



Episode 1,442: Business and the Just Society: Friends or Foes?

Guest: James Otteson

WOODS: I'm delighted to have you, and of course, I think naturally this is an important book, and I'm glad you did it.

OTTESON: Thank you.

WOODS: I'm curious, of course, to know what motivated you to do it. I mean, obviously, it's a gap out there. I think I was talking to Gary Chartier, who's written a textbook, so not quite the same as yours, on business ethics. And I was saying to him that the impression that I have been given by people in the field, the relative handful of people in the field who are kind of sympathetic to my way of looking at the world, say that generally, texts on this subject have a bias to them. And not that your book has a bias, but it's not, let's say, in the direction of your book. It's very much the opposite. Is that right?

OTTESON: Yeah, I think there's a lot of truth in that. A lot of the work that's done in business ethics focuses on what they see as market failures, various kinds of market failures. And a lot of the textbooks are cases, and the courses that are built on those textbooks present students with a series of cases, where you'll get one bad actor after another. So you look at Enron, and you say, weren't those guys bad? Yes, they were bad. You look at Bernie Madoff, wasn't he terrible? Yes, he was terrible. And the impression they can give is that business in itself is a very dangerous thing, maybe encourages all sorts of vices in people who engage in business, and it really needs to be very carefully monitored and regulated at all times so that it doesn't loose various kinds of evils in the world. So yeah, I think that is the strong impression one gets from a lot of, not all, but a lot of the business ethics literature.

WOODS: So that's more or less what you're going after in the early parts of the book, when you're saying that somebody who is engaged in business is actually not corrupting himself or liable to do that, but rather, is doing something that can enrich himself, that can help him to achieve his goals in life. It could be, in other words, part and parcel of what it means to live a good life, pursuing honorable business.

OTTESON: Exactly. And I mean, not all business is honorable, of course, and there are bad actors in business, just as there are in any other walk of life. But I think it's a weak argument to say, well, business is inherently bad, and so maybe something good can come out of it, but only if people make up for it afterwards, say, by giving back. Just think about that term "giving back." People don't say that business should give; they say it should give back. But if you think about, if your mother said to you when you were a child said, "Hey, you need to give that back," well, what does that mean you did? It means you stole something.

And so one of the questions I start the book with is, is that what business is about? Is it necessarily engaging in some kind of morally suspect behavior that you need to atone for like a sin? And make the claim, and it is a controversial claim, but I claim that if it's true, after we examine business and all the arguments in favor of a commercial society and against a commercial society, if we come to the conclusion after all of that examination, that business, in fact, is something that needs to give back for – in other words, atone for – then I think we shouldn't just ask it to give back; we should say don't do it in the first place. I mean, if you think about other things, you don't say to a thief: well, it's fine to keep stealing as long as you give some of what you steal to charity. You say, stop stealing.

So I think that means it's incumbent on us, especially if we're going to have things like business schools – I mean, we don't want to have a school to teach people to be good thieves. If we're going to have a business school and we're going to train students in the technical, functional areas of business – accounting, finance, marketing, and so on – then we need to have a way of understanding business, such that it's valuable in itself and the activity that it actually engages in. And I think there is a plausible way to understand business – I call it honorable business – where a person is benefiting not only himself, but also benefiting, at least one other person, but benefiting others at the same time. In other words, creating real value.

WOODS: Well, yeah, and that's really what you talk about in chapter one, "The Purpose of Business," and so I think you've kind of hit on it there, but how would you describe the purpose of business?

OTTESON: Well, so I think the way to begin thinking about business ethics is not to think about compliance with laws or regulations. That's not the first step. The first step is to ask for business, like for any other activity, what's the purpose of going into it? Is there some purpose beyond – if you ask business students why they go into business, or people ask business students, why are you studying business, it's often the case that people assume there are only two possible reasons you could go into it: either you want to make money or you want to get a job. And is it true that business students want to get a job and want to make money? Sure, of course it is. That's probably true, by the way, for every other college student too. But still, that's not a particularly inspiring vision.

And so what I do in the book is suggest that maybe there's a higher purpose that business itself can be part of. And so I suggest a kind of hierarchy of value. We think about things at the highest level. What kind of society do we want to live in? We want to live in a just and humane society. And a society like that will be constituted and protected by various social institutions: political, economic, cultural, moral institutions. One of those sets of institutions relates to a market economy, a properly functioning market economy. And what makes a market economy properly functioning is if people are engaging in honorable business where they create value for themselves only by at the same time creating value for others.

And so this can give people a kind of framework for understanding what they're doing in business, in their particular job, whatever it is. If they want to know whether they're not just earning money, not just having a job, but doing something that serves a higher purpose, they can ask themselves: well, is what I'm doing playing the proper role in creating value in society not just for myself, but for others, consistent with the set of institutions that ultimately undergird a just and humane society?

WOODS: The question that'll be on the minds of some people would be, if you're going to talk to people – like for example, in chapter three, "A Code of Business Ethics," some people will be inclined to think, all right, but I don't see why a business would want to adopt that when another business that's not so constrained can get extra advantages over them, because they don't have the same moral scruples that the first business does. How do you handle that?

OTTESON: Well, that's a difficult question, obviously, but I don't think that that question pertains only to people acting in business. I think that's in any walk of life. If you're the sort of person who keeps your word and keeps your hands to yourself, and if you make an obligation, you keep it no matter what, but you're in a society of people who don't always recognize their obligations or keep their word, then that can set you up for being taken advantage of, being exploited by other people. And that's in really all walks of life, not just business.

And I spent a lot of time talking about this in the book, but one way to think about this that I'd suggest to you is, if you think about it along the lines of a related topic, namely trade, free trade – so free trade, that's one of the few things that virtually all economists across the political and economic spectrum agree on. Free trade is good for everybody. It's good for individuals. It's good for our country. It's good for other countries.

But the question could arise: well, suppose free trade in general is good, but other countries are engaging in restricted trade. They have tariffs and quotas and other things. Should we still adopt free trade, even though – you know, maybe unilaterally, should the United States be a completely free-trade country, even if it's the case that other countries where American citizens might do business or might trade or exchange, other countries are engaging in subsidizing and quotas and tariffs and that sort of thing? And the answer is: yes, we still should. It still is a benefit to us. It's a benefit to our citizens and to our consumers, even if it's the case that other countries on their own are engaging in protection for their trade and for their business.

I think something similar applies here. It may be the case that following through on one's word and adhering to the code of ethics that I suggest in the book means that some people will be able to benefit themselves, because we are following rules that they aren't. Nevertheless, I think that's a short-term strategy. And as the market becomes more globalized, and as information about firms' activities and individual people's activities becomes more widely disseminated and easier to get, it's much harder to succeed as a person who doesn't keep his word or a business that doesn't keep its promises and offer good products. It's much more difficult to succeed in the long run. So these are short-term strategies for other people in countries and firms who don't want to keep a code of business ethics. And in the long run, even the individual, even an isolated firm or an individual or a country would still be better off in the long run.

WOODS: All right, let's talk about some of the moral issues you raise in chapter four. And there are great many of them, and they are very common, and there's a lot that can be said about all of them. You start off with inequality. That probably is the one that's on the minds of most people. I mean, yeah, textbooks talk about externalities, but if you were to talk to the average person on the street today, judging from what we read in the newspapers, they would say that the most urgent problem is inequality. So how do you frame that issue in terms of honorable business, when it doesn't seem like inequality is brought about by any deliberate choice of anyone?

OTTESON: Good question. And you're right, that is paramount in the minds of many people. In fact, I think it was in 2011, that former-President Barack Obama said that inequality was the defining issue of our times. So that is a very great concern for a lot of people. One way that I approach this topic in the book is to say, isn't it the case that in a market economy, there will be inequality in wealth and income? Yes, it is the case. Does that necessarily mean it's bad? Well, not necessarily.

So there are morally acceptable ways to generate inequality and morally unacceptable ways. And you can think about this just on the micro level, on the individual level. If you have something I want, there are two ways I could get it from you. One is I could steal it from you. I could conquer you. I could take it. I could steal it. Maybe I could defraud it out of you. I offer to pay, and then you give me the good or service or whatever it is, and then I don't actually pay. All of those ways, we might call extractive. And economists call those zero-sum exchanges, which means there's no net increase in value in the world; they're just taking goods from one place to another and doing so involuntarily.

But the other way I could get something from you is by making you an offer that you're free to accept or decline. And if you do accept, then when we exchange, it's a benefit to you; otherwise, you wouldn't have done it. And at the same time, it's a benefit to me; otherwise, I wouldn't have done it. So that economists call a positive-sum exchange, and in that way, we're actually generating a net increase in benefit. Now, is the benefit exactly the same to you as it is to me? Not necessarily, but we both do still benefit, and the overall net benefit value or prosperity has increased.

And that's a way that a lot of inequality is actually generated in the world, through these kinds of mutually voluntary and mutually beneficial transactions that, because they were both mutually voluntary and mutually beneficial, are innocent. So the mere fact of inequality itself is not necessarily morally suspect; it's how that inequality arose. So if you just take a snapshot look of society and you see, well, some people have a lot of wealth and a lot of other people don't have a lot of wealth, that's certainly true. But I would say it doesn't become problematic unless we can show that some person or firm, if you like, got its wealth through extractive means, rather than through what we might call cooperative and voluntary means. That's really the issue. And if it's the case that somebody or some firm is getting wealth through extractive means, then that's a failure of justice, I would say. And it's not the inequality itself that's the problem; it's the failure of justice.

WOODS: Okay, that's exactly the way I look at it. Now, you have a section on unfairness. Now, there, that's more problematic, because you have to come up with a definition of what constitutes fairness. And I think, in these sorts of discussions, the people arguing have completely different approaches to what constitutes fairness. So I think it's hard to make progress in that kind of discussion. How do you handle that?

OTTESON: Yeah, that is very difficult and for exactly the reason you specify, that people have very different definitions of fairness. And usually their definitions are what I would think of as something like a threshold definition, that distributions or redistributions of wealth or holdings are fair as long as they're below some threshold. But once they get beyond a threshold, then they begin to seem unfair. So maybe if you think about in the United States, is it the case that there are some people who have 100 times as much wealth as other people? Yes, that is the case, and so that might seem like, well, that's unfair. So we might say relative differences in wealth are acceptable, but extreme differences are unfair.

But to use an example I use in the book, if you think about, take that 100-fold difference in wealth threshold. Suppose you have one person who has 100 times as much wealth as another person. Does that seem inherently unfair to you without knowing anything else about them? Maybe it does. But suppose I say that the wealthier person is Bill Gates, who at the moment has about \$100 billion in net worth, which is a lot of money, obviously. But who's the poorer person who has to try to manage on only 1/100th the wealth of Bill Gates? Well, you could pick a lot of people, but one person is Michael Jordan. So Michael Jordan has a net worth of "only" about \$1 billion. So Michael Jordan is extremely poor relative to Bill Gates, not relative to most of the other people in the world. But it would seem very strange to say that because he's so relatively poor in comparison to Bill Gates, that therefore it's unfair that Bill Gates has as much as he does and we should redistribute some of Bill Gates' wealth to Michael Jordan.

So the threshold idea of fairness is a real one, and people are concerned about it, but figuring out A) what the threshold should be that traditional trigger, say, compensatory reaction or redistribution, or figuring out what exactly led to the differences in wealth, those are the real issues. And I think that complicates the issue much greater than saying, "Well, it seems unfair."

WOODS: Now let's talk about so-called creative destruction. That's a term that was popularized, I guess, by Joseph Schumpeter, looking at the way the market economy operates in that, let's say, in sometimes maybe an entire industry simply disappears, or a big chunk of an industry disappears, because there just isn't demand for it anymore, tastes have changed, technology has changed, whatever it is, or it's more profitable to build something somewhere else. And that can be very disorienting for people if they've built their whole lives and educations and expectations around that particular industry. But on the other hand, in the place of that, is created something else that serves consumers more, that actually caters to people's preferences.

But you can imagine people saying – and you don't have to imagine; they do say it – that this just goes to show how disconnected the market economy is from the welfare of ordinary people. I mean, yes, yes, yes, in the abstract, you're helping consumers by having some industries go by the wayside and others arise in their place. But that's cold comfort to the people who are suffering in that situation. And they would say, can it really be true, Jim Otteson, that the market economy is a mechanism through which people can live a good life and can behave in ways that are humane and that help other people to flourish? It seems, instead, as if it is amoral and searching only for profit. So what's the answer to that?

OTTESON: Yeah, that's a very good question or set of questions. And I think it doesn't do people any favors to say, when you think about that term, "creative destruction," well, there's the *creative* part, so we're generating new ideas, innovations, engaging in entrepreneurial activity to improve people's situations. But creative destruction also has the *destructive* part, as you articulate, that that means that some firms or some jobs or maybe even some industries could also go out of business. The market moves away from those people or those firms, those industries, and that makes it seem as if, well, we're benefiting some people, but at the expense of others. And I think that's the real worry about creative destruction.

What you notice that when you look empirically at countries across the world, the places where there's the most creative destruction are also the places where there's the most increase happening in overall prosperity. So wealth is growing. And what that means as a kind of secondary effect is that where you have creative destruction, that's where you have many

more opportunities being generated. So in the United States, for example, we have some 35 million or so businesses currently in operation, but that number is constantly changing and expanding. So it is true that if my job is eliminated, my firm goes out of business, that that can cause pretty significant disruption and anxiety and cost to me and my life, the tradeoff for that is that the country and I in particular should also have more resources that would enable me to try something else.

Now, that can still be cold comfort, but the other thing I would say about that is connected with one of the parts of your question, which is you said tastes might change. One of the things that leads to creative destruction is not just people innovating new ways to do things or new products or new services. But it's also choices that other people are making. So if I have a coffee shop, and you go to my coffee shop every day, and I expect you're going to keep coming and you expect you're going to keep coming, but then a new coffee shop opens up across the street from me, and suppose you try it and you like it better, well, if I lose you as a customer, maybe I lose other people's a customer, at the limit, maybe that means I can't even stay in business. I go out of business. That is certainly a loss for me. I wanted to stay in business, and I can't stay in business. But it's a loss that resulted from other people making choices that they're entitled to make. I don't have the right to demand that people buy my services or buy my goods. I have to respect other people's choices too. And unless we're willing to say that some people's choices are more important than others' and deserve more respect' or should be accorded more respect than others, then I think part of the price we pay for living in a free society is enabling people to make choices and to respect their choices.

WOODS: The section on creative destruction is in your chapter "Honorable Business and Treating People the Right Way." And again, I would say that, at least a good many of these chapter titles just fly in the face of what people would expect to see in a book like this, because so many people think treating people the right way is the exact opposite of what happens in a market economy because people are focused, supposedly, on short-term profit and on squeezing every dollar they can out of any particular situation. So give me a bird's-eye overview of what it means to treat people the right way and the role that honorable business plays in this.

OTTESON: Another good question. So one of the foundational moral principles that I argue for in the book is what I call the principle of equal moral agency. That means that we expect and treat and respect each person as being a moral agent equal in that regard to us, which means capable of making choices and capable of being held responsible for their choices. So if you think about treating people the right way, that sometimes means, if they need help, we help them, but it also means letting them work out a plan for their life that actually is appropriate to the circumstances they face and also their unique schedule of value and purpose in life. And that includes moral values.

Oftentimes, when we talk about business and markets and we think about markets being amoral, we think about it as if it were some kind of separately existing entity that's exerting power over us, rather than lots of people, millions of people making choices in their own cases. So what I suggest is that treating people the right way means, especially in business, things like keeping your word, doing the best you can for employees, customers, clients, etc. But it also means enabling and respecting people if they decide they don't want to buy from you, if they decide they don't want to work for you or under the terms you're offering, and allowing them to make that decision. Sometimes people make decisions we don't want, like people who don't want to come to my coffee shop and drink my coffee. That's not the

decision I want people to make. But treating people the right way, in part, means you have to allow them to make the choices they think are best in their own situations, even if there are choices that we disagree with, even if there are choices that we're pretty sure that they themselves would regret after having been made. Still, they're in their own rights to be able to make those decisions, and I think we have to respect those decisions. And that's a way of respecting their equal moral agency.

WOODS: You use the term the "just and humane society," and you have a chapter, "From Business to a Just and Humane Society." So you introduce the concept early on, but you don't elaborate on it until later. What does a just and humane society look like, and what is the business contribution to it?

OTTESON: Yeah, I bring that up later in the book, you're right, because first in the book, what I want to stipulate is what I think are the principles that an honorable business person would follow or should follow. And then I want to connect that to what I think is the role that honorable business could play in, as you say, a just and humane society.

And there, to understand what a just and humane society is, I rely on an argument from the ancient Greek philosopher Aristotle, who suggested that human beings, maybe alone among creatures on earth, but human beings have a hierarchy of values, meaning they have things they want to accomplish today that are in the service of ends that are sort of medium-term goals they have for six months or a year or five years from now. And then they have longer-term goals, things they want to accomplish in 20 years or by the end of their life. But this suggests that there should be some ultimate goal or ultimate end. And Aristotle suggests, as the term for this ultimate end, eudaimonia, which is a bit hard to translate. It's often translated as happiness, but it means something like living a life that was well and fully lived. The idea is that, at the end of your life, you look back on what you did and you say that was a life that was worth having been led.

So I connect that to society and social institutions by saying that a just and humane society is one that protects people's ability to achieve for themselves a path in life that is unique to them and for them, given their purposes, their moral values, their other values, that can enable the chance of having a eudaimonic life or a life that can actually be happy. And so my suggestion is that honorable business plays a role – not the only role obviously. There are many other things too: love, friendship, etc. But honorable business can play a role in enabling people to achieve some of their more near-term and even some of their longer-term ends, so that at the end of their life, they can say, yeah, that was a properly virtuous and a eudaimonic life that I led. And the society that's just and humane is the one that enables more and more people the chance at achieving that kind of life.

WOODS: I think it's possible that in a previous episode we talked about this. In fact, now that I think about it, I think we did an episode on it. But I've been very interested in the corporate social responsibility movement, and you have a brief discussion of that in chapter four. And again, I was talking to Gary Chartier about this, and of course, the quotation that gets brought up in this context a lot is the one from Milton Friedman about the purpose of business being basically to earn profits, not to be a philanthropic organization. What do you think about that? Is there something wrong with the corporate social responsibility movement? And is it that the particular causes that people are urging businesses to support are wrong, or is it the idea of supporting a cause that's wrong?

OTTESON: It's a good question, and corporate social responsibility, the idea has dominated a lot of the business ethics literature and research for about 40 years. So it has been one of the most important and talked-about topics. One of the difficulties or challenges I think it faces is that, oftentimes, it's framed in terms of understanding business as being the solution to all problems, as if maybe markets or commercial society generally or a business or a firm need to be able to serve all goals at the same time. And that's not true. So firms are created like every other organization that human beings engage in. They're created with certain kinds of purposes. And we can evaluate those firms and other organizations on the basis of whether they actually achieve the purposes they're set up to achieve. But the idea of corporate social responsibility is often taken to be the idea that businesses should serve not just shareholders, or the legal owners of a business, but what are sometimes called stakeholders. That means all the people who have anything to do with the business; that's employees, customers, maybe the local community, maybe the larger community, maybe the country.

And my suggestion that I spell out in the book is that, if you put too many of these different aims on business or these different purposes on business, then they're inevitably going to fail at even the narrow purposes they set themselves up for. If I start a coffee shop, I want to serve coffee to my customers, but if I have 2, 3, 4, 5, 10 different other goals that I'm also supposed to serve, then I might not be able to serve the immediate goal of giving good coffee to my customers in a way that they appreciate it.

So business is just one aspect of our life. It's an important aspect, but it's just one aspect of our life. And I think to understand corporate social responsibility, we should begin by thinking, well, what is the larger purpose that a business is supposed to serve? And is it serving that well? And if it's serving that well, then what that could do, and what I argue honorable business can do, is enable people to have the resources available to them so they can also begin building out the other elements of a life and a community that's worth serving. So there are very few problems in the world that we face that having more resources available to us would not help us solve. And if business can generate more resources and more prosperity, then in that way, perhaps indirectly, but in that way, what it can do is put us in a better position to be able to construct the kind of world we would like to live in.

WOODS: The book is *Honorable Business: A Framework for Business in a Just and Humane Society* by James R. Otteson, our guest today. Jim, thanks so much for your time, and I'm going to be linking of course to the book at TomWoods.com/1442, and I hope people will spend some time with it. It's important and very well done. Thanks again.

OTTESON: Thank you so much, Tom. It's my pleasure.