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FIRM, MARKET ECONOMY AND
SOCIAL RESPONSIBILITY

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Abstract

In January 2005, *The Economist* published a survey on corporate social responsibility (CSR), joining a long-running debate on the meaning and need for CSR in a market economy. The British weekly's thesis, widely accepted among economists, was first stated years ago by Milton Friedman (1962): a firm that maximizes its profits while acting within the law and the ethical rules that are intrinsic to a market economy is fulfilling all of its social and moral responsibilities and need not abide by any other type of constraint or demand. However, this thesis is disputed by many other authors.

This article seeks to answer the question of whether there is a role for CSR in the economic paradigm. Obviously, it does not pretend to give a final answer but simply to set forth the reasons that will enable each person to arrive at his or her own answer. The first part discusses the economic arguments about maximizing value for the owner and society and viewing the firm as a nexus of contracts. The second part discusses the different arguments about the possible role of CSR in the economic paradigm. The article ends with the conclusions.

Keywords: Contracts, Corporate social responsibility, Efficiency, Ethics, Value maximization

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Introduction[1]

In January 2005, *The Economist* published a survey on corporate social responsibility (CSR), joining a long-running debate on the meaning and need for CSR in a market economy. The British weekly's thesis, widely accepted among economists,[2] was first stated years ago by Milton Friedman (1962):[3] a firm that maximizes its profits while acting within the law and the ethical rules that are intrinsic to a market economy is fulfilling all of its social and moral responsibilities and need not abide by any other type of constraint or demand. However, this thesis is disputed by many other authors.

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The purpose of the firm in the economic paradigm

Maximizing value for the owner

In the theory of the firm, it is common to start with the hypothesis that the firm acts "as if" its managers' goal were to maximize profits (or the firm's value for the owner)[4] (Friedman 1953). We may accept or reject that hypothesis as a description of the way firms behave, but what interests us here is its normative content, i.e. the argument that firms *must* always act that way. Why, for example, does Friedman say (1962, p. 133) that "there is one

[1] This paper is part of the research work of IESE's Ethics and Economics Chair. I would like to thank the Fundación José y Ana Royo for its financial support and Professors S. Ramakrishna Velamuri, Joan Enric Ricart and Nuria Mas for their input. This subject has been discussed previously in Argandoña (2003b). A simplified version of this paper is forthcoming in *Papeles de Economía Española* under the title "Economía de mercado y responsabilidad social de la empresa" (Market economy and corporate social responsibility).
[2] Two excellent examples are Henderson (2001) and Sternberg (1994).
[3] His best known article on the subject is Friedman (1970).
[4] From now on, when we talk about maximizing value, we mean maximizing value for the owner or shareholder, unless specified otherwise (for example, maximizing social value).

and only one responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud”?[5]

The answer to this question is to be found in a feature of human behavior that is basic to the economic paradigm:[6] the “economic principle” (Mises 1949) or efficiency principle, which says that human beings always try to obtain the best results with the scarce resources available – or minimize the resources used to achieve a desired goal. This principle is based on the conception of the economic agent as an evaluating, maximizing, resourceful person[7] and is one that we can accept, at least as a significant component of human behavior.[8]

The same applies to economic institutions and organizations, both those created as spontaneous orders (such as the market) and those created by human design (such as companies): it is assumed that they all pursue maximum efficiency, measured as the difference (or quotient) between the results achieved and the opportunity cost of the resources used. This is why it is said that the social function of economic institutions and organizations such as the market and the firm is to create wealth – or rather, the greatest possible creation of wealth given prevailing constraints (for example, available resources and information and the economic agents’ preferences): in other words, maximum efficiency.

How is this achieved? Economics shows that, in general equilibrium and under certain conditions, maximum efficiency (a Pareto optimum) is obtained when firms maximize their profits,[9] or rather, when managers maximize the value of capital for the owners (the value of the stock in the case of a public corporation).[10] Hence the conclusion that firms *must* maximize this value: being economic institutions, it is their only responsibility because, by abiding by it, they are optimizing their contribution to society. And any other responsibility that prevents them from maximizing value will be undesirable.[11]

[5] Other classic references are Arrow (1973) and Hayek (1960). There exists an obvious relationship between what is said in the text and the definition of economics as the science that addresses that aspect of conduct that arises from the scarcity of means to achieve given ends (Robbins 1932, p. 24).

[6] Obviously, there is not “one” economic paradigm but many. The paradigm presented here is that of “neoclassical economics” and is that which best aligns with Friedman’s thesis mentioned previously – and, of course, does not give due justice to other proposals. The Austrian alternative is particularly worth mentioning; see Huerta de Soto (1999). See Sison (1995) for an excellent discussion of these subjects.

[7] This is the REMM model (*resourceful, evaluating, maximizing man*) described in Brunner & Meckling (1977) and Meckling (1976). This paper will not enter into any discussion of this anthropological principle, which would take us too far from our purpose.

[8] I say “in principle”, because the anthropological assumptions on which this theory is based have been the subject of considerable argument. It can also be viewed as a requirement of rationality: “To the classical economists, rationality (a term they never used) meant preferring more to less, choosing the highest rate of return, minimizing unit costs and, above all, pursuing one’s self interest without explicit regard to the welfare of others” (Blaug 1980, p. 229; cf. Gómez Biscarri 2000).

[9] See Winch (1971) for a demonstration and discussion of these conditions; the classic reference is Arrow (1968). The thesis that maximizing shareholder value is also an ethical mandate (Primeaux and Stieber 1994) is based on this argument.

[10] This applies in an environment with uncertainty, when decision-making in the firm is separate from ownership, the capital stock is endogenous and the decision is part of an intertemporal process. Cf., for example, Mossin (1977).

[11] The first theorem of welfare economics, which shows that a competitive equilibrium is a Pareto optimum (Arrow 1968), is equivalent to introducing the “invisible hand” in the process (Arrow and Hahn 1971, Hahn 1973). Using this theory, as any resource distribution can lead to a Pareto optimum, a “division of labor” can be performed between the efficiency criterion (guaranteed by the conditions of the competitive equilibrium) and the fairness criterion (by varying the initial distribution of resources, so that the optimum is obtained with the desired income distribution). This solves the problem (at least, in theory) of fairness in distribution. Cf. Hausman (2003).

The conditions that must be met for value maximization to achieve the optimum are, basically, the existence of perfect competition in all markets (the goods and factors are identical in each market; there is free exchange, free entry and exit; buyers and sellers have perfect information about the price and about the features and availability of goods and factors; and neither buyers nor sellers can influence the price), and the absence of public goods and external effects (so that prices fully reflect all the costs and social benefits).[12]

Of course, these conditions are never met, but the results may be corrected by regulations that reduce market power, increase available information, eliminate entry and exit barriers, provide public goods, correct external effects, etc. – regulations that, at least in theory, may come close to the optimum obtained in competitive conditions. In any case, even if the conditions for an optimum are not met due to imperfections in the regulations, there is no reason to believe that the instruments of CSR (which replace public regulations by private agreements, voluntary codes of conduct, supervision by non-governmental organizations, etc.) will improve the social outcome.

Friedman's thesis, therefore, is not arbitrary. In short, it is equal to saying that the firm's purpose, as an economic institution, is to contribute to the system's maximum efficiency and this is attained when the difference between the value generated by the firm and the opportunity cost of the resources used by the firm is maximal – and this difference, under certain conditions, is the profit generated for the capital's owner.[13]

Maximizing social value

What the conditions for the competitive optimum imply, in short, is that it is necessary to maximize the "social value" (Jensen 2001), which will be given by the difference between the (subjective) *value* that consumers attribute to the product or service produced and the *opportunity cost* of producing it, when the value includes all the (net) positive features for society and the cost includes all the opportunity costs incurred by society (Salas 2004). In other words, the maximum social value will match (approximately) the maximization of the consumer's and producer's surpluses in all the goods, services and resources markets, irrespective of who appropriates these surpluses.

The consumer's surplus is maximized when, given the consumer's preferences and the product's price, the utility obtained from each unit consumed is maximal. And the producer's surplus is maximized when, given the technology available and the prices of the product and the factors, the production costs for society are minimal. However, maximizing value requires appropriating at least part of both surpluses and this may entail non-optimization of social value. Without aiming to cover all the possible cases, let us see how this can happen in four specific situations.

The first case consists of appropriation of the consumer's surplus by the firm producing the good or service. This appropriation is maximal with perfect price discrimination. However, this is only possible under monopoly conditions – with partial appropriation in conditions of imperfect competition. Any limitation in competition implies a reduction in the quantity supplied in order to increase the price (except in the case of "perfect discrimination"), and this reduces the consumer's surplus, which takes us away from the optimum. Therefore, maximizing value may not be compatible with the social optimum. Hence the perfect competition condition we stated earlier.

[12] In short, these are not conditions imposed on the firm but on the market, which must be the mechanism (the "invisible hand": Smith 1776) coordinating the decisions implemented by firms.
[13] It is not necessary for the firm to know exactly the value it creates. It is sufficient to offer the right incentives so that the firm's managers and employees always seek to maximize value in their actions (Jensen 2001).

The second case is parallel to the first case but now the producer's surplus is appropriated by the seller. Total appropriation is only possible in monopsony conditions in factor markets with price discrimination – with partial appropriation in conditions of imperfect competition in these markets. However, this implies limiting the demand for factors to reduce their price, which, again, is incompatible with the social optimum. Again, this case invokes the condition of perfect competition in all markets.

The third case refers to the generation of the producer's surplus when there are (positive or negative) external effects in production, so that the producer does not bear all the costs (or receive all the benefits) associated with her action but instead passes on part of her costs (or benefits) to third parties not directly involved in the operation, such as the environment (pollution), the local community (traffic congestion, employee training) or society in general (spillover effects of the company's research activities). In addition, this result may be enhanced by the incentives created in the process of the firm's appropriation of the producer's surplus (for example, incentives to offload pollution onto the environment or to not carry out research that would be socially optimal). In short, this explains why social and private costs must be identical in order for value maximization to lead to maximum efficiency.

The fourth case addresses complex forms of cooperation between production factors (and between firms) to create capacities within the firm that enable maximization of the consumer's and producer's surpluses. In conventional economics, the existence of perfect information eliminated any competitive advantage, so that any product could be replaced perfectly by others in competitive conditions and all factors were remunerated in accordance with their contribution to production (the value of their marginal product).

However, if we drop the perfect knowledge assumption, the possibility of generating innovations that contribute social value (in the form of increased value for the consumer or lower cost for the producer) leads to cooperation among production factors that invest in specific assets (physical, human or organizational), forming teams whose members may include customers, suppliers, employees, managers, investors, etc. This enables optimization of value creation and cost reduction (obtaining competitive advantages) but raises new problems: appropriation of the quasi-rents generated, risk management and decision-making within the firm.

Let us suppose, for example, that an employee or manager has accumulated specific human capital (for example, knowledge of the firm's internal processes, its customers' preferences, in-house technology, etc.). This increases the firm's return because it increases the consumer's surplus (the consumer is willing to pay more for the goods) or the producer's surplus (because costs are reduced or productivity is increased). Consequently, this human capital generates quasi-rents whose amount will be governed, in static terms, by the difference between the value of the employee's marginal productivity and the wage he could command in an alternative occupation.[14]

The example of the employee investing in specific human capital is readily generalizable. The firm also accumulates specific physical capital, whose return would be substantially less if it were to be used to produce other goods, in another location, or using some other technology or organizational form. Suppliers also develop human, physical and organizational capital whose return would be less if it were to be used outside of the relationship with the firm[15] – and much the same may be true of customers. Even investors

[14] And other lesser items, such as the costs of severance payments and the costs of searching and training a new employee for the firm, and the costs of changing job for the employee.
[15] The extreme case could be that of a supplier that provides a specific, differentiated product or service to a single customer.

may develop specific capital if they use their knowledge of the firm to compare its value creation capacity with that of other investment options.[16]

And both the firm and the other stakeholders will have incentives to appropriate the quasi-rents that have been created in this manner. In the example of the employee who acquired specific human capital, the firm may offer him the lowest wage required to prevent him from leaving to join another firm and continue accumulating specific capital, while the employee may demand the highest wage that enables him to keep his job without being dismissed and being replaced by another employee.[17] What effects will this conflict have on the creation of social value and, therefore, on the thesis that maximizing value maximizes social value? The answer has been sought in the theory of the firm as a nexus of contracts.[18]

The firm as a nexus of contracts

If a firm is to be managed so as to maximize value for its owners, does that mean that the owners receive preferential treatment? The answer given by economics is no: the goal is to obtain maximum economic efficiency and this is the way to do it. In any case, the other stakeholders are protected by contracts signed with the firm, as employees, lenders, suppliers, customers, etc., including implicit contracts, such as those that bind the firm to the local community or society in general. And, again, observance of the law that regulates contracts is a necessary condition for maximizing efficiency.[19]

The existence of contracts must simultaneously solve 1) the problem of decision-making (who decides what must be done to maximize value) and the resulting control or monitoring by stakeholders (the problem of "corporate governance"), 2) the problem of distributing the value produced, and 3) the problem of risk management by all the stakeholders (Boatright 2002, Bradley et al. 1999, Masten 1988).

According to the contractual theory of the firm, the owners contract with the (internal and external) stakeholders the terms on which they will contribute to the production of goods and services in the firm, in return for a pre-established remuneration. This solves the problem of distributing the value of the output: if the contracts are voluntary and free, each contractual stakeholder receives the share that has been agreed, while the non-contractual stakeholders also receive a pre-established share (for example, the State collects taxes) and the owners receive the residue (Rappaport 1998).[20] The same applies to ordinary risks: the contractual stakeholders receive their risk-free remuneration, while all the residual risk is borne by the owners. If the owners accept the profit and the residual risk, then they are responsible to the other stakeholders, through market or internal control mechanisms (Easterbrook and Fischel 1991, Jensen 2001), for decision-making (which they will delegate to managers, through an agency agreement)[21] and monitoring.

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[16] Jensen (2001) points out that investors must learn how to value the firm's intangible assets.

[17] This subject has also been discussed in finance theory (cf. Rajan and Zingales 2003). The problem is more general, because all those who take part in production will want to appropriate all rents that may be generated, including those of location, market power, specialization, etc.

[18] For an excellent discussion, see Arruñada (1998).

[19] This is simply a consequence of the theorem that when value for the owner is maximized, value for all the owners of rights on the firm is also maximized (Fama and Miller 1972). This also requires perfect contracts and perfect financial markets (in addition to competition, absence of external effects, etc.).

[20] Fulfillment of the contract is essential, as, if the owners try to maximize the residue, they will want to minimize payments to the stakeholders.

[21] The problems entailed by this agency contract are well-known but not relevant to the argument proposed here.

However, the answer is not so simple when there are incomplete contracts (due to information asymmetries, fraud, etc., that the law cannot prevent), when there are external effects (i.e. when the contracts affect stakeholders who are not party to the contractual relationship) (Bradley et al. 1999), or when investments are made in specific (human, physical or financial) capital,[22] as the distribution of the quasi-rents will have effects on the parties involved (Brickley et al. 2000).

Indeed, in a team, each member's contribution to the overall result can only be determined by considering the performance of the team as a whole: it is not possible to remunerate each member in accordance with the value of her marginal productivity because that marginal productivity is not independent of that of the other members, of the entire team or of the firm as a whole. Therefore, the contract must maintain the incentive to cooperate, so that value is maximized and the stakeholders' interests are not harmed.

On the other hand, all those who provide specific capital, regardless of its nature, run a risk that cannot always be diversified (by, for example, transferring it to the owners of the firm's capital), because they have all made specific investments that lose value outside of the firm and, as we have seen, may be appropriated by other stakeholders (Kaufman et al. 2003).

In any case, the contracts must be complete, in the sense that all the parties affected by the firm's decisions are included in the network of contracts that constitutes the firm. And this condition may not be met in at least two senses: first, when the non-contractual stakeholders bear part of the external costs (and profits) (for example, due to pollution caused by the firm) and bear a risk on their assets, and, second, when there are parties who are not represented in these contracts (for example, future generations). This again argues in favor of a role for laws and regulations.

In short, the thesis that making decision and monitoring the execution of such decisions are the responsibility of the owners of capital is based on the assumption that there is an optimal contract structure that minimizes transaction costs, settles internal conflicts regarding the distribution of quasi-rents and is compatible with optimization of social value (Gibbons 2004).[23] However, it is impossible to distribute the quasi-rents a priori, before the provision of specific capital, because this generates free-rider behaviors. Neither can it be left for a negotiation a posteriori, when production has already been carried out, because this favors continuous reopening of the battle for the distribution of the quasi-rents. And, of course, it does not take into account the interests of those not included in the contracts, unless they are protected by law.

A number of solutions have been proposed for this problem. One of them is to create corporate governance mechanisms with the participation of all those affected by the problem (at least those who provide specific human or physical capital, and extracontractual stakeholders affected, for example, by externalities). This contradicts the thesis that monitoring should be performed by the owners with the sole goal of maximizing value for them.[24]

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[22] The "specific assets" addressed by these investments may be very varied, depending on the type of specificity: location, physical, human capital, "dedicated" assets, "co-specialized" assets, etc. Cf. Arruñada (1998), chap. 4, for a study of these assets within the firm, and chap. 5 for the relationships with customers and suppliers.

[23] Gibbons (2004) points out that the contract structure may settle disputes about the physical (disposable) capital, but not about the human capital or about the incentives for contractors outside of the firm (mainly suppliers and customers), because they possess specific assets whose value is modified by the firm's decisions and this value cannot be protected in a contract. Furthermore, (vertical) integration of these contractors outside of the firm does not solve the problem of the pursuit of quasi-rents, because the problems of "haggling/politics are inescapable problems in any governance structure" (Gibbson 2004, p. 35).

[24] This is the solution given by Freeman and Evan (1990) and Kaufman et al. (2003); cf. Argandoña (2003a).

Another solution, proposed by Jensen (2001), is to broaden the maximization of value to include not only the value captured by the owners of capital but also all of the firm's financial rights, including those of lenders, investors, etc. However, this only solves the problem for those who provide financing, not for the owners of specific human capital nor (necessarily) for outside suppliers and customers.

It should also be borne in mind that formal contracts are not the only possible way of addressing relationships within the firm and between the firm and its environment, which raises the possibility of "relational contracts" (Baker et al. 2002). These are informal agreements between parties, who undertake to abide by them (they are self-enforceable) due to the high cost that non-performance will have for their future relations, even though the agreements could not be enforced, for example, before a court. There are many relationships of this type, both within firms and with other stakeholders: unwritten codes of conduct, implicit agreements between managers and employees, informal relationships between suppliers and customers, or between companies operating in the same industry, etc. And all of them are based, in one way or another, on trust because they address the prospect of a long-term relationship, in which decisions made in the present affect the future (for example, by changing the incentives to invest in specific assets). In other words, they presuppose the existence of ethics.

Is there a role for corporate social responsibility?

If the above discussion adequately addresses the strengths and weaknesses of the economic paradigm, can there be a role for CSR? The discussion on this subject is complicated by the absence of any precise definition of CSR and, in particular, by the existence of very different positions, based on different conceptions of what can be expected from the firm and from its role in society.

As a provisional starting point, I shall take a couple of broad and quite similar definitions of CSR. The first is given by the European Commission (2001, p. 7): "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". The second is given by David Vogel (2004, p. 3): "policies and programs of private firms that go beyond legal requirements as a response to public pressures and societal expectations". As we shall see in the course of this discussion, this "voluntary integration" and these "policies and programs", also voluntary, constitute an ethical requirement that must be fulfilled by the firm, beyond the "social and environmental concerns" and the "pressures and expectations of society".

Social responsibility and the goal of the firm

As we have already said, the purpose of the firm is efficiency. But should economic institutions be governed solely by the efficiency criterion or are there other dimensions that are also important? The production and sale of goods and services with economic efficiency is, without doubt, an extremely important social function of the firm, but is it its only purpose?

The answer is probably no. From the viewpoint of positive science, it cannot be said that there are institutions that are purely economic but rather that there are institutions or organizations with economic, political, or ethical dimensions.[25] Thus, the firm is not only

[25] Cf. Pérez López (1993). This is the "holistic" approach suggested by Freeman and McVea (2001).

an economic institution but also a sociological, cultural, political and ethical institution, encompassed within a variety of disciplines, with different approaches and models, in terms of efficiency, but also in terms of power, conflict, legitimacy, social demands, meaning, culture,… (Lozano 2000).

Viewed in this light, CSR could be seen as a reminder, on a normative level, of the existence of these other dimensions, which must also be present in the firm:[26] for example, respect for its employees' dignity, solving conflicts within the firm and with its environment, etc. To an extent, it could be said that these are demands placed upon the firm as a human organization, even before we consider it as an economic organization focused on achieving maximum efficiency. In synthesis, the above considerations take us towards a concept of CSR that overlaps with that of ethics, connecting with Friedman's thesis mentioned at the beginning.[27]

In any case, this criterion would not be applicable to the versions of CSR which stress its voluntary nature, which would only be acceptable if the firm's managers have its owners' explicit or implicit authorization to carry them out, in accordance with criteria other than that of efficiency.[28]

Social responsibility and efficiency

The argument we have just presented can be formulated in an alternative manner with respect to the efficiency concept, that is, that condition that characterizes the firm as an economic institution and which legitimizes its social function. In the economic paradigm, efficiency in the firm is defined and measured in terms of the income statement, that is, including only what appears in present and future inflows and outflows (ends and means), measured in monetary terms or convertible to them.

And this would be the appropriate measure if they were the only relevant factors, that is, if there were no other ends different from those which can be evaluated in terms of the firm's income and no other means except those whose costs are included in the calculation of the firm's net earnings. That is, if it was not necessary to take into account aspects that cannot be measured in money terms, such as the agents' acquisition of attitudes and values, or their moral deterioration[29] (Argandoña 2003b).[30]

From this viewpoint, the role of CSR could be as a reminder of the existence of other ends and other means, of other "revenues" and other "costs", including, for example,

[26] This is the conception of business "in" society developed by Lozano (2004).
[27] For a brief review of the different ethical theories of CSR, see Garriga and Melé (2004).
[28] Avi-Yonah (2005) points out that there is a conception of the firm, which he calls "real" and considers to be dominant, under which managers would be authorized by the company, and often by its owners too, to carry out this type of voluntary CSR activities, even when they are incompatible with maximizing value.
[29] As Illanes explains (1994, p. 31), "efficiency is a quality that people talk about when the question is 'what is it useful for' or 'what is it valid for', that is, when we place ourselves in the context of the connection or relationship between means and ends. Hence the complexity of any efficiency statement, and, above all, of any efficiency statement that goes beyond the technical level in its strict or restricted sense, that is, it does not confine itself to indicating the capacity of a certain means to produce a certain end (...). For this reason, a discourse which is conducted in terms of efficiency is an incomplete discourse, suspended in a vacuum; or, in other cases, a discourse that does not make explicit its implicit elements because it presupposes a certain end, even though sometimes it does not clearly state this".
[30] Another problem, which I will not dwell on here, is that efficiency is defined in terms of a Pareto optimum, that is, a situation in which no-one can improve his welfare without diminishing another person's welfare. However, the Pareto optimum is not neutral from an ethical viewpoint. Cf. Argandoña (1998), Buchanan (1985), Hamlin (1986), Sen (1979).

changes in the preferences function induced by human decisions (Argandoña 2005) or the external (environmental, for example, but also moral) effects of decisions. To put it more bluntly: maximizing efficiency would indeed be an absolute optimum if it was possible to take into account all the –positive or negative– economic, political, social and moral effects on the agent who decides and on all of the other agents (present or future) over an unlimited time frame. However, this is not possible – among other reasons, because man is a free being. So we need rules, criteria and values, a moral framework to guide people in their actions. And this is the role of ethics.[31] So, CSR is once again identified with ethics.

Social responsibility and profits

The simplest instance of the acceptance of CSR would be that in which the firm exercises its social responsibility through the performance of actions that favor or, at least, do not prevent maximization of value for the owners (Avi-Yonah 2005, Mitchell et al. 1997, Odgen and Watson 1999) – which Jensen (2001) calls "enlightened" value creation.[32] This can happen, for example, when consumers are willing to pay a higher price because they perceive greater value in the goods and services obtained (for example, because the company protects the environment above and beyond what is required by law, or because it applies fair trade rules in its supplies), or when costs are reduced as a consequence of CSR actions (for example, because employees work harder or because regulation costs are decreased through the firm's self-regulation in environmental issues).

However, if firms seek to maximize value in their actions, and CSR is a party to this outcome, then CSR adds nothing of significance – unless it is interpreted as a means (among others) for identifying business opportunities, which implies ceasing to consider it as an exercise in social responsibility.[33] Of course, CSR can contribute to reducing costs or maximizing value, but this cannot be stated as a general rule.

Furthermore, it is questionable to argue that firms with CSR maximize value just as well as other firms, or even better than them. In actual fact, there are all manner of combinations along a continuum between efficiency and responsibility; empirical results are not and never can be conclusive, and it is impossible to establish what is cause and what is effect.[34] In addition, if all firms were socially responsible, the benefits (in terms of product differentiation, for example, or lower production costs) that each would obtain from its socially responsible actions would disappear (Vogel 2004).[35]

Social responsibility and the conditions for a competitive optimum

According to the arguments put forward by economists, if the conditions for a competitive optimum are met, there is no place for CSR. And if these conditions are not met, the creation of a legal and regulatory framework may guarantee achievement of those

[31] This is why Argandoña (1989) states that ethics is the condition of equilibrium of all human systems. See also Huerta de Soto (1999) and his discussion of the role of ethics as a coordinator of decisions.

[32] Garriga and Melé (2004) include this conception among the instrumental theories of CSR, while Lozano (2004) includes it among the reactive theories.

[33] This leads Chandler (2003, p. 33) to describe this way of advocating CSR as "unreal and amoral".

[34] Margolis and Walsh (2003) give an excellent summary of the attempts to find a relation between CSR and profits, and of the methodological and practical problems raised by these attempts.

[35] Which leads some to suspect that companies' insistence on promoting CSR may have other goals, such as blocking the entry of competitors or avoiding regulation (*The Economist* 2005). When CSR becomes a social norm, free-riding is privately beneficial for free-riders, even though they may be socially harmful.

optimal results. And if this framework is sufficient, CSR will be unnecessary.[36] But if this is not so, then there is a role for CSR. For example, legislation is usually reactive (it addresses problems after they have appeared), while CSR can be proactive; the law is usually incomplete, because it does not consider all of the relevant details which CSR can take into account; regulation may give rise to problems, such as that of "capturing the regulator", which CSR can avoid; etc. This leads us to view CSR as an exercise in the firm's ethical responsibility, that is, as a moral duty.

Consequently, CSR may be seen as a substitute for or a complement to legislation and regulation, even though it may be incompatible with maximizing value for the owners (Avi-Yonah 2005), provided that this takes us to a situation that is closer to maximizing social value.[37] In such cases, CSR would enable us to compensate for the lack of competition in the markets (for example, by paying above equilibrium wages in a job market in which the firm has monopsonistic powers), internalize external effects (by reducing pollution, improving product safety, etc.) or provide public goods by private means (by means of philanthropic actions).[38]

However, this proposal is not without problems. The first is that of incentives: why should a firm implement CSR criteria when this goes against the goal of maximizing value? In this case, it would be necessary to invoke ethics as a mandatory internal force, perhaps accompanied by the coercive role of social norms.

There is another problem in this approach to the legitimacy of CSR: are firms better positioned than the legislator to determine the causes of deviations from the optimum and do they have the necessary means to correct such deviations? In principle, CSR is less effective and less efficient than regulation (Vogel 2004) because the firm does not always have the means for analysis, it does not have the global vision that is necessary when making decisions that affect society as a whole, and it cannot easily counteract the opportunistic behaviors (free riding) that may appear in self-regulation situations (Howard et al. 2000), etc.[39] Consequently, CSR actions cannot guarantee attainment of maximum efficiency, and often they cannot even guarantee that social welfare will grow (Kapstein 2001).

In spite of this, CSR can complement regulation, particularly in those cases that cannot be included in the general rule,[40] or when, due to errors made by the State, the law or regulation falls short of the social optimum. Business practice shows that the strategies to address these problems may vary considerably, even within the same industry and geographical area, depending on the firm's internal factors (Reinhardt 2004). This in turn supports the thesis that firms have a margin for addressing them with their own CSR strategies.

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[36] Abiding by the law is one responsibility of firms, but it is not part of CSR, which is voluntary, as we explain in the definitions given above.

[37] This could be regarded as the firm's "primary" responsibility – to correct the "damage" (in a broad sense, as an impairment of social welfare) caused by its actions – as against its "secondary" responsibility to solve other problems in society that it has not caused but which we included earlier as voluntary actions. Cf. Preston and Post (1975), Wood (1991).

[38] How this is done and in what conditions it improves social welfare is not easy to determine. See Reinhardt (2004) for an excellent study of the problems created by the supposed internalization of external effects and the private provision of public goods.

[39] However, Porter and Kramer (2002) argue that firms can create more value in their philanthropic activities than governments or private donors, precisely because of their striving for economic efficiency.

[40] The employees and managers of an abattoir, for example, are likely to know better than the regulators about possible sources of contamination and will be able to cooperate with inspectors in establishing a health management system that is more suitable for internalizing external effects and reducing the costs of complying with regulations, thereby increasing private and social benefits. Cf. Argandoña (2004).

This brings us back to the consideration of CSR not as a specific responsibility dependent upon the "pressures and expectations of society", according to Vogel's definition (2004) given above, but as a further manifestation of the responsibility that all individuals and institutions have with respect to the consequences of their actions – a responsibility that is primarily ethical but which may also be legal (if it falls within the scope of the law) or social (if it is demanded by society), but which need not necessarily be concurrent with them.

Social responsibility in the nexus of contracts

In theory, tasks and quasi-rents within the firm (and between the firm and its closest external stakeholders, mainly customers and suppliers) may be distributed and coordinated by means of contracts. In practice, as we have already suggested, we have reason to believe that contracts may not be sufficient to develop, through investment in specific (physical, human and organizational) capital and in an atmosphere of cooperation and trust, learning and innovation, the distinctive capabilities that the firm needs in order to create social value.[41]

This trust will be based, for example, on the conviction that relations within the firm are governed by fairness in the distribution of the quasi-rents generated, particularly when the cooperation is carried out in teams. Can contracts alone generate such trust? If the answer is no, then there is a role for CSR, even within the economic paradigm. And again, this role concurs with that of ethics. CSR can help create the necessary environment for the nexus of contracts to give rise to a social optimum and this is often what is pursued when it is proposed as a requisite for the effective functioning of organizations.[42]

Venkataraman (2002, p. 46) says that "the essence of the corporation is the competitive claims made of it by diverse stakeholders. It is a fact of business life that different stakeholders have different and often conflicting expectations of a corporation. Indeed, the firm itself can be said to be an invention to allow such conflict to be discovered, surfaced, and resolved, because conflicting claims have to be discovered and methods for resolution executed". And not just for settling conflicts or distributing quasi-rents,[43] but for the creation of social value itself, which assumes cooperation between customers, suppliers, employees, managers, financial institutions and the firm (Barney 1991, Freeman 2004, Halal 2001, Wernerfelt 1984).

Social responsibility in the practice of business management

There is one other area in which CSR may have a place, namely, within the praxis of management, because maximizing value for the owners is a methodological assumption used to explain how firms act ("as if" they maximized that value: Friedman 1953), and it could even be used as a criterion for assessing managers' performance.[44] However, it is not an operational management principle – to say that marginal cost must be equal to marginal

[41] From a sociological viewpoint, Sennett (1998) points out the limitations that a purely contractual approach may have on the development of human links within the firm.

[42] Rosanas (2004) explains the conditions that must exist, with bounded rationality, for trust to be created within an organization, when the agents act moved by "higher interests" and resist the temptation of opportunism. In such conditions, CSR (again, understood as an ethical responsibility) may enable an approximation to the social optimum in the long term. I would like to thank Prof. Joan E. Ricart for this point.

[43] This would be the approach to stakeholder theory in terms of interest alone, criticized by Melé (2002).

[44] The need for a single management assessment criterion has been put forward on many occasions; for example, in Jensen (2001), Marcoux (2000), Sternberg (2000).

revenue does not explain how decisions can be made within the firm. Therefore, managers may need a variety of criteria, principles and rules, which can include CSR.

Indeed, some proposals about CSR view it as a management technique or management area. However, this implies stripping it of its normative function.

Conclusions

Friedman (1970, p. 138) stated that the responsibility of the person on whom the firm's management is conferred is "to conduct the business in accordance with [the owners'] 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". This is a private normative argument – this is what managers have the obligation to do, in accordance with fairness criteria, because that is what the owners expect, although "of course, in some cases his employers may have a different objective" (p. 138).[45]

However, if Friedman can say that "the social responsibility of business is to increase its profits", this is a social normative argument. The firm's social function is economic efficiency: creating the maximum possible value, greater than what its stakeholders can achieve individually or through exchanges on the market (Aoki 1894, Kochan and Osterman 1994, Post et al. 2002).[46]

And, in spite of the numerous criticisms it has received, Friedman's position is not arbitrary. The firm is an economic institution and, as such, it must apply efficiency criteria, which are part of its social function.[47] However, as we have already shown, these criteria are not sufficient by themselves. Does this mean that there is a role for CSR? My answer is yes, but not as often understood in books and articles on the subject. As a management technique, or as a voluntary activity allowed by owners, CSR needs no justification, but neither does it have any normative function. And whenever such a normative function is ascribed to it, whenever it is argued that firms *must* take CSR into account when performing their social function, we are identifying CSR with ethics. To put it rather bluntly and, probably, unfairly: CSR does not exist. What does exist is the firm's responsibility, which is the same as that shared by all individuals and all organizations. And this responsibility is ethical (Freeman and Velamuri 2005).

Does this take us back to Friedman's thesis that the firm's responsibility is efficiency, within the limits stipulated by law and, as we have just stressed, by ethics? Not exactly, for two reasons. First: Friedman views ethics as a series of social norms that are accepted for peaceful coexistence and to prevent deceit and fraud[48] (in short, a complement of the law insofar as the law cannot cover all the relevant situations) and not as a body of criteria, values and virtues for decision-making (Polo 1996). Consequently, his concept of ethics is insufficient as a guide for human decisions.

[45] This is a deontological criterion, which must not be overlooked. Managers are using the owners' resources and have a fiduciary undertaking to them to use these resources in accordance with the owners' wishes and instructions (Boatright 1994, Hasnas 1998). However, what we are trying to show is that there are other arguments that go beyond this contractual duty and may even take precedence over it.
[46] This is the explanation of the existence of the firm given by Coase (1937).
[47] Velamuri and Venkataraman (2005) defend this position from the viewpoint of the employer's function. For a discussion of the employer's role in value creation, see also Freeman and Phillips (2002).
[48] Sternberg (1994) talks about decency (not lying, stealing or cheating, respecting shareholders' ownership rights) and fairness (paying employees in line with their performance, promoting them on the basis of their merit, etc.) as ethical rules that are applicable to the firm.

And second, because Friedman considers that the economic decision is separate and independent of ethics which, together with law, is only an external constraint. On the other hand, the viewpoint proposed here is that decisions have several dimensions which are always interrelated. It is not a question of making efficient decisions after taking into account the constraints identified by law and ethics but of making decisions that are both ethical *and* efficient. If what we are talking about is optimal and excellent managerial behavior, the ethic of minimums is clearly insufficient.

The purpose of this paper was to shed a little light on the debate on the role of CSR within the firm. Having reached the end of the paper, it seems to me that we have not succeeded in our goal because, in essence, the disagreements on this issue are disagreements on the scientific paradigm we profess. In short, is economics a separate science that does not need to use the categories of other disciplines (in our case, other social sciences and ethics) to state its conclusions? If the reader believes it is, the arguments we have given will not convince him. The problem, as MacIntyre (1990) pointed out, is that the discussions on paradigms cannot be resolved from a particular paradigm: it is necessary to work from both at once, seeking a solution that overcomes their respective limitations.[49]

[49] On the level of practical debate, Tetlock (2000, p. 323) explains it very well: “Libertarian conservatives might oppose the (confiscatory) stakeholder model even when confronted by evidence that concessions in this direction have no adverse effects on profitability to shareholders. Expropriation is expropriation, no matter how prettified. And some egalitarians might well endorse the stakeholder model, even if shown compelling evidence that it reduces profits”.

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