Milton Friedman Versus Stakeholder Capitalism

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Milton Friedman was arguably the most influential economist of the second half of the twentieth century, associated with promoting 'neoliberal', free-market, shareholder capitalism.

Friedman's monetarist economics are now widely considered irrelevant, if not wrong, especially with the low inflation associated with 'unconventional' monetary policies following the 2008–2009 global financial crisis.

Friedman's Doctrine Challenged

Nevertheless, Friedman's 'shareholder capitalism' doctrine remains influential in most financial markets, especially emerging ones in the developing world.

His doctrine, prioritising short-term profit maximisation, has long dominated Anglo-American corporate governance despite chatter about 'stakeholder capitalism' and 'corporate social responsibility' (CSR).

Chicago University's Raghuram Rajan claims that long-term share-value maximisation can advance almost everybody's long-term interests.

But even Glenn Hubbard acknowledges that long-term shareholder-value maximisation cannot address many problems faced by firms, let alone societies. Having served George W. Bush's conservative administration, he recognises the need for public policy interventions.

Friedman's shareholder primacy principle can also become absurd. Rajan's erstwhile co-author, Luigi Zingales, argues, 'if you take Friedman to an extreme, I should sue a CEO who doesn't buy off all the members of Congress'.

More importantly, Zingales points out that corporations have duties as public institutions with special privileges granted by the state: 'limited liability, especially with respect to tort claims, is an extraordinary privilege granted by the state', implying reciprocal obligations.

Friedman's manifesto insisted that companies focus on making money, leaving ethical matters to individuals and government. US law enshrines shareholder rights as being able to challenge or replace boards whose members stray from their fiduciary duty.

Stakeholder Capitalism?

Friedman vehemently opposed stakeholder capitalism, whose proponents argue that companies have responsibilities to all stakeholders, not only shareholders, but also employees, customers, society and even nature.

He argued that 'stakeholders', typically ill-defined, will insulate directors from shareholders, reduce their accountability and compromise corporate performance. This would allow executives to pursue their personal priorities or cover up their own failures.

Straying from Friedman's singular focus on profit maximisation would mean that corporate executives were no longer loyally and exclusively serving shareholders, worsening the 'principal-agent' problem.

For Friedman, government and other stakeholders should not be allowed to interfere with shareholder corporate governance in any way, or worse, undermine incentives for investors to risk their capital. In his doctrine, profit alone should be corporations' sole motive.

Joseph Stiglitz has noted that US courts have ruled that firms are obliged to maximise profits and shareholder value, excluding all other objectives. Hence, 'stakeholder capitalism' is not rooted in US law, as corporate executives are not accountable by law to the communities in which they operate, or even to society at large, let alone to nature.

What A Wonderful World?

Friedman also presumed that market imperfections did not exist or would be fully taken care of by regulation. However, the rule of law has never really been adequate to such challenges.

Thus, he effectively gave companies 'moral cover' to be ruthless, free and unregulated to pursue their own interests, at the expense of the public good, while not worrying about society's larger interests.

Friedman also criticised business leaders for straying from maximising profits and worrying about their public image, the social good and public welfare.

While dismissing talk of empowering stakeholders as attempts by company directors to be free to run companies as they liked, and to improve public relations, Friedman approved of companies that 'generate good will as a by-product of expenditures that are entirely justified in its own self-interest'.

But he was silent about business interests involved in lobbying, rigging elections, making political contributions, or shaping public opinion, with tendentious research and image laundering with CSR, philanthropy and public relations.

Friedman's world view is remarkably simplistic, typically ignoring broader, 'longer term' consequences. For him, business efficiency—due to shareholder primacy, not undermined by company directors, managers, government taxes and regulations—can and will solve all problems.

Stakeholderism Challenged

Friedman's neoliberal 'doctrine' shaped major economic reforms the world over from the 1980s until the 2008–2009 global financial crisis. Lacklustre growth since then has given rise to various new challenges to shareholder capitalism, not least in the name of other stakeholders, and to appeals for corporate-governance reform and CSR.

Multimillionaires, even some billionaires and chief executive officers (CEOs), have joined the dissent, and influential business writer, Andrew Ross Sorkin, would have us believe that they represent the future.

To be sure, many have undoubtedly turned away from Friedman's thinking in recent years.

In 2019, the influential Business Roundtable, which had long advocated shareholder primacy, issued a pro-stakeholder statement. It replaced its Friedmanite Statement on the Purpose of a Corporation with 'a fundamental commitment to all of our stakeholders'.

A few months later, the World Economic Forum issued a similar 2020 Davos Manifesto, embracing stakeholder as well as environment, social and governance (ESG) principles.

Nevertheless, legendary investor Warren Buffett remains sceptical of 'purpose-over-profit' stakeholder advocacy. 'In representing your interests, business-savvy directors [will] seek managers whose goals include delighting their customers, cherishing their associates and acting as good citizens of both their communities and our country.'

Meanwhile, most who advocate a stakeholder approach to corporate governance argue that considering the interests of employees or other stakeholders is good for company profits and shareholders. Yet, they privately acknowledge that profits must come first, even if they feel constrained to say so in public.

Corporate Social Responsibility?

Some argue that they are defending capitalist free enterprise in the long term by having a 'social conscience' and taking responsibility for providing employment, avoiding pollution and pursuing other trendy CSR reforms, ostensibly in companies' 'enlightened self-interest'.

Others insist that many contemporary problems are too urgent for slowly meandering political processes. Instead, they argue, CSR 'is a quicker and surer way to solve pressing current problems'.

CSR is said to be a useful, if not necessary, complement to government policy and regulation. Friedmanite critics object that CSR involves spending shareholder money for a typically vague public interest, reducing company returns and spending 'other people's money'.

Friedman warned that the doctrine of 'social responsibility' would take over if not checked. But the converse is more true today as 'greed is good' and the 'short-termist' shareholder mentality is clearly hegemonic.

Others object that CSR involves the 'socialist' view that political, not market, mechanisms are better for allocating scarce resources to alternative uses. But CSR has also been invoked to justify wage curbs against trade union demands, ostensibly for some higher public purpose.

CSR has also been invoked when philanthropy and charity have been abused to minimise tax liability and for public relations and marketing, for example by 'greenwashing' products and services.

W(h)ither Capitalism?

Embarrassingly, US corporations that signed the 'stakeholder capitalism' statement have been more likely to lay off workers in response to the COVID-19 pandemic and less likely to donate to relief efforts.

With growing opposition to neoliberal capitalism, 'stakeholderism' and CSR have been invoked to save capitalism by offering a more sensitive 'human' face.

As capitalism may well be the only 'show in town' for some time to come, popular demands for more thoroughgoing reforms, checks and balances are likely to grow as the realities of stakeholder capitalism and CSR become increasingly apparent.

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