



Center for  
Economic Policy

HISTORY OF  
CHICAGO  
ECONOMICS

**Milton Friedman and  
The Social Responsibility of Business**

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Steven Durlauf  
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Zoom

# Outline

- Business and Corporate Structure (Sanderson)
  - What is a firm? Ronald Coase and the theory of the firm
  - Residual claimants and risk bearing
- What did Friedman Say? (Coleman)
  - Firms should maximize profits, ***follow laws, rules, norms***
  - Not “Firms should be socially irresponsible”
- Economic and Philosophical Foundations (Durlauf)
  - 1) Welfare theorems; 2) Responsibility of *agents*
- What about Social Responsibility of *Investors*?
  - A completely different set of questions?

# Business and Corporate Structure

- What is a firm? Ronald Coase and the theory of the firm
- Residual claimants and risk bearing

# What Did Friedman Say?

- Somewhat political and inflammatory
- Let's try to put aside inflammatory language (*“preaching pure and unadulterated socialism”*) and focus on the ideas

# Focus on Corporation, Employees

- *Corporations* – versus sole proprietors
  - But remember – *many* businesses sole proprietorship
- And thus, *employees* and their responsibilities
  - Employee as agent – acting on behalf of owners (shareholders)
- Two important implications
  - Employees should act to fulfill owners' objectives
  - Employees can of course act to satisfy their own social responsibilities – just not with owners' money
    - But Prof Durlauf will ask – what about “unethical acts”?

# What is the Role of the Corporation?

- Pushes focus to corporation objective, charter
  - Objective of the *owners* and investors
  - Corporation is an “artificial person”
  - Objective stated in charter, articles of incorporation
- Generally, for most corporations, objective is to make profit
- Not necessary, not only possible goal
  - “Eleemosynary” corporations – charities

# What Did Friedman Say?

- What do people hear?

- What did Friedman say?

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

- Friedman states how corporations are organized, and calls for employees to follow the rules
- If we don't like the rules, then change the rules

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# What Did Friedman *Not* Say?

- Did not say “Firms should be socially irresponsible”
- Did not say “Firms should flout laws, rules, norms”
- Did not say “Firms should ignore long-term goals”
  - Role of community investment in the “long-run interest of a corporation”
- Did not say “socially desirable goals (*say clean water, clean air*) are contrary to profits”
  - Large arena of investing argues that socially responsible firms more profitable

# Separation of Political vs Market Mechanisms

- I think Friedman is arguing for the separation of Political decisions (who to tax, how much to tax, what coercive regulations and laws to enact) from Market decisions (how to determine the allocation of scarce resources to alternative uses)
- Which provides segue to Prof. Durlauf's discussion

# Important Economic and Philosophical Underpinnings

- Economic: 1<sup>st</sup> and 2<sup>nd</sup> Welfare Theorems
- Philosophical
  - To what extent is profit maximization the appropriate goal of a corporation?
  - What are the responsibilities of employees, acting as agents?

# Discussion:

## The Role of Social Investment

- Friedman did not discuss this issue
  - Focused on the role of employees in a corporation – agents of the shareholders
  - Investment management – grown since Friedman's day
- Issues for investors are completely different
  - Investors should do what they wish with their money