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Corporations need to look beyond profits[*]

by
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'In theory, there is no difference between theory and practice. In practice, there is.' This adage is useful in assessing Lilac Nachum's *Columbia FDI Perspective*.[1] She suggests that society is best served when companies focus on maximizing profits rather than on their social and environmental impacts. In this regard, Nachum echoes Milton Friedman's famous and controversial 1970 position.[2] This may be good theory, but it is bad practice. The real world is too far from the idealized world of Friedman and Nachum to let companies off the hook.

Nachum argues that, so long as corporations obey the law in good faith, they produce the most social benefit by maximizing profits and bringing goods and services to the market. This argument works under strong theoretical assumptions, mainly that market prices provide accurate signals of social costs and benefits. This is true only when markets are perfectly competitive, negative externalities and information asymmetries are absent and governments are efficiently providing public goods.

In practice, market prices pervasively diverge from true social costs and benefits. Market power is widespread, and firms exercise considerable control over their product prices. Negative externalities are rarely addressed through corrective taxation, regulation or direct negotiation. Governments chronically underprovide public goods. And many enterprises flout the law, knowing that resulting fines will be dwarfed by ill-gotten profits.

To correct inefficiencies, governments must intervene. But many corporations employ their formidable resources to drive legislation and block or roll back responsible regulation. In 2016, special interests spent US$3.15 billion to employ 11,166 lobbyists in the US.[3] This is not the work of a few corporations; it is near-universal practice among large firms trying to influence the law for private benefit. When disasters strike, stories of special interest lobbying and deregulation are rarely far behind.[4]

Even in a world of governments scrupulously correcting market failures, corporate profits could still be mal-distributed because of control failures within the firm itself. Nachum implies that profit-maximization enables corporations to contribute to society through shareholder wealth, taxes, jobs, and innovation. In reality, greater profits often lead to exorbitant executive pay[5] (at the shareholders' expense)—even for CEOs dismissed for malfeasance[6]— as well as further efforts to avoid and evade taxation.[7]

Given the above, we propose the following standards:

- Companies should not aim to profit from negative externalities. Governments should induce firms to internalize externalities through corrective pricing or regulation, but the absence of government action or international regulation does not absolve firms of the responsibility to avert harms on others.
- Corporate law should ensure that directors' duties reflect a responsibility to minimize harm to the environment and to society, including through observance of workers' rights and environmental, health and human rights standards.
- Firms should refrain from lobbying for the narrow interests of the firm or sector, and legislation should restrict undue corporate influence on public policy. Governments should pursue the public good rather than narrow corporate interests.
- Investors should engage in environment, social and governance (ESG) investing, holding companies to account through shareholder engagement (such as the recent ExxonMobil shareholder resolution[8]) or by divesting from companies that do not pass ESG-filters.

Nachum is right that firms are evaluated based on their contribution to society. So, business leaders should consider why large companies have lost the public's trust. Firms need to stop self-interested lobbying, polluting, cheating, and feathering their own nests, to the detriment of the public and the firms' own shareholders. We need social responsibility throughout society, including in corporate boardrooms and C-suites.

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[1] "How much social responsibility should firms assume and of which kind? Firms, governments and NGOs as alternative providers of social services," *Columbia FDI Perspectives*, No. 207, August 28, 2017.

[2] Milton Friedman, "The social responsibility of business is to increase its profits," *The New York Times Magazine*, September 13, 1970.

[3] "Lobbying database," *The Center for Responsive Politics*, https://www.opensecrets.org/lobby/index.php.

[4] Juliet Eilperin and Scott Higham, "How the minerals management service's partnership with industry led to failure," *Washington Post*, August 24, 2010; Deniz Igan and Prachi Mishra, "Three's company: Wall Street, Capitol Hill, and K Street," *Vox Centre for Economic Policy Research*, August 11, 2011.

[5] "Executive paywatch," *AFL-CIO*, https://aflcio.org/paywatch. In 2016, CEOs of S&P 500 Index companies made an average of US$13.1 million—347 times that of the average US rank-and-file worker.
[6] Fox News paid US$65 million to executives dismissed following sexual harassment claims; http://www.newsweek.com/fox-news-payouts-rise-85-million-over-sexual-harassment-claims-587361.
[7] Frank Clemente, Hunter Blair and Nick Trokel, "Corporate tax chartbook: how corporations rig the rules to dodge the taxes they owe," *Americans for Tax Fairness*, September 16, 2016.
[8] Gary McWilliams, "Exxon shareholders approve climate impact report in win for activists," *Reuters*, May 31, 2017.

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