invisible hand to promote an end which was no part of his intention. By pursuing his own interest he frequently promotes that of society more effectively than when he really intends to promote it.

Liberal Economists

Another significant group of economists in the United States can be classified as *liberal economists*. Liberal here refers to the willingness to intervene in the free operation of the market. These economists share with the free-market economists a great respect for the market, the liberal economist, however, does not believe that the explicit and implicit costs of a freely operating market should or can be ignored. Rather, the liberal maintains that the costs of an uncontrolled marketplace are often borne by those in society who are least capable of bearing them: the poor, the elderly, and the infirm. Additionally, liberal economists maintain that the freely operating market sometimes results in economic instability and the resultant bouts of inflation, unemployment, and slow or negative growth.

Consider for a moment the differences between free-market economists and liberal economists at the microeconomic level. Liberal economists take exception to the free market on two grounds. First, these economists find a basic problem with fairness in the marketplace. Since the market is driven by the forces of consumer spending, there are those who through no fault of their own (they may be aged, young, infirm, or physically or mentally handicapped) may not have the wherewithal to participate in the economic system. Second, the unfettered marketplace does not and cannot handle spillover effects or what are known as externalities. These are the third-party effects that may occur as a result of some action. Will a firm willingly compensate its neighbors for the pollutants it pours into the nearby lake? Will a truck driver willingly drive at the speed limit and in the process reduce the highway accident rate? Liberal economists think not. These economists are therefore willing to have the government intervene in these and other, similar cases.

The liberal economists' role in macroeconomics is more readily apparent. Ever since the failure of free-market economics during the Great Depression of the 1930s, Keynesianism (still another label for liberal economics) has become widely known. In his 1935 book, *The General Theory of Employment, Interest, and Money*, Lord John Maynard Keynes laid the basic groundwork for this school of thought. Keynes argued that the history of freely operating market economies was marked by periods of recurring recessions, sometimes very deep recessions, which we call depressions. He maintained that government intervention through its fiscal policy - government tax and spending power - could eliminate, or at least soften these sharp reductions in economic activity and as a result move the economy along a more stable growth path. Thus for the Keynesians, or liberal economists, one of the extremely objectionable aspects of a free-market economy is its inherent instability.

Liberal economists are also far more concerned about the existence of imperfections in the marketplace than are their free-market counterparts. They reject the notion that imperfect competition is an acceptable substitute for competitive markets. They may agree that the imperfectly competitive firms can achieve some savings because of their large size and efficiency, but they assert that since there is little or no competition the firms are not forced to pass these cost savings on to consumers. Thus liberal economists, who in some circles are labeled antitrusters, are willing to intervene in the market in two ways: They are prepared to allow some monopolies, such as public utilities, to exist, but they contend that these must be regulated by government; or they maintain that there is no justification for monopolies, and they are prepared to invoke the powers of antitrust legislation to break up existing monopolies and/or prevent the formation of new ones.

Mainstream Critics and Radical Reform Economists

There are two other groups of economists we must identify. One group can be called *mainstream critics*. Included in this group are individuals like Thorstein Veblen (1857-1929), with his critique of conspicuous consumption, and John Kenneth Galbraith (b. 1908), with his views on industrial structure. One reasonably cohesive subgroup of mainstream critics are the post-Keynesians. They are post-Keynesians because they believe that as the principal economic institutions have changed over time, they have remained closer to the spirit of Keynes than have the liberal economists. As some have suggested, the key aspect of Keynes as far as the post-Keynesians are concerned is his assertion that "expectations of the future are not necessarily certain." On a more practical level post-Keynesians assert, among other things, that the productivity of the economic system is not significantly affected by changes in income distribution, that the system can still be efficient without competitive markets, that conventional fiscal policies cannot control inflation, and that "incomes policies" are the means to an effective and equitable answer to the inflationary dilemma. This characterization of post-Keynesianism is drawn from Alfred S. Eichner's introduction in *A Guide to Post-Keynesian Economics* (M. E. Sharpe, 1978).

The fourth and last group can be called the *radical reform economists*. Many in this group trace their ideas back to the nineteenth-century philosopher-economist Karl Marx and his most impressive work, the three volumes of *Das Kapital*. As with the other three groups of economists, there are subgroups of radical reform economists. One subgroup, which may be labeled contemporary Marxists, is best represented by those who have published their research results over the years in the *Review of Radical Political Economics*. These economists examine issues that have been largely ignored by mainstream economists, for example, war, sexism, racism, imperialism, and civil rights. In their analyses of these issues they borrow from and refine the work of Marx. In the process, they emphasize the role of class in shaping society and the role of the economy in determining class structures. Moreover, they see a need to encourage explicitly the development of some form of democratic socialism, for only then will the greatest good for the greatest number be ensured.

In concluding this section, we must warn you to use these labels with extreme care. Our categories are not hard and fast. There is much grayness around the edges and little that is black and white in these classifications. This does not mean, however, that they have no value. It is important to understand the philosophical background of the individual authors. This background does indeed color or shade their work.

SUMMARY

It is clear that there is no shortage of economic problems that demand solutions. At the same time there is no shortage of proposed solutions. In fact, the problem is often one of oversupply. The nineteen issues included in this volume will acquaint you or, more accurately, reacquaint you with some of these problems. And, of course, there are at least two proposed solutions for each of the problems. Here we hope to provide new insights regarding the alternatives available and the differences and similarities of these alternative remedies.

If this introduction has served its purpose, you will be able to identify common elements in the proposed solutions to the different problems. For example, you will be able to identify the reliance on the forces of the market advocated by free-market economists as the remedy for several economic ills. This introduction should also help you understand why there are at least two proposed solutions for every economic problem; each group of economists tends to interpret a problem from its own philosophical position and to advance a solution that is grounded in that philosophical framework.

Our intention, of course, is not to connect persons to one philosophic position or another. We hope instead to generate discussion and promote understanding. To do this, each of us must see not only a proposed solution, we must also be aware of the foundation that supports that solution. With greater understanding, meaningful progress in addressing economic problems can be achieved.

ISSUE 1

Are Profits the Only Business of Business?

YES: Milton Friedman, from "The Social Responsibility of Business Is to Increase Its Profits," *New York Times Magazine* (September 13, 1970)

NO: Thomas Mulligan, from "A Critique of Milton Friedman's Essay 'The Social Responsibility of Business Is to Increase Its Profits,' " *Journal of Business Ethics* (1986)

ISSUE SUMMARY

YES: Free-market economist Milton Friedman contends that the sole responsibility of business is to increase its profits.
NO: Philosopher Mulligan insists that a commitment to social responsibility is not a "fundamentally subversive doctrine in a free society."

Every economic society—whether it is a traditional society in Central Africa, one of the fossilized planned economies of Eastern Europe, or a wealthy capitalist society found in North America, Western Europe, or the Pacific Rim—must address the basic economic problem of resource allocation. These societies must determine *what* goods and services they can and will produce, *how* these goods and services will be produced, and *for whom* these goods and services will be produced.

The *what, how,* and *for whom* questions must be answered because of the problem of scarcity. Even if a given society were indescribably rich, it would still confront the problem of scarcity—in this case, "relative scarcity." It might have all the resources it needs to produce all the goods and services it would ever want, but it couldn't produce all these things simultaneously. Thus, it must set priorities and produce first those goods and services with the highest priority and postpone the production of those goods and services with lower priorities. If time is of the essence, *how* should these goods and services be produced? And since this society cannot produce all it wants instantly, *for whom* should the first bundle of goods and services be produced?

Few, if any, economic societies are indescribably rich. On the other hand, there are many examples of economic societies that face grinding deprivation daily. In these societies and in all the societies that fall between poverty and great affluence, the *what, how,* and *for whom* questions are immediately apparent. Somehow these questions must be answered.

In some societies, such as the Amish communities of North America, the answers to these questions are found in tradition. Sons and daughters follow in their parents' footsteps. Younger generations produce *what* older generations produced before them. The methods of production—the horsedrawn plow, the hand-held scythe, the use of natural fertilizers—remain unchanged; thus, the *how* question is answered in the same way that the *for whom* question is answered—by following historic patterns. In other societies—for example, self-sustaining religious communities—there is a different pattern of responses to these questions. In these communities, the "elder" of the community determines *what* will be produced, *how* it will be produced, and *for whom* it will be produced. If there is a well-defined hierarchical system, it is similar to one of the stereotypical command economies of Eastern Europe.

Although elements of tradition and command are found in the industrialized societies of Western Europe, North America, and Japan, the basic answers to the three questions of resource allocation in these countries are determined by profit. In these economic societies, *what* will be produced is determined by what will yield the greatest profit. Consumers, in their search for maximum satisfaction, will bid for those goods and services that they want most. This consumer action drives the price of these goods and services up, and, in turn, these higher prices increase producers' profits. The higher profits attract new firms into the industry and encourage existing firms to increase their output. Thus, profits are the mechanism that ensures consumers get what they want. Similarly, the profit-seeking behavior of business firms determines *how* the goods and services that consumers want will be produced. Since firms attempt to maximize their profits, they select those means of production that are economically most efficient. Lastly, the *for whom* question is also linked to profits. Wherever there is a shortage of goods and services, profits will be high. In the producers' attempts to increase their output they must attract factors of production (land, labor, and capital) away from other economic activities. This bidding increases factor prices or factor incomes and ensures that these factors will be able to buy goods and services in the open marketplace.

Both Mulligan and Friedman recognize the merits of a profit-driven economic system. They do not quarrel over the importance of profits. But they do quarrel over whether or not business firms have obligations beyond making profits. Friedman holds that the *only* responsibility of business is to make profits. He argues that anyone who maintains otherwise is "preaching pure and unadulterated socialism." Mulligan, on the other hand, contends that Friedman's argument rests on a questionable paradigm, a false premise, and a logic that sometimes lacks cogency.

YES

Milton Friedman

THE SOCIAL RESPONSIBILITY OF BUSINESS IS TO INCREASE ITS PROFITS

When I hear businessmen speak eloquently about the "social responsibilities of business in a free-enterprise system," I am reminded of the wonderful line about the Frenchman who discovered at the age of 70 that he had been speaking prose all his life. The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social ends; that business has a social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are—or would be if they or anyone else took them seriously—preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades.

The discussions of the "social responsibilities of business" are notable for their analytical looseness and lack of rigor. What does it mean to say that "business" has responsibilities? Only people can have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities, even in this vague sense. The first step toward clarity in examining the doctrine of the social responsibility of business is to ask precisely what it implies for whom.

Presumably, the individuals who are to be responsible are businessmen, which means individual proprietors or corporate executives. Most of the discussion of social responsibility is directed at corporations, so in what follows I shall mostly neglect the individual proprietor and speak of corporate executives.

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 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. 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 profit as his objective but the rendering of certain services.

In either case, the key point is that, in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them.

Needless to say, this does not mean that it is easy to judge how well he is performing his task. But at least the criterion of performance is straightforward, and the persons among whom a voluntary contractual arrangement exists are clearly defined.

Of course, the corporate executive is also a person in his own right. As a person, he may have many other responsibilities that he recognizes or assumes voluntarily—to his family, his conscience, his feelings of charity, his church, his clubs, his city, his country. He may feel impelled by these responsibilities to devote part of his income to causes he regards as worthy, to refuse to work for particular corporations, even to leave his job, for example, to join his country's armed forces. If we wish, we may refer to some of these responsibilities as "social responsibilities." But in these respects he is acting as a principal, not an agent; he is spending his own money or time or energy, not the money of his employers or the time or energy he has contracted to devote to their purposes. If these are "social responsibilities," they are the social responsibilities of individuals, not of business.

What does it mean to say that the corporate executive has a "social responsibility" in his capacity as 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. For example, that he is to refrain from increasing the price of the product in order to contribute to the social objective of preventing inflation, even though a price increase would be in the best interests of the corporation. Or that he is to make expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment. Or that, at the expense of corporate profits, he is to hire "hard-core" unemployed instead of better-qualified available workmen to contribute to the social objective of reducing poverty.

In each of these cases, 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 customers' money. Insofar as his actions lower the wages of some employees, he is spending their money.

The stockholders or the customers or the employees could separately spend their own money on the particular action if they wished to do so. The executive is exercising a distinct "social responsibility," rather than serving as an agent of the stockholders or the customers or the employees, only if he spends the money in a different way than they would have spent it.

But if he does this, he is in effect imposing taxes, on the one hand, and deciding how the tax proceeds shall be spent, on the other.

This process raises political questions on two levels: principle and consequences. On the level of political principle, the imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional, parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public—after all, "taxation without representation" was one of the battle cries of the American Revolution. We have a system of checks and balances to separate the legislative function of imposing taxes and enacting expenditures from the executive function of collecting taxes and administering expenditure programs and from the judicial function of mediating disputes and interpreting the law.

Here the businessman—self-selected or appointed directly or indirectly by stockholders—is to be simultaneously legislator, executive and jurist. He is to decide whom to tax by how much and for what purpose, and he is to spend the proceeds—all this guided only by general exhortations from on high to restrain inflation, improve the environment, fight poverty and so on and on.

The whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interests of his principal. This justification disappears when the corporate executive imposes taxes and spends the proceeds for "social" purposes. He becomes in effect a public employee, a civil servant, even though he remains in name an employee of a private enterprise. On grounds of political principle, it is intolerable that such civil servants—insofar as their actions in the name of social responsibility are real and not just window-dressing—should be selected as they are now. If they are to be civil servants, then they must be selected 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 guide 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.

On the grounds of consequences, can the corporate executive in fact discharge his alleged "social responsibilities"? On the one hand, suppose he could get away with spending the stockholders' or customers' or employees' money. How is he to know how to spend it? He is told that he must contribute to fighting 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 his 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? Even if he could answer these questions, how much cost is he justified in imposing on his stockholders, customers and employees for this social purpose? What is the appropriate share and what is the appropriate share of others?

And, whether he wants to or not, can he get away with spending his stockholders', customers' or employees' money? Will not the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employees can desert him for other producers and employers less scrupulous in exercising their social responsibilities.

This facet of "social responsibility" doctrine is brought into sharp relief when the doctrine is used to justify wage restraint by trade unions. The conflict of interest is naked and clear when union officials are asked to subordinate the interest of their members to some more general social purpose. If the union officials try to enforce wage restraint, the consequence is likely to be wildcat strikes, rank-and-file revolts and the emergence of strong competitors for their jobs. We thus have the ironic phenomenon that union leaders—at least in the U.S.—have objected to Government interference with the market far more consistently and courageously than have business leaders.

The difficulty of exercising "social responsibility" illustrates, of course, the great virtue of private competitive enterprise—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.

Many a reader who has followed the argument this far may be tempted to remonstrate that it is all well and good to speak of government's having the responsibility to impose taxes and determine expenditures for such "social" purposes as controlling pollution or training the hard-core unemployed, but that the problems are too urgent to wait on the slow course of political processes, that the exercise of social responsibility by businessmen is a quicker and surer way to solve pressing current problems.

Aside from the question of fact—I share Adam Smith's skepticism about the benefits that can be expected from "those who affected to trade for the public good"—this argument must be rejected on grounds of principle. What it amounts to is an assertion that those who favor the taxes and expenditures 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 attain by democratic procedures. In a free society, it is hard for "good" people to do "good," but that is a small price to pay for making it hard for "evil" people to do "evil," especially since one man's good is another's evil.

I have, for simplicity, concentrated on the special case of the corporate executive, except only for the brief digression on trade unions. But precisely the same argument applies to the newer phenomenon of calling upon stockholders to require corporations to exercise social responsibility (the recent G.M. crusade, for example). 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.

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. If he wishes to spend his money on such purposes, that is his right, and I cannot see that there is any objection to his doing so. In the process, he, too, may impose costs on employees and customers. However, because he is far less likely than a large corporation or union to have monopolistic power, any such side effects will tend to be minor.

Of course, in practice the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those actions.

To illustrate, it may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects. Or it may be that, given the laws about the deductibility of corporate charitable contributions, the stockholders can contribute more to charities they favor by having the corporation make the gift than by doing it themselves, since they can in that way contribute an amount that would otherwise have been paid as corporate taxes.

In each of these—and many similar—cases, there is a strong temptation to rationalize these actions as an exercise of "social responsibility." In the present climate of opinion, with its widespread aversion to "capitalism," "profits," the "soulless corporation" and so on, this is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified in its own self-interest.

It would be inconsistent of me to call on corporate executives to refrain from this hypocritical window-dressing because it harms the foundations of a free society. That would be to call on them to exercise a "social responsibility"! If our institutions, and the attitudes of the public make it in their self-interest to cloak their actions in this way, I cannot summon much indignation to denounce them. At the same time, I can express admiration for those individual proprietors or owners of closely held corporations or stockholders of more broadly held corporations who disdain such tactics as approaching fraud.

Whether blameworthy or not, the use of the cloak of social responsibility, and the nonsense spoken in its name by influential and prestigious businessmen, does clearly harm the foundations of a free society. I have been impressed time and again by the schizophrenic character of many businessmen. They are capable of being extremely far-sighted and clear-headed in matters that are internal to their businesses. They are incredibly short-sighted and muddle-headed in matters that are outside their businesses but affect the possible survival of business in general. This short-sightedness is strikingly exemplified in the calls from many businessmen for wage and price guidelines or controls or incomes policies. There is nothing that could do more in a brief period to destroy a market system and replace it by a centrally controlled system than effective governmental control of prices and wages.

The short-sightedness is also exemplified in speeches by businessmen on social responsibility. This may gain them kudos in the short run. But it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces. Once this view is adopted, the external forces that curb the market will not be the social consciences, however highly developed, of the pontificating executives; it will be the iron fist of Government bureaucrats. Here, as with price and wage controls, businessmen seem to me to reveal a suicidal impulse.

The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not participate. There are no "social" values, no "social" responsibilities in any sense other than the shared values and responsibilities of individuals. Society is a collection of individuals and of the various groups they voluntarily form.

The political principle that underlies the political mechanism is conformity. The individual must serve a more general social interest—whether that be determined by a church or a dictator or a majority. The individual may have a vote and a say in what is to be done, but if he is overruled, he must conform. It is appropriate for some to require others to contribute to a general social purpose whether they wish to or not.

Unfortunately, unanimity is not always feasible. There are some respects in which conformity appears unavoidable, so I do not see how one can avoid the use of the political mechanism altogether.

But the doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. 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."

NO

Thomas Mulligan

A CRITIQUE OF MILTON FRIEDMAN'S ESSAY

In this 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.

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.

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 'hard-core' 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?

From Thomas Mulligan, "A Critique of Milton Friedman's Essay 'The Social Responsibility of Business Is to Increase Its Profits,'" *Journal of Business Ethics*, vol. 5 (1986).

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 grassroots 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 responsibility, 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 is 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 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 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, 1979, 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