It is said that businessmen or labor leaders have a “social responsibility” that should take precedence over their “private” responsibility to themselves, or their stockholders, or the members of their unions. The most recent application of this doctrine is in President Johnson’s message of February 10, 1965 on the balance of payments, when he proposed “voluntary” restraint by banks in making loans to foreign borrowers and by business concerns in making investments overseas.

This particular application, especially to banks, recalls the attempt of the Federal Reserve Board in 1928 and 1929 to restrain stock market speculation by appealing to banks to avoid loans for speculative purposes. The resulting dispute between the Board and the New York Federal Reserve Bank on the “qualitative” versus the “quantitative” approach to controlling speculation is an important episode in our monetary history, and it had far-reaching consequences. The balance of payments application recalls also the resort, both during and after World War II, to “moral” suasion on banks to restrict credit to “productive” uses and to refrain from loans that would contribute to inflation.

I cite these examples to illustrate that there has been experience with the doctrine under discussion and that there exists much historical evidence by which we can judge how it in fact operates.

The first generalization suggested by experience is that the appeal to “social” responsibility or “voluntary” restraint has always occurred when the governmental agency which is responsible for the area of policy in question has been unable or unwilling to discharge its own responsibility. The agency wants both to shift the blame and to give the appearance of doing something energetic; hence it denounces “irresponsible” private action and calls for “voluntary” restraint.

In our most recent example, President Johnson is understandably unwilling to take measures sufficiently strong to guarantee to offset or eliminate the payments deficit (selling our gold freely, governmental borrowing abroad, tighter money at home, raising tariffs or other restrictions on trade of which the extreme would be direct exchange controls, or changing exchange rates and abandoning a fixed price for gold either through a supposedly once-for-all devaluation or through letting exchange rates and the price of gold float). So he resorts to exhortation. If we weather the present difficulties without a major crisis, the exhortation will doubtless receive some credit. If we have a major crisis, the blame will appear clear.

A second generalization from experience is that the appeal to “social responsibility” has little effect, unless there is an iron fist in the velvet glove of appeals to voluntary restraint. The program either breaks down and is discarded, or it is replaced by a compulsory program—as voluntary price control in the United States in 1941 was replaced by legally imposed maximum price legislation in early 1942. The failure of truly voluntary programs is inevitable and has
nothing to do with a lack of “patriotism” or social consciousness. Indeed, the doctrine of “social responsibility,” if taken seriously, is a truly subversive doctrine in a free society. This can be seen in the kind of challenge it offers to a free society.

The most obvious problem it raises is a conflict of irresponsibilities. Consider a bank official urged now by the President to turn down a foreign loan in the name of “social responsibility.” Let us assume for the moment that his rejection of the loan does in fact serve some relevant social interest. He is still faced with a real moral conflict. As a salaried official he is an agent of his stockholders. If he rejects the loan, he reduces their incomes. In effect he violates his contractual agreement with them. He may argue that he is serving their longer-term interest by acting in such a way that the government is not constrained to impose compulsory control on loans (which would be worse), but that is only an evasion of the issue. The President’s request has merely altered the private interest of the stockholder and hence of the bank official. The bank official is not accepting a new “social” responsibility. He continues to be guided by his former, “private” responsibility—but within new and narrower limitations.

Suppose the bank official does accept a “social” responsibility. Shall it be preemptive no matter what the cost to his stockholders? Or only if the cost is tolerable? And who decides what is “tolerable”?

The labor union official exhorted by Washington to hold down wages as a contribution to preventing inflation has a similar problem. He clearly is responsible to his union members. Let us assume for the moment that it does serve some relevant social interest if wages rise less than is in the private interest of the workers. Should the union leader sacrifice their interest? He is not a public official. He was hired, or elected, by his men to represent them, not by the citizens at large to represent the public.

There are only two ways out of this conflict. One is to appeal to the principal, not to the agent—appeal to the owners of the bank and the members of the union to instruct their agents, the banker and the union leader, to use a specified part of the potential income of the bank or of the potential wage of the workers for the social interest in question. At least each man is now being asked to spend his own money, not someone else’s, for the social interest. This is in effect voluntary taxation, but in a form so obscure and roundabout that it would be very difficult to make it work.

A second way out of the conflict is for someone other than the agent or the principal to specify the precise content of the socially “responsible” action—which means in practice a government official or a governmentally created committee, which typically will be composed of representatives of the industry in question. In the wage case, the guide-posts of the Council of Economic Advisers are intended to specify precisely what wage and price behavior is in the social interest—though I hasten to warn that the specification is far from unambiguous. In the balance of payments case, the President proposes that joint industry-government committees be formed and has asked Congress to exempt such committee actions from the anti-trust law (an obvious comment on the conflict between “social responsibility” and free competition). This, too, comes down to a system of voluntary taxation, but now the amount of the tax is determined by someone other than the agent or the principal.
Perhaps by now we can see why systems of voluntary restraint are seldom successful unless there lurks somewhere in the background, the coercive power of the state, either explicitly as when there are laws and penalties, or implicitly as when Washington brandishes the tax stick and the threat of anti-trust prosecution (steel, 1962) or when Washington offers the tax carrot (railroads, 1964). People are being asked to act against their self-interest. Even if we assume that most of them accept the “social responsibility,” the case is not won. A few, less “responsible” or more sophisticated, will reap fine profits from the opportunities made available to those who wish to flout, or who know how to refute, the doctrine of “social responsibility.” Their fine profits will rankle in the hearts of the “socially responsible” who are expected to continue to sacrifice their own interest for a social purpose that is obviously not being met.

For the sake of the argument, however, let us assume that everyone, without exception, wishes to act in accordance with his “social responsibility.” We still must face the problem: How can he know what behavior is “socially responsible”?

Consider the seemingly simple case of the foreign loan. Is it socially desirable to cut out all foreign loans completely? That cure would be worse than the disease. Then some foreign loans should and some should not be granted. How is our banker to know which is which? He knows tolerably well which loan will be best for the bank, but how is he to know which will be best for the balance of payments?

The President, or a Presidential committee, can fix a target. It might be a 20 per cent cut in foreign loans. Twenty per cent of what? If it’s 20 per cent of loans requested, then requests for loans will go up, and the payments problem remains untouched. If it’s 20 per cent of some earlier amount of loans, then the formula is the typical backward-looking device that crops up, sooner or later, in every governmental program that is said to be progressive.

Even then we are not out of the woods. Which 20 per cent? Shall each bank decide for itself? If so, each bank cuts off the least profitable borrowers. Borrowers then compete with each other for the privilege of getting a loan, and the interest rate on foreign loans (assuming perfect voluntary compliance) goes up. The voluntary exercise of “social responsibility” has become a governmentally approved cartel to raise the price to foreign borrowers—which helps to explain why leading New York bankers were among those who developed the program and why so many banks heavily involved in foreign lending have been so favorably disposed towards it.

The only alternatives is for the government officials or the private committee to decide which loans to eliminate. But they have no criteria that individual banks do not have. Those loans that will be used to buy U.S. goods and services appear at first glance to do the least harm to our payments position. But foreign borrowers can very easily make arrangements to juggle their purchases or connive with other foreign purchasers to make it appear that said loan to X is actually being used by X to buy goods in the U.S. Other stratagems, such as U.S. firms acting as intermediaries, can be dreamt up. There is no simple way to prescribe the social interest, and the record is full of case histories to the point.

Almost without exception, appeals to “social responsibility” arise from an unwillingness to let the price system work. But no one has yet invented or discovered a substitute for the price system in coordinating the activities of millions of people without central control. Because the
price system works impersonally, automatically, continuously, and quietly, because it has no press agents, there is a tendency when all goes well to take it for granted and to forget that a function is being performed by it. Almost without exception, however, attempts to replace the price system, or to prevent it from working, have ended in chaos.

Let us move to the final stage of the argument. Let us assume that there is complete and perfect voluntary compliance with the rules of “social responsibility,” and that everyone knows precisely what those rules say and mean. The deepest problem now comes to light. It is the political problem. It is entirely proper that stockholders be permitted to choose who shall manage their capital and that workers be permitted to choose who shall represent them. But if the business men are imposing sacrifices on their stockholders, and the union leaders are imposing lower wages on their members, all in the name of the “social interest,” this method of selection is no longer proper. Either the principals will in time discharge their agents, selecting new ones who will give primacy to the private interest, and the doctrine of social responsibility goes by the board; or else, if the doctrine is retained, if the business men and labor leaders are to act as “public” servants rather than as the agents of stockholders or of union members, they will come to be selected through an explicitly political process. The political mechanism, not the market and voluntary contract, will circumscribe their powers and control their exercise of them. That is why, ultimately, the doctrine of “social responsibility” in the form it has come to take is subversive of a free society and a stepping stone to socialism.

The way out of the apparent dilemma is as old as Adam Smith’s invisible hand. There is no natural harmony between social and private interest—Mandeville and Bastiat to the contrary notwithstanding. But it is possible for an economic, social, and moral framework to exist within which “every individual,” as Adam Smith wrote, “generally neither intends to promote the public interest, nor knows how much he is promoting it…. He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of his intention. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it.”

Let me allay a possible misgiving. “Private interests” are not to be taken to coincide with “narrow, material, selfish interests.” The man who devotes his life to religious evangelism under a vow of poverty is pursuing his private interests no less than the man who accumulates money with an eye to wine, women, and song. The pursuit of “private interests” has built churches, universities, research institutions, hospitals, museums—and, yes, movie theaters, beach resorts, athletic stadiums, and the myriads of cars with and without tailfins.

By contrast, said Adam Smith: “I have never known much good done by those who affected to trade for the public good.”

1/30/13