Business, Ethics and the Modern Economy

THE SIR RONALD TROTTER LECTURE

1997

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NORMAN BARRY

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NEW ZEALAND BUSINESS ROUNDTABLE

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The Sir Ronald Trotter Lecture

SIR RONALD TROTTER was the first chairman of the New Zealand Business Roundtable in its present form, a position he held from 1985 to 1990.

Among his many other roles he has been chief executive and chairman of Fletcher Challenge Limited, chairman of the Steering Committee of the 1984 Economic Summit, a director of the Reserve Bank of New Zealand, chairman of the State-owned Enterprises Advisory Committee, chairman of Telecom Corporation, chairman of the National Interim Provider Board, a chairman or director of several major New Zealand and Australian companies, and chairman of the board of the Museum of New Zealand Te Papa Tongarewa.

He was knighted in 1985 for services to business.

This lecture was instituted in 1995 by the New Zealand Business Roundtable to mark Sir Ronald Trotter's many contributions to public affairs in New Zealand. It is given annually by a distinguished international speaker on a major topic of public policy.

The third Sir Ronald Trotter lecture was given by Professor Norman Barry at the Wellington Parkroyal Hotel on 4 November 1997.

Norman Barry

Norman Barry is Professor of Politics at the University of Buckingham in the United Kingdom. He is a political theorist with an interest in political economy and in the connections between politics, ethics and economics.

His books include Hayek's Social and Economic Philosophy (1979), An Introduction to Modern Political Theory (1981), The Invisible Hand in Economics and Politics (1988), The Morality of Business Enterprise (1991) and Classical Liberalism in the Age of Post-Communism (1996).

Professor Barry has been a visiting scholar at the Centre for Social Philosophy and Policy, Bowling Green State University, Ohio, and at the Liberty Fund, Indianapolis. He is a member of the Academic Advisory Councils of the Institute of Economic Affairs, London, and the David Hume Institute, Edinburgh.

Introduction by
Bob Matthew,
chairman,
New Zealand Business Roundtable

Ministers Of The Crown, distinguished guests, ladies and gentlemen.

It is my very pleasant duty to welcome you here this evening on behalf of the New Zealand Business Roundtable.

This is the third Sir Ronald Trotter lecture. The series was inaugurated in 1995 to recognise Sir Ron's achievements in business and his many contributions to public affairs in New Zealand.

This year Sir Ron has reached the age of retirement from some of his board roles in New Zealand and Australia. He remains chairman of the board of the Museum of New Zealand Te Papa Tongarewa. We hope he will continue to play a role in public life for many years to come. We are delighted that Sir Ron and Lady Margaret Trotter have been able to join us this evening.

The purpose of the lecture series is to feature an outstanding international speaker on a major topic of public policy. Our speaker this evening is Norman Barry, professor of politics at the University of Buckingham in the United Kingdom. We are delighted to welcome Professor Barry to New Zealand.

Norman Barry is a political theorist with an interest in political economy and in the connections between politics, ethics and economics. He has eight books and dozens of articles to his credit.

In one of his books, The Morality of Business Enterprise, Professor Barry explores some themes that are very relevant to public debate in this country. One is the common belief that because business is founded on self-interest, it must lead to an indifference towards society at large and to a neglect of moral standards in the pursuit of profit. This belief often leads to proposals to impose regulations on business enterprises which go beyond those imposed on other sections of society.

More recently, Professor Barry has been writing on the topic of corporate social responsibility. Business is constantly asked to be 'socially responsible' and is criticised for its alleged individualism and the priority it gives to the interests of owners over those of some wider group of so-called 'stakeholders'.

These are important issues for New Zealand as we have moved from a highly regulated environment to one in which businesses are required to stand on their own feet and compete internationally. We are still some distance, I believe, from having a widespread understanding of the role of business and from developing a strong and instinctively understood business culture.

I believe Professor Barry's lecture this evening will throw light on some of these important issues. His title is Business, Ethics and the Modern Economy. It is my very great pleasure to invite him to address us.

Business, Ethics and the Modern Economy

THE COLLAPSE OF COMMUNISM and the discrediting of even minor experiments in socialism, such as those of Sweden and New Zealand, has brought a new examination of capitalism. The debate is no longer about the market versus the state but it concerns the merits and demerits of various types of capitalism; and although individualism and collectivism have not been expelled from the political and economic vocabulary, they now describe different forms of economic organisation. Of particular significance is the fact that erstwhile critics of Western economics now confine their attacks to Anglo-American (or, as it is sometimes called, Anglo-Saxon) capitalism. Apparently, some of the aims of socialism can now be realised through particular versions of the market – notably the social market economy, communitarianism and stakeholder capitalism. Indeed, at the time of reunification the former East Germany was specifically not offered Wall Street-type capitalism, and of the former East European communist countries only the Czech Republic embraced wholeheartedly that form of economic order. Anglo-American capitalism is obviously not the only form of private enterprise, and it seems to be confined to the United States, the United Kingdom and the rest of the English-speaking world, including Australia and New Zealand; and even within those countries there is considerable hostility to the forces – individualism, self-interest and exclusive concern for profit – that are said to drive it. A whole academic discipline in the United States is predicated on the assumption that capitalism requires some validation by a morality external to its own rules and practices.

To some critics, Anglo-American capitalism has a morally tainted biography: its mainsprings seem to run counter to the prevailing moral tradition of the West, especially in its religious manifestation. Conventional morality understands the public interest as a deliberate product of good will (and the specific suppression of self-interest) rather than the benign and unintended outcome of the operation of the egoistic spirit. It was put melodramatically in an early demonstration of the social advantages of commerce – Bernard Mandeville's eighteenth century satirical poem, The Fable of the Bees. In this comic celebration of the market, morality is thought to be a positive disadvantage. The successful commercial order depends on the cultivation of self-interest, even greed. Morality or the communal spirit were hindrances to commerce: 'Each part was full of vice/But the whole an earthly paradise'.[1] In The Fable, when the bees 'got morality' they became fractious, quarrelsome and unproductive.

The Fable is a paean for self-interest which has had an abiding influence on capitalist thought. Indeed it provides the utilitarian justification for the market system – a rationale that dispenses with conventional morality and which regards the rules that the system requires as no more than artificial devices which supply the players with some security and predictability. Society benefits from the overall increase in productivity that self-interest generates – not from any altruistic or benevolent motivations from the actors. It was a theory which Adam Smith felt bound to refute,[2] even though he adopted at least some of its features, and it had a peculiar resonance in the frenetic world of the 1980s when the slogan 'greed is good' became almost a mantra in some pro-capitalist circles. The era could be said to be a reflection of the realistic, or cynical, view of human nature offered by Mandeville. Those who claim that ethics is 'good for business' would fall victim to his cynicism – this claim would simply be an example of that hypocrisy which for Mandeville was the main feature of the moral life.

Undoubtedly the myth of amoral business persists, and indeed a common observation is that the phrase 'business ethics' is an oxymoron, and that the mainsprings of business activity, self-interest and the pursuit of profit, preclude considerations of morality. But the modern critic of business has a peculiarly constricted view of morality, just as Mandeville did: the ethical life must necessarily involve a sacrifice of personal interest. The persistence of this myth has encouraged the rise of a type of business ethics, especially in the United States, which requires business agents to fulfil moral duties which are extraneous to business itself. They must somehow act under licence from the moral philosopher or the church leader. It is this attitude which explains the rise and continuing attraction of alternative capitalisms to Western business.

But this attitude mistakes the nature of both morality and business, and its influence over the intellectual life of Western capitalist countries has led to a kind of 'legislated business ethics' which threatens to do considerable harm to business enterprise. It can also be shown that the alternative capitalisms, especially the communal variety apparently practised in Japan, do not score particularly highly in moral grading when measured against the normal standards of ethical conduct.

The point here is that there is a kind of generic morality to business life which is more or less universal. Wherever capitalism is successfully practised it requires respect for personal autonomy, the obligation of promises, the protection of justly acquired property, an implicit or tacit understanding of the rules of fair play and a certain degree of 'trust'.[3] Thus although there is a good deal of variety in particular capitalist systems, they all acknowledge these demands: just as legal orders are heterogeneous with regard to particular procedures, they all recognise the substantive goals of crime prevention, the protection of contract and property, and the necessity of tort. We must not let the current obsession with multiculturalism blind us to the common features of civilisations. When talking of capitalism we should not be embarrassed about the universality of the desire to better ourselves. As Richard Epstein recently pointed out:

> This characteristic of wanting more is universal. It applies to greedy and rapacious firms and self-interested individuals. Indeed, wanting more is not a characteristic for which we

> should want to condemn people. The desire for more is one of the few features that is indispensable for human progress and advancement.[4]

Predictability and stability are part of the conditions necessary for success in 'wanting more', but they are intrinsic to the business process itself, not imposed from outside. David Hume described the trading relationship with his usual clarity:

> Your corn is ripe today; mine will be so tomorrow. 'Tis profitable for us both that I should labour with you today, and that you should aid me tomorrow. I have no kindness for you, and know you have as little for me. Hence I learn to do service to another, without bearing any real kindness, because I foresee that he will return my service.[5]

Voltaire, on a visit to England in the 1770s, noticed how traders of a variety of faiths and ethnic backgrounds dealt with each other in perfect security under the flimsiest of regulations in the embryonic London stock exchange. What united them was not just the commercial instinct but a developed idea of trust.

What Hume was referring to was the emergence of morality as a series of conventions which it is in the self-interest of all parties to adopt. As long as the parties meet repeatedly they can rely on each other to keep to a deal, even though it might be in the immediate self-interest of one of them to breach the arrangement. In the language of modern game theory, of which Hume was an unwitting precursor, they are playing an 'iterated prisoners' dilemma' game, ie one in which the opportunity to punish defectors from an arrangement guarantees observance over time and allows trust to emerge (something which Mandeville would have found difficult to explain). Of course, this notion of trust might be said to be a method of lowering transactions costs (indeed, the Japanese way of doing business is frequently admired, in comparison with the United States, because it is characterised by extraordinarily low legal costs). It is no moral failing when business is accused of adopting such practices of self-regulation as a device to ward off state regulation, for it is almost certainly the case that the latter will be inefficient and driven by political considerations which are normally unsympathetic to business. This is especially so in the stock market in the United States, the United Kingdom and the Commonwealth, where regulation to police 'insider dealing' regularly fails to distinguish adequately between information derived from genuine research (which is essential if coordination is to be achieved in the capital markets) and that obtained illicitly by someone breaching a fiduciary duty of confidentiality.

However, although this is an apparently minimalist morality, which is inextricably linked to utilitarianism and does not meet the heady ideals of those who talk repeatedly of the 'social responsibility' of business, it is really rather economical with its use of our moral resources and it is capable of being followed by agents who need to know little of each other and are not required to sympathise with others on personal religious and moral ideals. The basic feature of this business morality is that it functions efficiently in a system which is open to all comers, and its rules do not make any discriminations derived from race, religion or nationality. Those who would make the world of business subservient to some notion of community must be prepared to accept a business ethic which sanctions such discrimination. For example, those countries which, by law or business practice, prevent takeovers by foreign countries are institutionalising this very exclusivity.

There is one feature of Anglo-American business which superficially might make it inappropriate for the kind of minimalist morality just described. This is its relative anonymity. If the traders do not meet regularly there is limited opportunity for the morality of conventions to build up and every chance for self-interested maximisers to betray a trust or take an unfair advantage. The financial markets may illustrate some of these problems since there can be victims of wrongdoing (which may not be technically criminal) before the self-correcting processes can take effect. And of course the profession of business ethics profits immensely from publicising occasional breaches of propriety. But it does not appreciate the many examples of perfectly moral coordination which proceed every day and are not 'seen'.[6] Certainly, the environment presents us with well publicised examples of the failures of self-regulation, many of which can be attributed to the feature of anonymity; most environmental predators cannot possibly be known. Again, the manufacture of dangerous products, which will be consumed by people far removed from the producer (one thinks here of the notorious Ford Pinto example), would be encouraged by anonymity. The correcting process of the market may be too late to save victims. It is clear that modern business imposes duties which are much weaker than those that emerge from family relationships, and perhaps those critics of Anglo-American capitalism who wish to infuse it with more intimate community values see these latter as surrogates for the family: they are needed apparently to constrain the alleged destructive egoism of the anonymous market.

It is, of course, true that the vast impersonal markets of the twentieth century are different from the eighteenth century commerce described by Hume (and Adam Smith), but this does not make the morality he adumbrated irrelevant. It would be unwise to overstate anonymity: most business agents when dealing with each other have every incentive to follow informal rules and to discipline their fellow practitioners. Indeed, the rise of business codes in publicly quoted companies is indicative of the concern that business feels for self-regulation. And, of course, the anonymity of modern business has not protected it from a vigilant press and a public opinion which is led by intellectuals who are likely to be hostile to business and ever-anxious to expose its failings.

The Moral Structure of Anglo-American Business

Undoubtedly, Anglo-American business is individualistic in its foundations. Yet this does not mean that business agents are atomised individuals identified merely by their preferences and incapable of forming any human relations except by the cold logic of contract. Relationships of an informal kind do develop between employers and employees, suppliers and customers, and business and the local community. Furthermore, many implicit and strictly unenforceable obligations emerge which oil the wheels of commerce. But it is true that in comparison with other business cultures, notably in Germany and Japan, commerce in the United States and the United Kingdom does tend to be conducted at arm's length with participants using others as a means to their own ends (though to avoid the protests of the Kantians, participants are not used merely as a means to another's ends). The assumption is that with all agents pursuing their self-interest, the public good will tend to emerge spontaneously. Under the pressure of competition employers will provide returns to owners (shareholders), jobs for workers, and goods and services at affordable prices.

A crucial feature of Anglo-American business is entrepreneurial profit. Entrepreneurial profit is often thought to be immoral and undeserved because it is well above the returns to labour as described in conventional economic theory (based on marginal productivity). But most markets are imperfect and require coordination by alert and astute individuals. Profit is simply the reward for that alertness. The entrepreneur creates value by discovering a price differential which can be exploited, anticipating consumer demand and noticing some opportunity which has hitherto been undetected; and the entrepreneur is entitled to rewards on grounds of utility and rights. The United States especially reveres this human quality, which can be displayed in the firm or by an innovator who breaks into a market. Indeed, many of the large corporations in America are the products of original acts of entrepreneurship.

In an argument made famous by Milton Friedman, the social responsibility of business is to increase its profits subject to the constraints imposed by the "basic rules of society, both those embodied in law and those embodied in ethical custom".[7] Although there can be dispute over what exactly is prescribed by ethical custom, Friedman's basic message is clear: there is a principal-agent relationship here which imposes a fiduciary duty on employees to work in the best interests of the owners. In a publicly quoted company employees must maximise shareholder value. This fiduciary duty on employees is still the position in the company law of Anglo-American economies despite the assaults repeatedly made on it. What is particularly sinister is the claim, frequently made, that companies would be in breach of their fiduciary duties if they did not fulfill their social responsibilities. While there is often a coincidence between maximising owner value and serving the interests of the community, it is surely too vague an association to be the subject of litigation.

The argument is basically one about property rights and, although no ownership rights are absolute, it is clear that the assets of the company belong to the owner.[8] If managers pursue their own agenda, perhaps one supplied by business ethics, they are, in effect, implicitly and illegitimately, claiming ownership rights. Thus Friedman's thesis, with some minor modifications, still holds. What is not often appreciated is that any serious departure from the goal of maximising owner value (which is not necessarily revealed in the current share price) puts a public company at a competitive disadvantage and makes it vulnerable to a takeover. Indeed, if there are moral duties that transcend profit maximisation, they can only be properly fulfilled by privately owned companies. Body Shop, a very publicly virtuous company anxious to avoid shareholder pressure for value, once considered going private but found that the constraints of banks and bondholders would be as onerous as those of shareholders. This illustrates that in a competitive economy there is little slack for companies to pursue non-commercial forms of social responsibility: ironically, the best prospect for the exercise of non-commercial forms of social responsibility would be in monopolies, but there are surely moral as well as economic objections to such a practice.

There are more serious objections to the attribution of social responsibilities to business which relate specifically to Anglo-American societies. These are characterised by a certain pluralism (even subjectivism) about values. Indeed, there is little agreement about ends and purposes beyond the maintenance of a broadly neutral set of rules, institutions and practices. If there were agreement about, say, religion, it would be plausible to suggest that the rigour of profit-maximisation could be relaxed for religion's pursuit. However, in Anglo-American economies the economic nexus is the only mechanism we have for the ordering of competing purposes and, imperfect though this is to the believer in objective moral standards, it provides at least a certain impartiality. But given the plethora of competing demands that are likely to be made on the socially responsible corporation, it is difficult to see how the selection of which local project is to be supported with shareholders' money can be other than arbitrary. In a famous example of social responsibility from the 1970s, Coca-Cola provided a mini-welfare state for its workers who were working in unpleasant conditions in Florida.[9] What was noticed was the corporate virtue which the scheme exemplified, but what was not so visible was the subsequent unemployment brought about by the rise in the company's costs.

Certain activities, such as the voluntary provision of education, can have a direct effect on business profitability by supplying a technically skilled workforce. In these circumstances social responsibility is part of a firm's investment and can be judged by the conventional criteria. I am sure that many firms would claim that they could make a better job of running education than the state. But this is not what the advocates of social responsibility normally have in mind, as most of their suggestions necessitate a sacrifice of shareholder value.

This absence of moral agreement amongst the inhabitants of Anglo-American economies has a further implication for the social responsibility thesis. In an environment which values individualism and entrepreneurial flair there is the danger that these human qualities will degenerate into opportunism and rent-seeking. From Adam Smith onwards there has been the fear that the joint-stock company will be run in the interests of the managers rather than its owners. In every successful economic activity the factors of production earn economic rent, or income above that necessary to attract them to the business, and if managers are not closely monitored they will seek to capture all of this for themselves. Also, they will behave opportunistically, shirk on the job and divert income to themselves in the form of perks. Other economies may have more attractive methods for securing loyalty than the traditional sanctions of the profit-maximising enterprise. Even business ethics itself can be used opportunistically by managements. Doing good for the community is often more attractive than working for the shareholder.

The latest assault on the integrity and autonomy of the corporation has come from 'stakeholder' theory. This is partly an efficiency argument and partly a moral claim. The efficiency case derives from the doubt that many critics of capitalism have about the stock market as the indicator of economic value.[10] Other successful capitalist economies show less concern for shareholder value and are financed more from bank loans than stock issues. The Anglo-American way is said to lead to short-term thinking and planning, and the projects that don't show a quick return for investors are believed to be undervalued.[11] This is an economic argument that has lost something of its force over the past few years, especially with the extraordinary success of the American economy.

The moral argument depends on a quite radical theory of ownership. According to this perspective, the shareholders are not the 'owners' of the firm with all that that implies for property rights. Businesses would appear to be owned by coalitions of stakeholders, each segment of which would have a say in important decisions such as plant location, investment policy and layoffs. Shareholders, as the suppliers of capital, would have no special significance in decision making. Indeed, if the example of Japan is anything to go by, they could not expect much in the way of dividends either.

From one point of view the idea of stakeholding is perfectly acceptable and is fully consistent with the profit-maximising business enterprise. Employers who treat their employees as easily dispensable at the first sign of economic misfortune would soon find it difficult to acquire and retain loyal staff. Certainly, the supply of 'firm specific' human capital, ie labour that is exclusively linked to one enterprise and which therefore becomes vulnerable in the event of a takeover, would dry up. There must be an element of trust in human relationships which extends beyond the boundaries set by the simple labour contract.

But it should be noted that all this is a feature of prudence or good business practice rather than of business ethics itself. However, the proponents of stakeholder capitalism want to go further: the various stakeholders – suppliers, workers, residents of the local community etc – should have the right to be consulted over important business decisions, and presumably the right of veto. Such influence derives not merely from the contribution stakeholders might make to profitability but from their position as quasi-owners. In an influential contribution to the theory, Evan and Freeman write that "the very purpose of the firm is to serve as a vehicle for stakeholder interests",[12] and that "the reason for paying returns to owners is not that they 'own' the firm, but that their support is necessary for its survival".[13] In other words, stakeholder representation is a requirement of a morality that is not intrinsically a feature of business itself.

But this is a very dangerous doctrine which, if fully implemented, would have deleterious implications for corporate governance. For there could be no chain of command, no authoritative decision-making structure or 'control rights' if every interest group had to be consulted. Assets would not be effectively handled if ownership rights were not exclusively vested in those who had put up the capital.

Indeed, it is hard to imagine why anyone would invest in a company in such circumstances. If the company were treated as a coalition of stakeholders, decision making would not resemble the rationality of the market. It would not necessarily lead to an increase in that valuable commodity 'trust', for each stakeholder group would have reason to think that it was unjustly treated by a personal process that deliberately dispensed with the blind, impersonal verdict of the market. But even if an economy were so well integrated socially that there were no intractable disputes between rival stakeholders, that could simply lead to stagnation. In Japan, for example, there is arguably too much trust. The workers trust the employers not to dismiss them and promise, in return, docile labour unions. The result is that most large-scale Japanese corporations carry excessive numbers of employees.

Evan and Freeman do recognise that there is a problem of ordering the demands of the various stakeholders and recommend the appointment of a 'metaphysical director' to the board who would presumably provide the requisite detachment and impartiality.[14] Apart from the bizarre nature of this proposal, it sounds like rent-seeking by philosophers. One of the first things the metaphysical director would do would be to reduce the influence of the price mechanism in the value ordering process since it would make the director redundant.

Takeovers, the Community and the Ethics of Capitalism

One of the most important, and controversial, distinguishing features of Anglo-American capitalism is the use of the takeover mechanism for bringing about industrial change. It is a feature closely related to the maximisation of shareholder value and involves the same questions of efficiency and morality that excite critics of this form of capitalism who can point to the examples of successful capitalist economies which make little use of it. In Germany and Japan, for example, stable communities are apparently not destroyed and needless unemployment created by the remorseless pursuit of shareholder value; firm-specific labour is not sacrificed on the altar of immediate profit; successful companies are not acquired and then disposed of just for their break-up value; and, most importantly, unconscionable profits are not made by 'unproductive' financial intermediaries whose only skill is in paper churning. It is also true that some of the most controversial phenomena in business, eg insider dealing, 'greenmail' and 'golden parachutes', have been generated by takeovers.

However, it is important to understand the logic of takeovers before any moral evaluation of their significance can make sense. A takeover takes place because an outsider notices that a company is underperforming as measured by its share price – the company is not realising the true value of its assets. The conjecture is that an improvement could be achieved by new management and a wholesale reorganisation of these assets. In the more or less impersonal and anonymous world of Anglo-American business, where company loyalty and the pull of communal affiliations are less significant, the ultimate sanction of a takeover is the major method of enforcing good behaviour from potentially rent-seeking managements.

A brief consideration of the history of takeovers in the United States from the late 1960s to the present day is a good illustration of the economic and ethical issues involved. In the former period, takeovers were often not efficiency-inducing, ie designed to bring about a better use of assets. They tended to be management-driven, and it was this empire building which led to the creation of unwieldy conglomerates which were a primary cause of the then inefficiency of the US economy. As Michael Jensen has pointed out, profit which should have been paid to shareholders in the form of higher dividends was spent on managerial expansion.[15] The corporate raider, by offering a premium to existing shareholders, was actually performing a service which the management had failed to perform. Furthermore, the break-ups that occurred in the 1980s had a rationale that would have been appreciated by Adam Smith: they led to the revival of the owner-managed enterprise and to the publicly quoted corporation in which management had considerable investment. The much-maligned 'junk' bond[16] was instrumental in this process too, for its development enabled many start-up companies which could not get an investment grade rating to secure loans.

It was the realisation by predators that more value could be extracted from existing assets by the break-up of these conglomerates that provided the economic rationale for takeovers. And the moral question, which is rarely considered by the critics, partly involves the behaviour of managements, for not only were they in breach, at least ethically, of their duties to shareholders by appropriating much of the rent the corporation originally created, but they were big players in the political and legal campaigns that were launched, with some success in all the states of America at the end of the 1980s, to end the takeover boom. Indeed, they were instrumental in getting judicial approval for the 'poison pill',[17] a controversial device, forbidden by the Takeover Code in the United Kingdom, which protects companies from unwelcome bids by raiders.

Much of the objection to the takeover boom of the late 1980s was driven by emotionalism, by a certain sentimentality and often by the self-interest of those who stood to lose from the necessary industrial reorganisation that takeovers involved. The empirical evidence in favour of the argument that takeovers wrecked communities and caused needless unemployment is sparse. In fact, most of those adversely affected were not ordinary workers, who quickly found employment in the new open markets that were created, but layers of middle and upper management. What was not noticed was the unemployment that was created by the established corporations that managed to protect themselves from the corporate reorganisation that was taking place elsewhere.

At the philosophical level, the communitarian objection to the takeover movement was based on anti-individualism. To the communitarian the identification of people by their preferences, and the detaching of the agent from any social connections, is a fundamental error. It isolates people from all those social characteristics that constitute genuine personhood. Individualism places the economic right to exchange before the good of communal association, while communitarianism places a duty on the state to preserve and protect supra-individualistic affiliations, and social bonds which are specifically not the product of choice are highly valued. For the communitarian there would appear to be a prohibition on any form of voluntary agreement which is not validated by collective approval. This is why, in policy terms, somewhat convoluted notions of the public interest are often used as criteria by authorities to approve a takeover. However, beyond the interest we all have in the preservation of the market order subject to the rule of law, this notion is highly contestable and is likely to be used by private interests as a shield against competition. The British requirement that a takeover not be against the public interest, eg it should not establish a monopoly or lead to collusion and cartels, is a much more market-friendly policy. On the other hand, far from promoting freedom and efficiency, German policy which is hostile to takeovers produces the reverse effect. This was seen in the recent unsuccessful battle for Krupps in which an economically rational bid was defeated by a coalition of stakeholders, consisting mainly of trade union barons and community leaders.

As matter of fact, recent economic history in Germany reveals that business ethics cannot defeat the laws of economics, for German investors are simply fleeing the high non-wage labour costs of German industry and investing overseas. And the much-vaunted Japanese economy, with its legendary disdain for shareholder value and heavy emphasis on long-term thinking and planning, has been mired in recession since the early 1990s. Its corporate structure, which is more or less insulated from competitive pressure through the operation of the kereitsu, has proved to be quite inadequate for the new global economy. In the United States, the much-maligned 1980s – the so-called age of greed – was an era in which the economy was efficiently reorganised, many more private sector jobs were created and industrial innovation proceeded at a great pace. And, in retrospect, the much-publicised business scandals appear to be minor. The fact that they were publicised is itself a tribute to the openness of that society and its economy.

The argument that relentless market relationships destroy communities is little more than an assertion. The fact that individualistic motivations power the exchange system should not be taken to mean that other more communal affiliations are excluded. 'Relational' interests which transcend formalised contractual obligations flourish in the context of market individualism, and the world of business is itself characterised by a myriad of informal rules and practices which reduce the need for purely legal regulation. It is rather odd that the critics of capitalism should condemn the exchange relationship for destroying communities when the market economies of East Asia have managed to resist its corrosive force. Although capitalism there is rather different from the Anglo-American model, it is quite consistent with the generic moral code which is common to all varieties of the system. If the private property market system were so relentless in its anti-social effects one would have thought that unaided social forms would have been powerless to resist it. Yet these social structures have coped very well with such an allegedly irresistible force. Communal relationships prosper best in an atmosphere of freedom, and there is no reason why the traditional market freedoms should be a deterrent to them. To the extent that the communitarian agenda authorises the state to resist the effects of the market, it is implicitly impeding the growth of voluntary communal relationships. Genuine community, like the market, depends on free action, and to the extent that communitarians depend on the coercive power of the state they can only produce an ersatz version of that ideal. In their attempts to resist the effects of takeovers, communitarians find themselves in a strange alliance with self-interested groups who don't have the interests of the community at heart at all.

None of this is meant to imply that there are never ethical problems in takeovers. They can be bruising affairs in which the impersonality and relative anonymity of the market preclude the influence of our more refined notions of community and social solidarity. Also, while corporate raiding is an example of legitimate entrepreneurship, it is not always clear that the successful predator is morally entitled to the rewards that go with alertness to an opportunity. A classic example was the notorious Guinness takeover of Distillers.[18] It appeared that James Goldsmith of Argyll originally discovered that the company was mismanaged, and did all the research only to find that Ernest Saunders of Guinness effected the takeover by the use of what turned out to be an illegal share price-rigging scheme. Although there might be doubts about the original convictions of Saunders and his associates, serious ethical questions remain about who had the claim to the property right in the discovery of the opportunity.

The Social Market Economy

Most of the alternatives to Anglo-American capitalism alluded to have not been formulated as an over-arching economic ideology; rather they are significant modifications to what has become an almost irresistible force, a softening of its rougher edges not a self-consistent social and economic ethic. However, in Europe there was thought to be a coherent doctrine which captures all the known efficiency advantages of capitalism while preserving some of the more attractive features of a social democratic or welfare state. I refer to the German social market economy, the allure of which was heightened by the fact that it was the ruling doctrine of the most successful post-war market economy in Europe. Much of the contemporary attraction of the social market stems from its welfare policy, but this was embedded in a general doctrine that contained significant departures from laissez-faire. As a matter of historical fact, the social market itself was a mutation out of a doctrine called German Ordoliberalism, which was actually closer to the traditional model of capitalism.[19]

The doubts that the German liberals had about laissez-faire are encapsulated in a comment by the most distinguished member of the school, Ludwig Erhard. He claimed that he was “unwilling to accept without reservation and in every phase of development the orthodox rules of a market economy according to which only demand and supply determine price”.[20] And Wilhelm Röpke wrote that: “Like pure democracy, undiluted capitalism is intolerable”.[21] The modifications that the

German liberals made to undiluted capitalism were primarily instrumental and concerned the likely development of the market into a system of cartels and monopolies if it were not subject to some regulation by the state. They had much less faith in the self-correcting properties of an unaided market, or for the prophylactic effects of common (or civil) law than did laissez-faire enthusiasts. The unrestricted right to freedom of contract would lead to the undermining of liberty, for what the German liberals had in mind was a Kantian conception of ordered liberty rather than the idea of liberty as the achievement of sensuous satisfactions, as perceived by classical utilitarianism and by theorists of negative liberty. In addition, they thought of the market economy as a venue for harmonious community relations rather than as the stage for permanent confrontation between capital and labour. It is this idea that underlies the co-determination arrangements, instituted in the early 1950s, which guarantee trade union representation on the supervisory boards of German public companies. Furthermore, the stock market plays a much smaller role in the raising of capital in Germany than it does in Anglo-American economies. Indeed, this had the curious effect of producing an amazing insouciance about insider dealing, which was not forbidden in Germany until the country was compelled to adopt the recent European Directive on the matter. We have already seen that Germany has a marked distaste for takeovers, which is as much founded in social attitudes as it is in legal impediments.

Still, one wonders how different the original version of the social market was from conventional capitalism. The doubts about the self-correcting properties of the market were even echoed by early Chicago economists who were prepared, until quite recently, to tolerate some version of anti-trust law (which is partly reflected in anti-cartel measures in post-war Germany). In may ways the German liberals were anxious to reproduce ‘perfect competition’, which they saw as exemplifying ordered liberty and the absence of market power. It is true, of course, that many market theorists today are quite suspicious of anti-trust law, are supremely confident of the self-correcting features of the market and are satisfied with the adequacy of law (either civil or common law) for the preservation of liberty, but at the time of their dominance over the German economy the social market theorists propagated an ideal that was not too far from orthodox classical liberalism. Even co-determination left owners with ultimate property rights (which explains the current flight of capital from Germany).

It was the social part of the social market economy that was eventually to bring about the decline of the German economy, and it is mainly this that has proved to be so attractive to anti-capitalist social theorists. But even the purely economic features of the system seem to have lost some of their allure. There is currently a movement among German investors to establish shareholder power and to make the pursuit of shareholder value the prime aim of German business. It is apparent that the banks are no longer monitoring managements as efficiently as they once did; a trend that is likely to lead to a new reverence for the takeover mechanism (which is already beginning to appear on the German industrial scene). That social cohesion which once gave German capitalism a less individualistic face is starting to show signs of strain as the economy weakens in the face of fierce competition from low-cost countries. In the light of these developments one can see the irony in the reply of Vaclav Klaus (the prime minister of the Czech Republic) to a question about what sort of market he wanted for the then Czechoslovakia: “A market without adjectives”, he said.

The Ethics of Business and Capitalism

Business is coming under increasing moral pressure in the contemporary world. This ethical interrogation basically has two sources. First, its activities have been subjected to merciless scrutiny from a rightly vigilant press, and business personnel have been accused of frequently breaking those moral rules by which we are all expected to live. And second, because of their alleged privileged position, business enterprises are expected to go beyond the constraints of normal morality and to act positively for the public good even if it should be costly to them to do so. The pursuit of profit has to be legitimated by external moral criteria.

With regard to the first issue, scandals have been ruthlessly rooted out and the behaviour of business agents subjected to the kind of public censure that politicians rarely receive. This is largely because they are assumed, perhaps mistakenly, to be motivated by unalloyed self-interest in a way that others are not. But this is surely an error, for there is little evidence that politicians and public officials are motivated by higher ideals merely because they do not appear to be attracted by the lure of immediate profit. A measure of self-interest is not harmful. It appears to be so only when it is exercised in a context which does not direct it into socially valuable ends. Governments and law makers are themselves reprehensible when they fail to devise rules which harness this natural motivation to productive purposes.

For example, business agents are often assailed for not taking proper care of the environment and the assumption is that they are in need of a moral education in public duty. However, as David Hume pointed out long ago, “men cannot change their natures. All they can do is change their situation, and render the observance of justice the immediate interest of some particular persons”.[22] Thus, if property rights are ill-defined, there is every incentive for profit-seeking business agents to exploit the environment. They face a dilemma, for good behaviour on their part is most unlikely to be reciprocated. Of course, under certain circumstances it may be in the interests of these same agents to combine together to discipline themselves. Indeed, they are doing so more frequently these days. The fact that they do so to ward off excessive regulation is by no means an ignoble motivation; it is merely a rational response to the dilemmas of social life.

The appropriate legal environment is especially important for the securities market where the opportunities and temptations for fraud are obvious. It is also an area in which the asymmetry of knowledge between the professionals and their clients is likely to be significant. But what is required here are transparent rules which are predictable in their effects and easily understood by participants. They should not be overly complex or designed to create equality or ‘level playing fields’ – conditions which, if enforced, are bound to coagulate the flow of information on which coordination depends. Furthermore, attempts via the judicial system to protect investors against loss, as we see in the United States, should be resisted. The securities market is risky and failure to provide an expected return is not a moral error on the part of financial intermediaries. Success cannot be guaranteed but crime and immorality can be avoided.

In fact, if we compare the Anglo-American economies with their rivals in meeting the requirements of the generic moral code, their performance is not at all reprehensible. They are open economies whose moral rules make few discriminations deriving from race, religion or, these days, even gender. Furthermore, details of Anglo-American public companies are much more available to investors than information about, say, German companies, which have to adjust to much more rigorous disclosure rules to satisfy American law when their shares are traded in New York. The reason why scandals have been much more venal in, for example, Japan is that moral behaviour there is more clearly linked to the group and the small community. Indeed, corporations in Japan are almost impenetrable to outsiders. Outsiders are not given much protection by these ruthlessly utilitarian customs and practices. Stockholders are treated extraordinarily badly by managements, and it is no surprise that scandals involving gangsters have afflicted at least one eminent brokerage house.

The second instance of moral pressure on Anglo-American business is, if anything, even more controversial. Business is now expected to perform supererogatory duties, ie those which are not morally compelling, as the obligations of generic morality and minimalist justice are, though these new responsibilities are often prescribed in the form of strict duties. We have already come across them in the analysis of the social responsibility of the corporation, but it is instructive to recall the relevant historical and philosophical background.

It is often claimed that business is in receipt of certain privileges granted by the state and positive law. The company has certain features which enable it to function effectively. They are perpetual life, the collective form (it can sue and be sued as an artificial person) and, most importantly, limited liability (especially for torts). It is argued that these ‘privileges’ would not have emerged spontaneously out of common law and conventional morality. These legal features, it is now claimed, put the company in a special position, and it should therefore be subject to a special morality. However, this is historically inaccurate. The corporation did emerge spontaneously and its so-called privileges were a result of contract. Indeed, no creditor is obliged to deal with organisations that protect themselves in these familiar ways.

What we are witnessing is a retreat from the individualistic foundations of the corporation. This is graphically illustrated in the tendency for corporations to be collectively liable for criminal wrongs, such as manslaughter and other offences which were hitherto thought to be purely individual acts requiring a mens rea.

Similarly, there is no analytical basis for the claim that the corporation ought to perform supererogatory duties in return for the alleged privileges that society has bestowed on it. These duties are often written of as if they constituted actions of strict obligation (like telling the truth and keeping promises). But the modern business corporation is quite different from those corporations created in the mists of history by the Crown, which were in receipt of special privileges and subject to appropriate duties. There is no need for the statutory interventions in the United Kingdom on which the modern business corporation is based. Analytically, since the rights of the corporation are reducible to the rights of individuals, the same follows mutatis mutandis for its duties. If this is the case, the business enterprise ought to be subject to no higher morality than that to which private persons are answerable. The fact that there is little agreement about what the higher duties are indicates that they really are optional and hence should be voluntarily undertaken by the owners and not dictated by moral philosophers or legislators. The owners who behave virtuously would then be entitled to the normal moral praise that is earned by those who so act.

It may be the case that in other cultures business organisations are expected to take on a different role and not confine themselves to maximising returns to owners, providing employment and producing goods at cheap prices. But any activity that goes beyond this is only feasible in communities characterised by unusual levels of cohesion and common purposes. In the pluralistic societies of the English-speaking world such activity is likely to develop into rent-seeking by organised groups, and the business world would then become a pale reflection of the political world. It would be a serious mistake to transplant a business culture into a community which may be sociologically and ethically quite inappropriate for it. The loss of efficiency and freedom that would result would be incalculable.

Notes

[1] Mandeville, B, The Fable of the Bees, Kaye, F B (ed), Oxford, Clarendon Press, 1924, p. 24. First published 1705.

[2] Smith, Adam, The Theory of Moral Sentiments, Raphael, D D and Macfie, A (eds), Oxford, Clarendon Press, 1976. First published 1759.

[3] See Fukuyama, F, Trust: The Social Virtues and the Creation of Prosperity, London, Hamish Hamilton, 1995.

[4] Epstein, R, Simple Rules for a Complex World, Cambridge, Mass., Harvard University Press, 1995, p. 75.

[5] Hume, D, A Treatise of Human Nature, Aiken, H (ed), New York, Macmillan, 1948, Book 111, pp. 61–62. First published 1737.

[6] This point derives from a nineteenth century essay by Bastiat, F, 'What is Seen and What is Not Seen', which is discussed in Boaz, D, Libertarianism: A Primer, New York, Free Press, 1997, pp. 182–84.

[7] Friedman, M, 'The Social Responsibility of Business is to Increase its Profits', in Beauchamp, T and Bowie, N (eds), Ethical Theory and Business, Englewood Cliffs, New Jersey, Prentice Hall, 1988, pp. 55–60.

[8] For an erroneous view of corporate ownership, see Griffiths, M and Lucas, J, Ethical Economics, London, Macmillan, 1996.

[9] Manne, H, The Modern Corporation and Social Responsibility, Washington, DC, American Enterprise Institute, 1972, p. 29.

[10] The stakeholder idea has been popularised in Britain with the publication of Will Hutton's somewhat naive critique of Anglo-American capitalism, The State We're In, London, Jonathan Cape, 1995.

[11] Anglo-American economics relies largely on the efficient markets hypothesis, ie the theory that the stock market is the most reliable guide to the effective allocation of capital.

[12] Evan, W and Freeman, R, 'A Stakeholder Theory of the Modern Corporation', in Beauchamp and Bowie, op. cit., p. 82.

[13] ibid., p. 82.

[14] ibid., p. 83.

[15] See Jensen, M, 'Takeovers: Their Causes and Consequences', Journal of Economic Perspectives, vol 2, no 1, 1988, pp. 21–48.

[16] For a brief account of the phenomenon of junk bonds, see Barry, N, The Morality of Business Enterprise, Aberdeen University Press, for the David Hume Institute, 1991, pp. 77–80.

[17] For a description of poison pills, see Ruback, R, 'An Overview of Takeover Defenses', in

Auerbach, A (ed), Mergers and Acquisitions, Chicago, University of Chicago Press, 1988, pp. 42–44.

[18] See Ricketts, M, 'Kirzner's Theory of Entrepreneurship', in Caldwell, B and Bohm, S (eds), Austrian Economics: Tensions and New Directions, London, Kluwer, 1994, pp. 80–81.

[19] For an account of the varieties of post-war German liberalism, see Barry, N, 'The Social Market Economy', Social Philosophy and Policy, vol 10, 1993, pp. 1–25.

[20] Erhard, L, Prosperity Through Competition, London, Thames and Hudson, 1958, p. 102.

[21] Röpke, W, The Social Crisis of Our Time, Edinburgh, Hodge, 1950, p. 119.

[22] Hume, D, A Treatise of Human Nature, vol 111, p. 220.