Business Ethics and the 'Social Audit'

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*In the first of two articles on business ethics, **Norman Barry**, Professor of Politics at Buckingham University, examines the argument that business corporations have 'social' obligations that go beyond universal moral obligations.*

Although socialist regimes have collapsed throughout the world, and the case for capitalism is currently being argued with unprecedented intellectual vigour, the ethics of free enterprise and the virtue of the profit motive have not secured universal acceptance: least of all in the intellectual community. Whatever success capitalism has been granted in its generation of an efficient allocation of resources, and however adequate its response is to those perennial problems of the human condition, scarcity and the insatiability of wants, its achievements are thought to come at the cost of justice. Indeed, the successful operation of the enterprise system depends, it is said, upon a partial suspension of familiar moral rules.

The fact that modern business is conducted between individuals who deal with each other at 'arms length' means that those moral restraints that govern more intimate relationships, such as those that obtain in the family or the local community, are often absent in modern commerce. For example, it seems less morally reprehensible to exploit someone else's ignorance of the potential value of a stock than not to inform your grandmother that the painting she is about to sell you for a few dollars is actually a Rembrandt, precisely because the former exchange takes place between strangers. Again, the fact that unrestrained capitalistic exploitation of natural resources might 'unjustly' deprive future generations is said to be of no moral concern to the present generation, which is apparently governed entirely by self-interest.

In all of these issues, the traditional moral rules that underpin capitalism, encapsulated in Adam Smith's (1759,1969:160) sparse definition of justice ('Mere justice is, upon most occasions but a negative virtue, and only hinders us from hurting our neighbour') appear, superficially at least, to be inadequate: for even when these have been observed, the complex moral problems of business remain. Smith himself conceded that the basic rules of justice, which he likened to the rules of grammar, were adequate for the servicing of a commercial order only, and not the 'good society'. Nowadays, they are thought to be insufficient even to maintain the ethical viability of the competitive private property system.

More germane to the problem is the fact that the modern enterprise system does not resemble Smith's benign order of decentralised traders, each driven by the exercise of 'natural liberty' and each vulnerable to the corrective forces of competition. The vast and centralised modern corporation, characterised by limited liability, 'perpetual life' and a division between owners (the stockholders) and management, is, to many sceptical observers, immune from those natural competitive forces that made Smithian capitalism morally acceptable. It exercises 'power' over its employees and can behave irresponsibly towards the outside world with little fear of retribution.

Much of the criticism of the modern corporation, especially its alleged immunity from competitive processes, has been grossly exaggerated, but its existence, and the financial world in which it is embedded, has generated the subject 'business ethics': a discipline invented in America and fast gaining ground elsewhere. The discipline is another type of applied ethics, like medical ethics, in which familiar moral theories, such as utilitarianism, Kantian deontology and Rawlsian justice, are applied to specific problems and dilemmas. However, unlike medical ethics, business ethics, in some circles, challenges business precisely because it rests upon an immoral, or at least non-moral, human motivation: self-interest. There is indeed a tradition, perhaps deriving ultimately from Bernard Mandeville's *The Fable of the Bees* (1705), that posits a dichotomy between commerce and ethics in that the pursuit of profit must mean the breach of traditional (especially Christian) virtues. Capitalism would have at most only a crude utilitarian justification.

Milton Friedman and the Limits of Business Obligations

Although some businessmen may hold this view in unguarded moments, it is not the view of even the most ideological devotees of the capitalist system. It is certainly not the view of Milton Friedman (although there are Mandevillian strains in his writings). In a famous essay 'The Social Responsibility of Business is to Increase its Profits' he argued that business executives should act so as to maximise the returns to the owners (stockholders), but he also claimed that they should conform to 'the basic rules of society, both those embodied in law and those embodied in **ethical cus-**

tom' (Friedman, 1988:8; emphasis added.) The difficulty here is in determining the constraints 'ethical custom' imposes on the participants in what Friedman undoubtedly believes to be a moral enterprise, i.e. business activity. What Friedman is firmly opposed to is the notion that business executives have moral duties to act in the interests of 'society', for example in their employment, pricing and environment policies. For this, he claims, would be to usurp the functions of government as well as to violate the rights of the owners of corporations.

It is precisely here that business ethics comes in: for the proponents of 'morality in commerce' simply do not accept the view that business agents are limited in this way. They maintain that the interests of the stockholders are merely one of a range of legitimate concerns. Hence, demands are made that business enterprises should satisfy a 'social' and a 'moral' audit in addition to the conventional profit and loss account: and the claim is made that there is some criterion by which priorities can be established for those competing purposes that characterise the business decision. Furthermore, business ethics is almost invariably 'legislated': it is assumed that the Mandevillian motive (amoral self-interest) is too strong to allow for spontaneous virtuous action. It should be noted here that the ethical demands that are made on business normally **exceed** those that pertain to individuals in their private capacities, because the corporation is said to exist by the permission of society: that its familiar legal features could not have emerged through the transactions of private individuals but depend upon statute law.

Sometimes this does not arise out of anything more than expediency. This can be shown in the many examples of corporations being 'punished' by massive fines in relation to damages to the environment and in cases of horrific accidents. For in such cases it is often the actions of culpable individuals that are the causes of the wrong. But since corporations have 'deep pockets' they become responsible for the balancing of the moral books. Yet the stockholders, who ultimately bear the costs, are remote from the action itself and cannot possibly be said to be subjects of blame in a legal or a moral sense.

The Corporation as a Person

Yet a significant part of business ethics is predicated upon the assumption that the corporation itself is a 'person' whose actions are equivalent to those of a biological person: the truth of this has to be demonstrated if there is a range of moral and legal duties appropriate to business. But this is highly contestable; for although a corporation is obviously an artificial entity to which rights and duties can be attributed under civil law, it is far from obvious that it can have criminal (or moral) **intent**. However, since the prosecution (ultimately unsuccessful) of the Ford Motor Corporation for reckless homicide in 1980 over the production of the faulty Pinto car, it has been accepted by American courts that a *mens rea* (or guilty mind) can be attributed to artificial agencies for actions once thought possible only of biological agencies. Exxon is likely to face criminal penalties (in addition to civil damages) over the recent oil spill in Alaska; yet can it seriously be maintained that it intended to damage the environment? In 1989 the Boeing Corporation incurred a massive fine for 'corporate theft', even though the culpable individual had already been indicted.

Things are perhaps not quite so advanced in Britain. In the controversy that followed the Zeebrugge tragedy (in which a ferry sank because of two crew members' negligence with the loss of 157 lives) the P & O company was charged with 'corporate manslaughter'. However, during the trial the judge threw out the case before it went to the jury. In doing so he laid down tough conditions for a corporate manslaughter prosecution to succeed. Most important was his ruling that individual wrongful acts could not be 'aggregated' so as to demonstrate a corporate liability.

Of course, no one would deny that corporations, when acting through their agents, have a responsibility for making good the damage that they cause, and it makes perfect theoretical and practical sense to make them liable for torts (indeed, the nature of the employment contract could remove that liability from individuals). In addition, the economics of property rights shows how many of the typical environmental problems could be overcome: an equilibrium could be reached within a legal framework that allowed for the internalisation of external costs (see Demsetz, 1988).

Competition, Morality and Efficiency

What room, then, is there for business ethics? After all, as most socialists have belatedly discovered, the market is not a bad thing in theory. Perfect competition has certain intuitively desirable ethical features: in it, functionless inequality ('profit') has been eliminated, instant re-contracting nullifies the potential coercive power of employers over employees, 'harms' have been accounted for (externalities are internalised) and economic society has achieved a welfare 'optimum'. The attribution of social and moral responsibility to 'fictitious entities' called corporations would be redundant. In other words, perfect competition has ethical as well as efficiency properties.

However, it has long been recognised that perfect competition is a theoretical nirvana: that at most, real world markets reveal a process towards this goal and not an instantaneous realisation of it. Presumably the problems of business ethics arise in the appraisal of those actions by economic agents (either individuals or artefacts, such as corporations) that are essential to the process of coordination. It follows, I think, that while it is legitimate to speak of a moral audit for business (agents are likely to commit wrongs in the process of coordination), the demands for a **social** audit are misplaced. For if a business executive or a corporation is to fulfil certain social ideals, such as affirmative action in employment or the preservation of enterprises for non-economic reasons, this can be achieved only at the cost of efficiency. Thus, the nearer an economy approaches perfect competition, the less opportunity there is for virtuous action. If there are desirable social goals, the existence of obvious 'prisoners' dilemmas' will prevent their realisation by the voluntary actions of business. Ironically, only monopolists would have that 'slack' that is required for the performance of social functions: yet monopoly is rightly opposed on moral (as well as efficiency) grounds.

This does not dispense with the problem, however, for there are clearly ethical problems that can arise in markets that have little to do with the attribution of social responsibilities of corporations. As already noted, Friedman speaks of 'moral conventions' that business agents should observe in the conduct of commerce. Unfortunately, he concentrates almost entirely on the refutation of the heady 'social' claims of business ethics and says very little about the implicit and perhaps tacit rules of the game under which business has to be conducted. There is a host of problems here.

In the present and the past there has been a heavy emphasis on the production of unsafe products, in which the desire for profit overrides widespread moral convictions. Sometimes, the market filters out such problems: after all, there is no demand for really unsafe and faulty products. At the margin, however, there are bound to be conflicts. Consumer ignorance may be unavoidable so that the basic feature of arm's-length morality — that everyone is a rational, responsible and moral person — could turn out to be an inadequate check on the natural self-interest of business agents. Still, civil actions for damages, and criminal actions for individuals, may be the best solutions if corporations are not to be impeded in their necessary economic function in a free economy.

In recent years, however, there has emerged a new issue to excite the zeal of business ethicists that poses most acutely the Mandevillian problem of the supposed dichotomy between virtue and commerce. I refer to the ethics of the financial system and the securities market in particular. Here, the vast gains that can be made and the opportunities for dishonesty have produced spectacular scandals that have brought business into disrepute. 'Insider trading' is the subject of my second article.

References

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