



The Role of Business in the Modern World

Progress, Pressures, and Prospects for the
Market Economy

DAVID HENDERSON

FOREWORD BY STEVE FORBES

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THE AUTHOR

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Since leaving the OECD he has been an independent author and consultant, and has acted as Visiting Fellow or Professor at the OECD Development Centre (Paris), the Centre for European Policy Studies (Brussels), Monash University (Melbourne), the Fondation Nationale des Sciences Politiques (Paris), the University of Melbourne, the Royal Institute of International Affairs (London), the New Zealand Business Roundtable, and the Melbourne Business School. He is currently a Visiting Professor at the Westminster Business School in London. Among his recent publications is *Anti-Liberalism 2000* (IEA, London, 2001). He is an Honorary Fellow of Lincoln College, Oxford, and in 1992 he was made Commander of the Order of St. Michael and St. George.

FOREWORD

In June 2004, the United Nations hosted a Global Compact Leaders' Summit, an assemblage of U.N. environmental bureaucrats, NGOs, labor leaders, and financial world representatives, to endorse "voluntary" principles "to embed environmental, social and governance best practices at the heart of the world's markets." With the collapse of traditional socialism, entrepreneurs, private enterprise, and corporations have become the unchallenged engines of economic growth. And that has led to efforts by interest groups of all types to piggyback their agendas onto corporations. To paraphrase Jimmy Durante, in today's world, everybody wants to get into the corporate act.

This is part of a larger movement, "corporate social responsibility" (CSR), which seeks to force firms to accept responsibility for a number of social objectives beyond their duty to shareholders.

CSR may be viewed as the collectivists' backhanded compliment to the success of the modern corporation. Statism, centrally directed economies, and foreign aid have all failed to deliver liberty and prosperity. The modern corporation's mobilizing of entrepreneurial talent is now recognized as the best way to advance global prosperity. Thus, political interventionists now focus on capturing these forces of change. Utopians no longer reject the market; rather, they now seek to geld and harness it "to serve mankind."

The CSR thesis is simple: Politics should determine the goals of society; the private sector – incentivized by regulatory quotas and taxes – will provide the motor force for their realization. The modern corporation, CSR advocates argue, has power greater than many states – that power should be harnessed to ensure social justice, sustainable development, and global stability. CSR activists – through the use of disclosures, shareholder resolutions, and institutional investment decisions – seek to push firms to divert resources to these agendas. This is the market socialism dream: The market will efficiently row; the government will steer.

If adopted widely, the CSR approach would radically transform the corporation. It would strengthen some voices within the firm – those involved with the NGO community or environmental resources – at the expense of those involved with investments to expand output to foster innovation and to enhance profitability, once the firm's core missions. Profit is a dirty word – but profits are the seed corn for future advances in our standard of living, as well as rewards for past and current risk-taking.

Under the label of Corporate Social Responsibility, firms are to take on a non-wealth-producing agenda of goals; profits will be lowered to safeguard labor rights, human health, civil liberties, environmental quality, sexual equality, and social justice. The fact that the corporation already plays its most effective role in these areas by profit maximization is little understood by CSR advocates. They want direct action and they want it now.

They also want power and influence. A new economic order based along CSR lines would empower activists and bureaucrats to plan for society as a whole. But that society would be poorer. Shifting the firm's attention to non-economic goals will stall economic progress, harming workers, consumers, and share-

holders – in short, all of society.

In this concise and convincing work, David Henderson provides a brilliant analysis of CSR and an excellent summary of the proper *Role of Business in the Modern World*. His insights should not be ignored if we genuinely want to build a future of increasing prosperity and freedom.

STEVE FORBES

Editor, *Forbes*

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EXECUTIVE SUMMARY

Preview

- The twin related subjects of this book are, first, the role and conduct of business enterprises, and second, the status and prospects of capitalism and the market economy, in the world of today.
- It is now widely held that a new era has just dawned, in which businesses need to adopt a new conception of their mission, purposes and conduct, by endorsing and putting into effect the doctrine of "Corporate Social Responsibility" (CSR). They are urged to embrace "corporate citizenship", and to conduct themselves, in conjunction with an array of "stakeholders," so as to further the cause of "sustainable development" by pursuing on their own account a range of social and environmental goals.
- I have already presented a critique of CSR in *Misguided Virtue: False Notions of Corporate Social Responsibility* (2001). Here I treat the issues in a broader way, which incorporates but goes well beyond that critique. Against the background of the economic history of the past 50–60 years, I present an alternative conception of the role of business within a market economy. I argue that this primary role is strongly positive, and that there is no good

reason either to question or to redefine it in the light of recent events; I set the emergence of CSR in context, where it appears as a new addition to already established collectivist ways of viewing the world; and I discuss more fully questions of enterprise conduct and motivation. In conclusion, I outline ways in which the primary role of business can be reinforced today, chiefly through public policies designed to extend economic freedom. Finally, I consider the situation and prospects of capitalism and the market economy in the light of developments since World War II.

Economic progress and the role of business

- Over the past half-century or more, economic progress over the world as a whole has been strikingly rapid by all previous standards. Besides the countries that were already relatively rich in 1950, an increasing number of previously poor countries have achieved sustained rates of growth in material standards of living that were either rare or unprecedented anywhere in earlier history. These developments were not foreseen.
- As one would expect, economic performance has been uneven: by no means all countries have shared in rising prosperity. However, the disparities that have thus opened up or widened, between the more successful and the less successful economies, are neither the result nor a manifestation of injustice.
- Generally speaking, the extraordinary advances that have been made by many previously poor countries owed little

or nothing to direct foreign assistance. Recent experience has confirmed (1) that the material progress of people everywhere, rich and poor alike, depends above all on the dynamism of the economies in which they live and work, and (2) that rapid progress is now to be expected wherever the political and economic conditions exist for a market economy to operate effectively.

- As in the past, the principal *direct* impulse to economic progress in recent decades has come from profit-related activities and initiatives on the part of business enterprises working within the framework of a competitive market economy.
- This business contribution results from the twin stimuli which a market economy provides: wide-ranging *entrepreneurial opportunities* and pervasive *competitive pressures*. The two aspects are inseparable, since the competitive pressures arise from market opportunities which are themselves opened up by economic freedom.
- *From an economy-wide perspective, now as in the past, the primary role of business is to act as a vehicle for economic progress.* This role is not, and cannot be, “internalized” by enterprises themselves. Economic progress does not depend on a commitment by businesses to bring it about.

The true impact of globalization

- A different view is taken today by the many advocates of CSR. They argue that “the business of business has changed”: companies today should meet “society’s expectations,” and safeguard both reputation and profits, by pursuing the goal of

sustainable development and thus consciously contributing to the public welfare.

- The main reason given for believing that such a radical change is required is that the “globalization” of recent years has transformed the environment in which businesses operate. Such a view is not consistent with the facts. Contrary to what is now widely asserted, the closer international economic integration of recent years is not a new phenomenon, nor has it been forced on governments. It has not “marginalized” poor countries, conferred undue benefits or new powers on multinational enterprises, deprived governments of the power to act, or created a need for new procedures for “global governance.” Far from having transformed the primary role of business, it has confirmed and reinforced it.
- The mechanisms of “global governance” now favored by advocates of CSR, and by others too, are liable to do active harm. They assign a role which it cannot rightfully claim to what is misleadingly termed “civil society”, in the form of “public interest” non-governmental organizations (NGOs); and they open the way to forms of cross-border regulation, whether by companies or by governments and international agencies, that would restrict opportunities for advancement on the part of people in poor countries.

The rise of global salvationism

- Despite the clear record of progress on many fronts, alarmist beliefs about the situation and prospects of the world are widely held, today as in the past: they make up a *global salvationist* consensus.

- The consensus has two main established elements which have come together over time. One focuses on the plight of poor countries. It presents a picture in which international inequalities are greatly overstated and viewed as evidence of remediable injustice; and it argues that the progress of poor countries largely depends on assistance from outside. The second element is environmental alarmism, in which issues relating to the environment are treated predominantly with reference to problems, threats and potential disasters, often viewed as arising from profit-oriented economic activity. Both lines of thinking disregard or play down the evidence and lessons of past and continuing progress. Both point to collective “solutions” to the problems they identify. Leading businesses and business organizations have lent uncritical support to global salvationist assumptions and beliefs.
- Global salvationism has gained ground in recent years. Mutually reinforcing reasons for this trend include the spread of mistaken ideas about the nature and effects of globalization, the growing influence of NGOs, the rise of radical egalitarianism, and concerns about the possibility and the associated risks of global warming. The main single factor, however, has been the endorsement, by governments as well as elements of public opinion, of sustainable development as a goal.
- CSR has attracted growing support, both official and unofficial, and within the business world as well as from outsiders, largely because it is seen as a way to promote sustainable development. There are strong pressures on leading businesses to endorse it.

Profits, virtue and welfare

- In a well-functioning market economy, enterprise profits are performance-related: they can only be earned by providing customers of all kinds with products and services that they wish to buy, and doing so in a resourceful and innovative way. Profits can thus serve as an indicator of each enterprise's contribution to the welfare of people in general; and as such, they provide an indispensable economic signaling function. How well they serve this purpose depends on how far they are in fact performance-related. This in turn depends largely on the extent of competition and economic freedom.
- A leading objective of economic policy is to improve the working of the market economy. This points to actions by governments (1) to make good the limitations of markets, in particular by dealing with external effects, and (2) to maintain and extend the scope of competitive markets. Under both headings, the aim is to make profits more performance-related; and in both cases, the responsibility for action rests with governments not businesses.
- Advocates of CSR take a different approach to profitability and its status. They view enterprise profitability, not as a *criterion* which can be improved as such, but as the happy *outcome* of virtuous conduct. They believe that enterprises can best contribute to the general welfare by consciously adopting sustainable development as their objective, and pursuing in consequence a range of self-chosen social and environmental goals, with higher expected profits as a likely reward. They assume uncritically that the notion of sustainable development, and with it these new goals, is well defined and

generally agreed: the path of virtue is supposedly clear for all businesses to follow.

- Even leaving aside the mistaken ideas about globalization to which it is typically linked, this approach is flawed. At the level of enterprises, it sets questionable aims and presents risks to good performance. For the economy as a whole, it points the way to anti-competitive tendencies and over-regulation.

The impact of CSR

- Within businesses, the adoption of CSR carries with it a high probability of cost increases and impaired performance. Managers have to take account of a wider range of goals and concerns, and to involve themselves in new and time-consuming processes of consultation with outside stakeholders. New systems of accounting, auditing, and monitoring are called for. On top of all this, the adoption of more exacting self-chosen environmental and "social" standards is liable to add to costs, all the more so if, as the doctrine of CSR requires of them, firms insist on observance of these same standards by their partners, suppliers and contractors – and even, on some interpretations, their customers.
- For the economy as a whole, CSR points the way to anti-competitive tendencies and over-regulation. Insofar as "socially responsible" businesses find that their new role is bringing with it higher costs and lower profits, they have a strong interest in ensuring that their unregenerate rivals are compelled to toe the same line, whether through public

pressure or government regulation. In particular, large firms have an interest in ensuring that smaller rivals do not escape the net, while firms in rich countries have a similar incentive to see to it that their competitors in developing countries are made subject to the same pressures and regulations that bear on them.

- In a competitive market economy, businesses should be free to take the path of CSR; but also, and equally, they should be free to reject that course. Insofar as firms have no choice but to conform, whether because of strong informal pressures or through legislation, market opportunities will be narrowed and competitive pressures reduced. The general adoption of CSR, in response to social pressures, would undermine the market economy and make businesses less effective in the performance of their primary role.

Morality, profits and business conduct

- The positive function of performance-related profits is often overlooked or played down, while profit-earning as such is often condemned or viewed with suspicion. Some see the profit motive as simply a manifestation of greed: such an approach disregards the signaling function of profits and gives a distorted picture of the business mentality. A more moderate critique views the profit motive, not as evil or unworthy, but as inherently defective because tainted by self-interest. This approach typically takes no account of the virtues that may go together with self-interest; makes no distinction between self-interest, on the one hand, and selfishness, egotism and greed on the other; and gives

insufficient weight to the benefits which the self-interested conduct of people and enterprises can bring within a market economy.

- Both extreme and more moderate critics of the profit motive fail (1) to distinguish between profits that are performance-related and those that are not, and (2) to recognize the indispensable signaling function of profits. They also focus on motives rather than results, and assume too readily that actions that will benefit others must involve personal sacrifice.
- To emphasize the primary role of business, and with it the signaling function of performance-related profits, is not to imply that ethical considerations have no place in the business world. Today as always, profit-oriented businesses have moral as well as legal obligations. Situations can well arise in which directors and managers, and often shareholders too, may need to consider what it would be right for a company to do, as well as what is legally permitted to it or required of it. Further, managers have moral responsibilities to owners. Issues of professional ethics arise in business just as in other walks of life.
- It is too simple to view business conduct in terms of a choice between profit-oriented and altruistic behavior: other motives are involved, including the personal satisfaction derived from meeting and overcoming obstacles to success. Such motives typically help to improve entrepreneurial performance. But worthy aims and motives can form the basis for ventures which serve only to make the world poorer: the Concorde project was a conspicuous example. The acid test of whether business professionalism is well directed is performance-related profitability.

- In relation to the complex issues of enterprise and individual conduct that arise in business, as also those of corporate governance, the doctrine of CSR has little or nothing to contribute. Much of the thinking that underlies it betrays the age-old obsession with the purity of motives, together with a failure to understand the role of performance-related profits. Profits are viewed as a means to higher ends, through providing room for virtuous conduct, rather than as a possible indicator of an enterprise's contribution to the general welfare.
- It may be true, or become true, that businesses will increasingly have little choice but to take the path of CSR, in the interests of profitability or even survival. But its general adoption, whether from social pressures or legal requirements, would do more harm than good. The case against CSR is not that it would necessarily be bad for profits, but that, whatever its effects on enterprise profitability in particular instances, it would make people in general worse off.
- Today as in the past, the case for private business rests, not on the commitment by business enterprises to questionable though widely accepted goals, and their willing compliance with social pressures, but on the links between private ownership, competition and economic freedom within a market-directed economy.

The case for liberalization

- It is not through transforming enterprise goals and conduct, in the ways suggested by CSR adherents, that the business

contribution to the general welfare can be improved, but through actions by governments that would serve to reinforce the primary role of business. Such actions have to be directed to widening market opportunities and increasing competitive pressures. Their aim and effect is to increase economic freedom. The key element is *liberalization*.

- Economic liberalization is not designed to serve the interests of business, nor does it do so. It does not increase the power of corporations. It opens up opportunities for individuals as well as enterprises.
- To argue a case for liberalization today does not carry with it a commitment to some abstract libertarian blueprint. It implies no more than a belief that, as compared with the present state of affairs, extending economic freedom would bring significant and widely diffused gains in material welfare, chiefly through reinforcing the primary role of business.
- In today's world, there is everywhere ample scope for further liberalization. It is not the case that the market-oriented reforms of recent years have brought a "neo-liberal hegemony" or signalled "the end of history."
- The main headings for liberalization now include: greater freedom of international trade and investment flows; further privatization, through arrangements that will promote free entry and competition; opening up to competition the provision of goods and services that are made available largely or entirely at public expense; "marketization," i.e., charging people, whether as individuals or as voters, for what are now free or heavily subsidized goods and services; and deregulation under many headings, including reversal of the

general trend towards eroding freedom of contract.

- Of course, economic policy has other aspects and aims. In particular, governments and people everywhere are concerned with questions of equity and fairness, and it is arguable that greater equality brings with it a more cohesive and more prosperous society. Economic freedom and economic equality need not be in conflict; but they are distinct goals, and conflicts can arise. However, the case for liberalization is not necessarily undermined if considerations of fairness, equality and poverty are emphasized. There are many anti-liberal measures which do not claim to promote equality; and even where liberalization gives rise to greater inequality, the case for it may still be strong, if it makes poor people better off than they otherwise would be. Historically, poverty reduction has largely resulted from the gains that economic freedom has brought, by opening up opportunities both for poor people and for others. Markets are a source of empowerment.

Capitalism, the market economy and new millennium collectivism

- Contrary to the apparently well-founded expectations of many, capitalism has not only survived during the period following the end of World War II, but has become more securely established. This is largely explained by the successful performance of market economies, on the one hand, and on the other, by the collapse of communism and the general underperformance of public enterprises.
- From the end of the 1970s, though with exceptions and many

local variations, economic policies across the world became on balance more market-oriented. But collectivist ideas and anti-market pressures remain influential everywhere. Across the world, the future scope and status of the market economy are put in question by today's *new millennium collectivism*.

- This collectivism takes its character and strength from a number of mutually supporting elements, some long-established and others more recent. The main elements are three: the constant and varied pressures of interest groups of many kinds, whether for economic gain or for influence and control; the widespread adherence to ideas and beliefs that can be put under the heading of "do-it-yourself economics" (DIYE), which has developed some new aspects while keeping old ones in place; and the increasingly influential presumptions and beliefs of global salvationism.
- A continuing threat to the market economy arises, not just from radical anti-capitalist groups and movements, but also, and principally, from mainstream opinion of various kinds in conjunction with a wide range of constant interest group pressures.
- The influence of new millennium collectivism is partly explained by two instances of failure. First, the business world in general has failed to make an effective case for profit-directed activity, while pro-CSR businesses and business organizations have typically lent support to global salvationism and taken the line of appeasement, or even collaboration, in dealing with anti-market critics. Second, ministries of economics and finance have largely failed to resist, or even to recognize, today's newer forms of collectivist thinking and practice.

- Whether economies across the world will on balance become more market-oriented or less is not at all certain. Anti-liberal influences and tendencies will persist, and on some fronts they may gain ground.
- Two rival diagnoses of the status of capitalism and the market economy are on offer. On the one hand, it is argued that socialism is now finally discredited, and that the choice between more or less market-directed forms of capitalism in democratic societies is not a fundamental one. A contrary view is that collectivist influences within these societies could well pose a threat to prosperity and freedom. There are good arguments on both sides. Even on the first hypothesis, however, the case for further liberalization remains valid.
- Measures and policies that narrow the scope of markets and reduce economic freedom can do extensive harm. Not only do they act as a brake on economic progress, but they are liable to impair the quality of individual and social life. A well-functioning market economy gives people the freedom to act in ways that will make their lives more complete, as well as materially richer.

PREFACE

This essay is a revised and greatly expanded version of the text that I used as a basis for delivering the Lang Hancock Lecture at the University of Notre Dame in Fremantle, Western Australia, in December 2002. In adapting and building on the original text, I have retained in places the relatively informal and personal style of a lecture. This is partly in the interests of readability, but also because I am conscious of having dealt with a complex set of issues in a summary way.

The Notre Dame University lecture series commemorates a notable Australian businessman. Lang Hancock (1909–92) played a leading role, right from the start, in the discovery, exploration and development of what became revealed as the immense iron ore deposits of the Pilbara region of Western Australia. In what had been a remote, desolate and virtually uninhabited area, an industry has grown up which in 2002 shipped out 175 million metric tons of ore. In revising my lecture text I took out most of the specifically Western Australian allusions; but I have kept in the main references to Hancock, since he can be seen as a local instance of a worldwide phenomenon. His career exemplifies the entrepreneurial role in promoting innovation and economic progress within a market-led economy.