HENDERSON ROCKFORD CONFRONTS A DILEMMA:
THE NEW REALITIES OF CORPORATE SOCIAL RESPONSIBILITY

by

DAVID P. EASTBURN, PRESIDENT

Federal Reserve Bank of Philadelphia

before the

Joint Meeting

of the

NEBRASKA ECONOMICS AND BUSINESS ASSOCIATION

and the

NEBRASKA COUNCIL ON ECONOMIC EDUCATION

Seventh Annual Meeting

Sheraton Motor Inn

Lincoln, Nebraska

October 18, 1974
Henderson Rochford Confronts a Dilemma: The New Realities of Corporate Social Responsibility

To put some flesh and blood into what is often just a theoretical issue, let's begin by a look at a day in the life of Henderson Rochford, chief executive of Conglomerated Industries, Inc. (CII).

Things seemed to be piling up. Someone down the line at the Camden plant turned the wrong valve and released thousands of gallons of toxic chemicals into the Delaware River. This wasn't the first time and reporters were trying to get hold of Rochford to know what CII was going to do about it. This would be especially difficult for him because his board of directors had not decided on his proposal to install new filters. The environmentalists had been pressing hard but the board had been holding off because the plant was running at capacity and the project would reduce output for several months.

Rochford hoped the reporters would hold off until after his meeting with the securities analysts in the afternoon. It was going to be tough enough explaining what had happened to profits in the latest quarter. Moreover, labor negotiations underway looked as though they would escalate costs by over 10 per cent and with sales about flat, considerable layoffs seemed inevitable. He would have to pay special attention to the proportion of minorities laid off.

Having just participated in an economic summit session in Washington, Rochford also was sensitive about repercussions of the planned 5 per cent increase in prices of CII's products, but he could see no alternative. He would just have to do the best he could with the analysts, but he was not looking forward to the session.

Sometime he would have to find a few minutes to go over his speech for the United Fund wind-up dinner that evening. As this year's chairman of the fund drive he now realized how time-consuming that activity had been. The
drive was lagging and a million dollars had to be scared up from somewhere if the goal was to be reached. Perhaps CII could kick in $20,000 more. Rochford would be glad when the day was over.

Each of us can be glad we don't have to face dilemmas like this, but they are being faced somewhere in the corporate community every day. This evening I'd like to look at these dilemmas in the light, first, of what's been happening in recent years; second, what economists and others tell us about principles at issue; and finally what some new realities suggest for the future.

Growth of the issue.

There is nothing new, of course, about the issue of corporate social responsibility. What is new in the past decade is its intensity. In the 1960's debate over civil rights, poverty, student dissent, urban decay, protection of the consumer and the environment all erupted in one great outburst of social concern. Corporation executives were part of the ferment. They searched their consciences. They generated much rhetoric. They acted - individually, in groups and with other civic organizations. A few of them even tried to revise their accounting system to include social costs which they imposed on others in the form of such things as air and water pollution. They spent money—no one knows exactly how much, but [any data on expenditures].

Where does the issue now stand? I think I detect two facts. First, corporate responsibility has come of age. It is an economic, political, social and moral question that must be reckoned with in the remainder of this century. It will not go away. Second, however, the issue, I believe, has reached a new phase. The novelty has warn off. The intensity of concern is behind us. As corporations confront their most difficult economic problems in decades, they
see the issue in a new light. While these problems persist corporate social responsibility is likely to be moved toward the back however. This is the new reality.

Before explaining this reality, let me take time to analyze corporate social responsibility in a little detail. For how far on the back burner it will be and how long it will stay there depends partly on the substance of the issue. What do economists and others tell us about it?

Anatomy of the dilemma

The dilemma which Henderson Rochford confronted was actually a thin cut of a very deep and complex phenomenon. Let me try to lay open the anatomy of the dilemma with this table.

<table>
<thead>
<tr>
<th>Ethics</th>
<th>Economics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of life</td>
<td>Economic growth</td>
</tr>
<tr>
<td>Social action</td>
<td>Market system</td>
</tr>
<tr>
<td>Social welfare</td>
<td>Profits</td>
</tr>
<tr>
<td>Social costs</td>
<td>Private goods</td>
</tr>
<tr>
<td>Public goods</td>
<td>Voluntary action</td>
</tr>
<tr>
<td>Government action</td>
<td></td>
</tr>
<tr>
<td>Society</td>
<td>Individual</td>
</tr>
</tbody>
</table>

Arguments for corporate involvement in social concerns are represented on the left; arguments against, on the right.

For. If you look for people who hold all the values listed on the left, you are hard pressed to find many economists, let alone Henderson Rochford. You may run across a few, young, "radical economists, but you are much more likely to encounter a number of sociologists and philosophers. Some of the arguments
they give are economic, but most have a firm base in ethics. In return for the special status which society confers on the corporation, they say, the corporation has an obligation to society. Irving Kristol has put it tersely: "business should be profitable because it is honorable, not honorable because it is profitable."

Life is more than growth in GNP, they say. Society has become preoccupied with material gain--more gadgets, more indulgence in affluence--at the cost of the quality of life. J. K. Galbraith put it well: "The family which takes its mauve and cerise, air-conditioned, power-steered, and power-braked automobile out for a tour passes through cities that are badly paved, made hideous by litter, blighted buildings, billboards, and posts for wires that should long since have been put underground. They pass on into a countryside that has been rendered largely invisible by commercial art....They picnic on exquisitely packaged food from a portable icebox by a polluted stream and go on to spend the night at a park which is a menace to public health and morals. Just before dozing off on an air mattress, beneath a nylon tent, amid the stench of decaying refuse, they may reflect vaguely on the curious unevenness of their blessings. Is this, indeed, the American genius?" Part of this argument, too, is that our economy stresses private goods at the expense of public goods. We have too many high-powered cars, electric tooth brushes and beauty parlors and not enough parks, clear streams and health care.

These things, the argument goes, are not adequately provided by the market system. They require action by society, which, in the end, means government. The corporation should be in partnership with government, the corporation

---

providing its know-how to social problems, government providing leadership and necessary incentives and prohibitions.

The goal of the corporation should be to benefit all society, not just stockholders. Corporate management acts independently of stockholders anyway; stockholders are essentially unconcerned absentee owners. The corporation actually must be concerned with a multiplicity of groups; in addition to stockholders are customers, suppliers, employees, community neighbors. All of these call for a broader focus of corporate activity, one that goes well beyond the mere making of profits, a demeaning motivation at best. In short, proponents say, a purely market system is too narrowly directed not only to profits but to welfare of the individual, rather than the general welfare of society.

Moreover, the individual is virtually powerless to accomplish many of the goals of society. He can do little by himself to solve inflation; by driving less he does little to conserve energy or reduce air pollution. The individual investor can do little to force a corporation to be socially responsible, especially if that corporation is an attractive investment. Similarly, the individual corporation often has little to gain by not polluting. The cost system under which enterprise operates counts only the direct economic cost incurred by the corporation in production, not the indirect social cost incurred by others who may be affected by production. So if Conglomerated Industries, Inc. dumps toxic chemicals into the Delaware, the costs incurred by others, say, in filtering the chemicals out of drinking water is not counted in the cost of CII's products. (In fact, when GNP is added up, the expenditures for cleaning up the water are counted not as a negative cost but as a positive output!) Those who
argue for corporate involvement say that the corporation must assume responsibility for these social costs. Somehow, usually of necessity through Government action, the corporation must be obliged to include these social costs inflicted on others as part of its production costs. On this last point, in contrast with most of the others, the economist is increasingly vocal. What he calls "externalities" are the main basis for his espousal of corporate responsibility.

Against. When it comes to arguments against corporate involvement in social concerns, you will find only a few economists who hold all the values in the right column of the table. Most economists would be inclined, however, to lean toward the right side. (As economists, that is. I should stress that the economist is very finicky about differentiating his views as an economist from those as an individual. So you would find him leaning to one side of the table or the other, depending on which hat he is wearing at the time.)

The most forceful opponent of corporate involvement is Milton Friedman. Let him make the argument for me. He bases his case on economic grounds, but comes to ethical conclusions. He believes almost religiously in the competitive market system. He bases this belief in the old tenets of Adam Smith in which the individual in pursuing his own interest is (to complete the famous quotation) "led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good."

The market system is the mechanism by which individual welfare is translated into social welfare. Its essentials are spelled out in every basic
economics text. Scarce resources are allocated to their most desirable ends, and means of production are rewarded in accordance with workings of the price system. The driving force is profits. In a competitive economy the welfare of society is maximized when corporate executives behave as profit maximizers.

Friedman says: "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 make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom."

If the Henderson Rochfords behave otherwise, Friedman concludes, not only will the market system not bring the economic and social benefits expected to it, but unethical consequences ensue. When the corporate executive acts in some way that is not in the interest of his employers, he is "spending someone else's money for a general social interest. ...The stockholders or the customers or the employees could separately spend their own money on the particular actions 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."

Friedman concludes, therefore, that corporate social responsibility is a big step toward socialism in which political mechanisms rather than market mechanisms determine the allocation of scarce resources. Since freedom is a
value to be held above all others, it is important for ethical reasons not to violate fundamentals of the free market.

Choosing. Here you have a smorgasbord of values from which you can pick and choose those that best suit your taste. My own platter looks something like this:

1. People do want to improve their material well being. This is not the only driving force in their lives, and probably it is a diminishing one as they gain more affluence, but it is very important.

2. The corporation exists primarily to satisfy this want.

3. The drive for profits is an essential aspect of the competitive market system which has enabled the corporation to be so tremendously successful in its primary task.

4. The corporation, however, must look to the long run. In serving its own ends and the public's needs for goods and services, the corporation may well take many actions that are not directly related to profits in the short run. Thus it may contribute to the local United Fund in order to maintain good relations in the community from which it draws employees.

5. The corporation has an obligation to include in its costs of production the external costs it inflicts on others in the form of such things as air and water pollution.

6. In most cases it cannot do this alone; it needs help from Government. The role of Government should be to provide leadership to the corporation, inducing it to act in ways that competition
makes difficult for the corporation to act. It is entirely appropriate, for example, for Government to provide safety standards for the guidance of automobile producers.

7. Hopefully, Government can exercise this function largely by providing incentives rather than imposing the dead weight of bureaucratic restrictions.

My own position, in effect, is somewhere between the right and left columns. It maximizes the advantages of the market system and the role of the corporation in it, but recognizes that the corporation legitimately has many responsibilities to society that require it to act in ways that go beyond the quest for short run profits. And, finally, it gives a vital role to Government not only in providing incentives to the corporation to act in that way, but also in meeting many other social needs that are beyond the ability of the corporation to satisfy.

Wherever you and I may come out on the issue, it is clear that sentiment has been moving, particularly in the past decade, from the right toward the left side of the table. As Daniel Bell puts it, we are moving from an "economizing" mode to a "sociologizing" mode, from a market price system to a cultural value system, from concern for the individual to concern for society. This thrust is basic, will persist, and will carry the corporation along with it. But for the immediate period ahead it seems likely to be hung up on some new economic realities.

The new realities.

The Henderson Rochfords in our corporations are a new breed, as many (such as the Committee for Economic Development) assert. They are socially concerned.
Yet they are under tremendous pressure to perform. Along with the rise of social consciousness in the 60's came the cult of the equity. Economic growth was a new national objective, increase in the market price of its stock was a new corporate objective. Investors and mutual funds served by sharp-pencilled securities analysts, combed the list for growth stocks, switching from one to the other as fancy dictated. The latter-day Adam Smith caught the mood in his book "The Money Game."

So the Henderson Rochfords for some time now have not been able to sit back and contemplate their social responsibilities philosophically. Their focus has had to be on the bottom line. Today the state of the economy requires them to sharpen that focus. Corporate executives confront a combination of economic circumstances that is unprecedented. They are trying to do business in the most severe inflation of any peacetime period. At the same time demand in important parts of the economy is sluggish, in other parts capacity is insufficient to relieve shortages. Costs are rising rapidly. Interests rates are at unprecedented levels. The stock market has collapsed. Internal flows of funds are being depleted. Profits are high in nominal terms but after adjusting for rising prices and in relation to GNP are near historical lows.

This environment has two implications. One is that it forces the chief executive to focus, even more than usual, on profits. The other is that it shortens his focus to the near term. Both distract him from matters of social responsibility.

How long will these conditions persist? I hope, of course, that the peculiar combination of inflation and stagnation will disappear soon. But I am not at all confident that the corporate executive realistically can expect
to live in a non-inflationary economy for some time to come. Looking back, the 60's, chaotic as they may have seemed then, were much more conducive to the exercise of social responsibility than conditions that seem to lie ahead in the foreseeable future.

If I'm at all correct in this prediction, and I hope I'm not, an important question is how social problems are to be met. Right now, for example, there is strong pressure to delay anti-pollution efforts in order to solve the pressing problems of public utilities and energy shortages. It seems to me that the role of Government will be even more critical. It should be one of nudging the Henderson Rochfords to keep looking to the longer run. The rationale for social responsibility will not disappear, despite short-run problems. It will be important for the corporate executive to come to grips with his dilemma in the uneasy times ahead and not just to live for the moment, for tomorrow will surely come.