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# Seeking the Real Adam Smith and Milton Friedman

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**Abstract** In this paper we will analyze the relationship between free market principles and ethics through an exploration of how too many business managers often approach the ideas of Adam Smith and Milton Friedman. In doing so, we aim to provide a thoughtful foundation for future discussions of how we ought to navigate this intersection. We briefly examine questions such as: What is the relationship between the "best" economy in terms of efficiency and the common good for society? Is pursuing one's individual economic advantage the same as promoting the general interest? As we analyze and discuss these questions, specifically in the context of Smith and Friedman, we also make some alternative normative assertions, grounded in social welfare, about adopting a broader societal perspective for the purpose of business.

**Keywords** Business ethics · Business managers · Invisible hand · Corporate social responsibility · Stakeholder ethics · Shareholder ethics · Market effectiveness

## Introduction

The latter half of the 20th century brought with it a shift in political and economic thought—both in the minds of academics, and in the popular US culture. No longer was the market merely a dynamic instrument of exchange—a tool which when used properly, could help industrialized societies rapidly achieve resource allocation and distribution. Ushered in by Robert Nozick's (1974) magnum opus, *Anarchy, State, and Utopia*, the free market would become more than an instrument, it would transform into the barometer of morality itself. In recent years, this line of thinking has evolved to become an increasingly powerful mantra in Western capitalist democracies, and two titans of free market thought have become flag-bearers for an arguably muddled and sometimes destructive message.

In this paper, we will discuss the impact that the writings of Adam Smith and Milton Friedman have had on popular beliefs about the free market, and on conceptions of free market

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morality. Hovering around and above the debate between welfare liberalism and laissez-faire capitalism are misunderstood portraits of two great thinkers—caricatures that have been stretched beyond what was written and spoken. We will deconstruct the sometimes warped portraits of Smith and Friedman, and in so doing, we hope to lay the foundations for a more informed dialogue in both practitioner and academic settings. Finally, we will discuss the *normative* implications of a balanced reading of both thinkers, and how a shift in our economic lens from strict efficiency to overall effectiveness may lead to a greater well-being for individuals and society. In other words, *efficient* economic exchange alone may not be the pathway to the most *effective* market outcomes. For example, the exchange of "money for product" between buyers of gas-guzzling SUVs and their manufacturers may produce satisfied parties on both ends of the transaction but whether this outcome, with its inherent environmental impacts, is the most effective exchange that might occur is another question entirely.

## The Popular Conceptions of Adam Smith and Milton Friedman

Adam Smith is rightly considered one of the founding fathers of modern economics. His book, *The Wealth of Nations*, has become a legendary tome on workings of an efficient economy, and the healthy relationship between states and markets (Ross 1985). But public discourse about such matters has become warped as nuanced concepts such as "market efficiency" and "minimal government intervention" have been used to denigrate or support a variety of political and economic positions.

In this essay, we will mainly focus on one of Smith's enduring legacies—the metaphor of the invisible hand. The most common interpretation of Adam Smith's metaphor of the invisible hand is one of an autonomous, self-regulatory entity that ensures that the market, when properly functioning via rationally self-interested exchange, will achieve the most economically efficient results (Mueller 1993). Some expand this argument further and suggest that the most economically efficient outcome also produces the *most* moral result. To understand how pervasive this interpretation is, consider one popular culture and convenient description:

> "In economics, the invisible hand of the market is a metaphor used by Adam Smith to describe the self-regulating behavior of the marketplace" (Wikipedia 2013).

The invisible hand as so conceived suggests that free markets are a necessary condition for free actors to engage economically in a productive manner. Unless the free market is respected as a self-regulating entity, efficient exchange between parties will be dampened and even damaged. At its most robust, the concept of the invisible hand also substitutes for government regulations and ethical rules of business. Tariffs, subsidies, antitrust rules, consumer protections, and more (according to some) are unnecessary since the market itself will dictate proper and fair play. As the invisible hand ensures the best results when properly regarded, external regulation is worse than superfluous; it is downright destructive. Consider a company that attempts to cheat its customers by selling products it knows to be of poor quality. In theory, once word gets out, customers will not buy said good, economically punishing the company. This force, more than any regulation, ought to compel companies to offer quality goods and services. In this manner, the invisible hand also drives markets toward more moral results. This reading has become a dominant interpretation in the greater business community (Buchanan 1985). While there are strong arguments to be made that this is not what Smith intended, especially given his work in *Theory of Moral Sentiments*, we will focus on this "market

supremacy" oriented view initially before expanding our analysis to include a further nuance of Smith's thinking.

Milton Friedman was an extremely influential economist and leader of the Chicago school of economics. While his Nobel Prize was awarded for his research into monetary history and theory, his famous *New York Times* essay, "The Social Responsibility of Business is to Increase Profits," set an agenda for the relationship between the market and morality that has only magnified today (Butler 1985). *The New York Times* essay popularized the view about social responsibility that Friedman had previously advocated in his 1962 book, *Capitalism and Freedom*, where he wrote:

> Few trends could so thoroughly undermine the very foundation of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine. If businessmen do have a social responsibility other than making maximum profits for their stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is (Friedman 1962, p. 133)?

Below we will focus on that argument and how it has informed discussions of business ethics, and corporate social responsibility. Today, many perceive a tug of war between two dominant theories in the world of business ethics. This conflict plays out in the classroom, on social media, and on cable TV news. Stakeholder theories (Freeman 2010) and shareholder theories of corporate responsibility are pitted against each other in binary battles of greed versus altruism, liberal versus conservative, free market versus government interventionism. Some paint a picture of Friedman as an advocate of corporate greed, unrestrained markets, and profit over and above social goods. Others portray Friedman as a paragon of business freedom, deregulation, the intrinsic societal good of private profit, and even of capitalism as the embodiment of morality. While few modern academics endorse such rigid views, we still encounter them frequently in the political arena, and such reality matters greatly from a public policy standpoint. Advocates for minimal market interventions cherry pick pieces of *Wealth of Nations* and *Capitalism and Freedom* to further their world view. Lost in this thrust is that Friedman not only allows for the law but expects it to constrain business, plus, he is also aggressively anti-monopoly (Friedman 1962, p. 131–132).

Friedman's *New York Times* essay unleashed a flurry of discussion both in academic circles as well as in the business community. To this day, business ethics professors around the country dedicate days of class-time to having students read and discuss the piece. In business symposia, MBA classrooms, and even academic journal analysis, the Friedman article is often framed as a showcase of the clash between profits versus ethics by critics and of ethics *through* profits by proponents (Jennings 2012).

Support for Friedman's argument often comes in a particular flavor that one might find familiar after discussing the modern narrative surrounding Adam Smith. In arguments repeated in textbooks and in classrooms, proponents of Friedman's argument *against* CSR rely on an appeal to the distinction between private and public property. For the typical business (publicly held or not), self-interested actions in the name of profit maximization, is the most rational course of action. As long as the business is not intentionally causing legally demonstrable harm, it should not be restrained in its economic pursuit. Forcing or even suggesting that business to do something for the greater social good would not only harm the business unfairly, but might not even succeed at its intended goal. CSR contradicts the primary function of a business, which is profit. If a business's role in society is to make money for its owners, it

seems logical that by striving to maximize profits, a business is doing the best thing it can do for the community it resides in. Some extrapolate beyond this point and suggest that any regulation is a form of attempting to enforce efficiency-eroding CSR principles, and thus is unjustified and harmful. We can recall interpretations of Smith that also suggest unfettered profit maximization will always generate the best results for all involved (Gaski 2013).

Criticism both from the public and others in the academic community has often been harsh, denouncing Friedman's argument as morally bankrupt. Sometimes even business executives have powerfully sounded their doubts. In 1979, Quaker Oats president Kenneth Mason famously wrote that Friedman's philosophy was "a dreary and demeaning view of the role of business and business leaders in our society. Making a profit is no more the purpose of a corporate than getting enough to eat is the purpose of life. Getting enough to eat is a requirement of life; life's purpose, one would hope, is somewhat broader and more challenging. Likewise with business and profit (1979)."

Critics of unconstrained commercial operations, like Mason and many business ethics faculty members, see business as a powerful force with social responsibilities. But some critics also minimize, or at least disregard, the impact that good external oversight (i.e., regulation) might have on economic systems and its business dealings. Good *regulation*, as we discuss, is left on the sideline by some in favor of a discussion about what a business ought to do of its own volition.

As we move forward, we will begin to pull apart these depictions, and suggest (we hope) a richer and more nuanced view of Smith and Friedman.

## Deconstructing the Simplified Portrait of Adam Smith

As mentioned earlier, in the media, classrooms, and academic journals, Adam Smith is often cited as a proponent of free trade, and a critic of government intervention. Unfortunately, while much of this has some foundations in the truth, it is nevertheless not always clear what writers mean when they use terms such as "free trade," and "government intervention" to extrapolate the thinking of Smith.

In *The Theory of Moral Sentiments (1759)*, Smith lays the foundation for his views about self-interest, and the common good. In *Moral Sentiments*, Smith points out we humans have a strong altruistic tendency to be other-regarding in our actions.

> How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it… (2002, p. 11)

For Smith, such sympathy helps guide our understanding of the sentiments of others. We sympathize with another, because we can understand what others are feeling in a particular situation—a tenet of Smith's writings that we will touch on again below. What then do we make of Smith's appeal to self-interest in *The Wealth of* Nations? Does Smith abandon his views on "other-regarding" in *The Wealth of Nations (1776)* in favor of self-interested economic gain? Some have called this apparent turnabout the "Adam Smith problem" but we have good reason to think that this is not the case (Wilson 1989). Throughout his life, Smith continued to revise the *Theory of Moral Sentiments*, implying clearly that he did not repudiate it. And he remains concerned, throughout *The Wealth of Nations*, with an overarching justice that an efficient economy can be a part of, but cannot replace. Pure selfishness

tends toward results that actually harm the free market. *Short-sighted* selfishness is not the same as self-interest, and it is actually a threat to a well-functioning society (Werhane 1989).

To illustrate this key point, we will work through two famous passages from Smith's, *The Wealth of Nations*. First, let us consider Smith's oft cited example of the Butcher, Brewer, and Baker.

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages (2001, p. 15).

In addition to this passage, the *Invisible Hand* is perhaps the single most famous concept credited to Smith. It is presented to us, much as the butcher, brewer, and baker passage, as Smith hammering home the value and benefits of an unrestricted free market. The message to the uninitiated is clear—a good economy needs no oversight, no regulation, and no interference. The market regulates itself with an invisible hand, Smith seems to be telling us, but is that really the case? Here's the original quotation about the motivation of producers:

> By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, 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 not part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it (2001, p. 484–485).

*If* Smith is advocating, in no uncertain terms, that external regulation is our enemy, then he seems to be contradicting himself not three paragraphs later when he writes, "if a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry (Smith 2001, p. 487)." Rather than contradicting himself so blatantly (see quote below), we think it is more likely that Smith is making a more nuanced argument than might be clear at first blush. We must take into account the mercantilist times Smith lived in; regularly, governments tried to manipulate tariffs, taxes, and subsidies to best each other. Conversely, Smith was very aware that the short term interests of businesses were not always naturally aligned with the public interest as seen by government.

> The interest of the dealers… is always in some respects different from and even opposite to that of the public.... The proposal of any new law or regulation of commerce which comes from this order ought always be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions both deceived and oppressed it (Smith 2001, p. 292).

In discussing regulations, Smith is focused on these tendencies toward manipulations. When he takes aim at efforts to guide economies, Smith is making an argument *against*

*protectionism*. His critique is aimed at the inefficiencies and harm caused by tariffs, taxes, and subsidies, not necessarily all regulation.

The notion of the invisible hand has become so poorly understood by modern audiences, that it often comes as shock to many that Smith wrote about beneficial regulations at all. William D. Grampp emphasis this point—Smith's had no theory of The Invisible Hand; he only considered the metaphor of the invisible hand with regard to the movement of capital over national borders. Grampp considers the scope of the original metaphor, by stating, "the invisible hand guides a merchant only when circumstances induce him to keep his capital at home (2000, p. 447)."

Later Grampp notes, [there are] 35 or 40 measures of government intervention of which Smith approved, or which he advocated…The most numerous have to do with helping buyers, sellers, and people in need of help of one kind or another (2000, p. 460).

Smith does not consider the invisible hand to be an impartial overlord of economic activity, ensuring moral outcomes. He seems to implicitly recognize what today's economists call "externalities"—i.e., the costs that private actions impose on others, some unintended, some foreseen, but ones that might be considered for rectification. One analyst of Smith even writes: "Smith is often thought of as being indifferent, even hostile, to the poor. On the contrary, he was not opposed, as a matter of principle, to redistributing income: He wanted to tax horse carriages so that "the indolence and vanity of the rich is made to contribute in a very easy manner to relief of the poor (Nasar 1994)."

That said, a balanced reading of Smith both suggests and explicitly points to "laws of justice" that must not be violated in order to ensure the ability of agents to pursue their interests. Laws that apply to economic actors equally, in order to ensure a more level playing field, *are* acceptable. Smith's critique of government oversight is primarily aimed at rules and regulations that give some competitors an advantage or disadvantage. The invisible hand is not *the* arbitrator; we still need some form of external governance for that. The invisible hand, which is only mentioned four times throughout *Wealth of Nations,* is at most a descriptive mechanism; one that shows how the pursuit of economic self-interest can commonly yield unintended *positive* outcomes beyond the scope of the individual's self-interested decision.

And when discussing banking, Smith also acknowledges that government regulation can be justified due to the consequences to the public. This is because, the risk of failure of certain elements is of such high consequence that restrictions on the completely free dealings of the banks are worth the loss of some economic liberty. By restricting the most egregious endangerments, the whole of society is made better off. When successful, regulation does not, as is often argued today, generate inefficiency; Smith argues that it can help ensure better dealings by recognizing negative and harmful tendencies within an industry. At their best, good regulations can actually promote greater freedom. The free market depends on free actors, not the other way around.

## Deconstructing the Simplified Portrait of Milton Friedman

Milton Friedman lays out his thinking on managerial responsibilities quite succinctly when he writes,

> In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility

> is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom. Of course, in some cases his employers may have a different objective. A group of persons might establish a corporation for an eleemosynary purpose—for example, a hospital or a school. The manager of such a corporation will not have money profit as his objectives but the rendering of certain services.
> In either case, the key point is that, *in his capacity as a corporate executive* [emphasis added], the manager is the agent of the individuals who own the corporation or establish the eleemosynary institution, and his primary responsibility is to them (1970).

At first blush, this might seem callous and dismissive toward notion that corporations are also citizen-members of communities. From the standpoint of stakeholder theories, our intuitions suggest that as members of communities, business, like the individual folks within those communities, have definable moral responsibilities to the other members of those communities. From the standpoint of *shareholder* theories, Friedman seems to be promoting a view that 'business does what business does' apart from the goings on of the rest of society, and that *the best thing a business can do for society is make money*—therefore, its ability to earn profits ought to be unimpeded.

Contrary to this interpretation, Friedman explicitly advocates for the role of governments and other institutions as impeders of business in this way. Friedman writes that, "The role of government just considered is to do something that the market cannot do for itself, namely, to determine, arbitrate, and enforce the rules of the game (1962, p. 27)." Free markets, aren't, as the dominant rhetoric suggests, unchained from regulation and rules. Free markets, for Friedman, are beholden to *proper* regulations and rules. Drawing on Adam Smith no less, Friedman argues,

> It is the responsibility of the rest of us to establish a framework of law such that an individual in pursuing his own interests is, to quote Adam Smith again, 'led by an invisible hand to promote an end which was no part of his intention (2002, p. 133).'

Advocates of traditional formulations of corporate social responsibility can think about this passage with a thought exercise. Suppose a factory is the source of significant pollutants that are damaging a river. Currently, there are no local or federal regulations that prohibit this, though there is good evidence that the pollutants are having a detrimental effect on the surrounding community. The factory has the ability to dramatically reduce emissions, but at great financial cost. Friedman argues that in this circumstance, the factory management ought to first, consider the goal of the owners. If the owners want to prioritize environmental concerns, so be it. That's certainly the prerogative of the owners, for Friedman. But if the owners want to prioritize profit however, it is the managers' responsibility to do that. In this scenario, some advocates of CSR might argue that management must consider *all of the stakeholders* before making a decision. As the community around the river is made up of stakeholders, their concerns must be factored into business decisions. This however, pushes well beyond the basic structure of the business. Friedman's point is that, businesses do not—and should not—make the rules of the game; it's beyond their scope. Businesses are institutions that make money via service provision; that is their primary function. If we want a clean river, we (the people) need to make the rules such. Do we truly want the manager of the factory determining what the rules of

the game ought to be? What about scenario's where the good or right thing is not as seemingly obvious? For example, suppose it is known by the managers that a very tiny amount of a *lethal* chemical is leaking into the water? We end up in the situation where different managers make very different decisions in the name of corporate social responsibility. Friedman wants managers to defer ethical judgments to the corporate charter of their organizations, or effective oversight institutions—the government.

The upshot here is that Friedman is not simply prioritizing business over ethics; he's advocating for a decoupling of business and ethics insofar as we expect business *managers* to create society's ethical frameworks. Friedman's point is that not only is this bad business, but it's also bad ethics. If we want businesses to adhere to particular ethical principles, we must codify those rules. If we want to achieve particular society goals, such as taking care of those that are worse off, we must engage or even create other institutions that are better served at meeting those goals. In this way, Friedman is *not* denying the ethical endgame of those who prioritize stakeholders. We believe a fair-minded reading of Friedman does not result in a trade-off between stakeholder theory and shareholder primacy. Friedman's perspective is *not* that of the heartless corporatist, but that of a functional realist, depicting which institutions ought to be focused on what particular societal goals and goods. Profit motivated business, for all of its far-reaching impact, still operates in a narrow way. According to the Friedman view, tasking it with things beyond its scope is not only unfair to the business, but detrimental to society. If we want money out of politics, codify that; if we want institutions that redistribute income from the top brackets to lower ones, codify that as well. Friedman understood that the free market is not the embodiment of delivered morality, but instead, it is a powerful instrument of resource allocation. The market is but one societal instrument among many that, when regarded and constrained properly, can generate good moral outcomes. Here is the bottom line: For Friedman, ethics exists in legal consensus, and ethical forces exist *outside* the agent, e.g., the manager who is only tasked with doing her job. The danger is that without strong countervailing institutions, such as the prudent regulations of government, the protocol of Friedman can be detrimental to society. It makes little sense to talk about "business ethics" from Friedman's standpoint. The market is defined in fairly narrow terms, and there is little regard for society's best interests. This compartmentalized position stands in stark contrast with the more altruistic and society focused view of Smith, at least when Smith is seen in the context of his *Theory of Moral Sentiments*.

## Prioritizing Effectiveness over Strict Efficiency

To summarize what has been argued thus far:

1. A careful reading of both Adam Smith and Milton Friedman does not reveal the mania for unconstrained free markets that ideologue caricatures of those two writers often claim.
2. Adam's Smith's invisible hand, a metaphoric ideal in the main, does not pre-empt a role for personal ethics or targeted government intervention.
3. Milton Friedman's profit focused management style for agent-managers, while clearly skeptical of managers exercising their individual ethical values, is compatible with stakeholder empowering strategies *as long as* those values are embedded in the law or the operational charter of that corporation.

One abiding legacy of both Smith and Friedman is that they recognized the *efficiency* of free market allocations and the importance of allowing managers to focus on their primary function of economic provisioning. However, they both suggest that other market outcomes beyond pure efficiency matter to the society and that to achieve such *effectiveness,* both markets and business actions sometimes needed to be externally constrained. Put another way, economic efficiency is mainly directed at transactional resource allocation; market effectiveness takes pro-social and pro-environmental outcomes into account.

While this is primarily an analytical essay on the doctrinal implications of carefully reading Smith and Friedman, we offer some concluding *normative* thoughts on the nature of constraining institutions and their purposes. That is, we briefly address what sort of constraints larger societal institutions might provide upon managerial actions and market machinations. And, we preview what factors should be kept in mind if the efficiency of free markets is ever to be constrained for societal effectiveness.

Drawing partly on the recent writings of (one of) the authors, a few threads of the needed debate are proffered below. The discussion is not meant to be comprehensive by any measure, but rather to suggest that MBA classroom discussions and op/ed essays should delve deeper than the superficial "free markets, minimum regulation and an eye to profit are all that's needed" mantra.

> How deterministic are the invisible hand metaphor of Smith and the "discount corporate social responsibility" views of Friedman in shaping contemporary business views?

The short answer here is that no organization is required to embody in its operational decision-making the simple minded views of Adam Smith and Milton Friedman that we critique above. There are many case studies of enlightened business firms that have embraced corporate social responsibility; that regard proactive ethics as instrumental to good business; that work in partnership with local, state or federal government to clarify, demarcate and secure stakeholder fairness. On the other hand, it is also difficult to watch a financial news TV program or read the editorial page of a business periodical without someone proposing that *if only* markets were deregulated and compliance costs were eliminated, profits would soar and whatever "problem" was at focus would be instantly solved. Too often, the source authority for such views, if given, is attributed to a long standing wisdom proposed by Adam Smith or Milton Friedman, unfortunately misunderstood. Typically, this is followed up with public policy recommendations to remove or delimit regulation of business and/or to measure "success" by purely what the market decides. Thus, the complex issue that we address in this essay is stronger and more enduring than the proverbial straw man.

> What are the elements of business performance that go beyond self-interest and profitability in assessing business effectiveness?

Our above discussion of Smith and Friedman begs the question, '*Why* does society care about a level of business impact that goes beyond mere economic efficiency?' On one level, it is tempting to glibly ask: "Does everyone remember the copious financial shenanigans leading to the global recession of 2007–08?" But the better answer lies in the fundamental *social contract* that exists between businesses and society (Laczniak and Murphy 2014). Within a capitalistic system, businesses play a major role in providing the goods and services that all communities require to flourish and grow. In exchange for investing capital, fostering

innovation and bearing risk, the rewards of *profit* rightly accrue to participating business organizations. However, the license to operate as the "provisionary" of needed products and services comes *from society*. For example, according to the U.S. Constitution (Article 1, Section 8), the federal government (representing society) reserves the right to regulate commerce *in the public interest*. Similar institutional constraints upon business activity are extant in almost all developed economies. In this macro context, society is understandably concerned with social outcomes other than the profits to which business aspires. Often, even as local businesses prosper, the mix of goods and services being provided by unconstrained markets and unregulated operations is *not* optimally beneficial to the broader society. For instance, primary to this inquiry might be questions such as: Are the type of goods required by the public being provided in sufficient quantity and at a fair price? Does distribution and marketing cost too much? Is business providing as much to the host community (i.e., fair taxes being paid) as it receives from it? Are the economic successes of a publically supported business climate being shared equitably with the host community?

Along with the policy implications of such questions, society does not wish to bear undue costs from the side-effects of business endeavors (e.g., environmental pollution, exploitation of workers, predatory rent seeking). Minimally, this means ala Friedman, that business is expected to conform to the existing law. Proactively, the social contract would imply that Business [*writ large*] be evaluated on implicit social dimensions such as effective job creation, living wage rates, whether investments have reasonable long-run sustainability, the absence of stakeholder exploitation and, if companies pay their fair share of taxes to support the public infrastructure from which they directly benefit. Thus, the notion that financial outcomes for individual firms should be "maximized" clearly can be at odds with the *principle of the common good* as perceived by society.

> What societal institutions provide the oversight to constrain certain market workings and the operations of business to enhance societal effectiveness?

In order that the social welfare of all stakeholders are protected from the sometimes negative side-effects of business operations, various institutional entities need to guarantee the power structure required by society to receive what is their due, i.e., a just marketplace that balances the right of buyers and sellers. Put differently, it is institutions and their associated oversight arrangements that provide the power to assure fairness in business operations when it does not naturally occur (Santos et al. 2014). The entities that do this—the essential instruments of transformative justice—include primarily the government, but also industry associations, professional bodies (e.g., the ABA), and corporate cultures, especially when driven social purposes embedded in their charters. As the role of government has been primary in our discussions of Smith and Friedman, our brief commentary here centers on the government regulation.

One way that the government can ensure that the rights of all stakeholders are protected is by enacting legislation and enforcing existing regulation aimed at ensuring that a firm's stakeholders are not exploited by corporations in their quest for efficiency. Our above discussion of both Smith and Friedman seems to dutifully allow for such adjustments. For instance, many states in the U.S. have passed legislation that caps the interest rates that lenders can charge on various financial transactions, regardless of what supply and demand might dictate. In a similar vein, the Federal Reserve Board approved rules in 2008 that protect credit card users from assorted unfair practices of credit card companies. In addition to legislation that acts as a protective shield against abusive and exploitive practices of stakeholders, the

government also can implement various pro-business policy measures such as tax-breaks and subsidies that encourage greater investment in certain economic sectors that are not well served. For example, incentives might be utilized to attract retailers of healthy food to economically challenged city markets. Obvious impediments to utilizing government as the successful guarantor of the power necessary to achieve transformative justice for all of society's stakeholders are its historic bureaucratic inefficiencies and/or its corruptions—situations all too common in the public sector, and a fact recognized by Adam Smith back in 1776 (Wilson 1989).

What considerations do unfettered markets routinely ignore?

Economics has a "stylized response" for making market adjustments. Consistent with the ideologue view of Smith's 'invisible hand" metaphor outlined above, markets, if left "free", should be self-adjusting. Consistent with Friedman's disposition to profit maximization by business without open-ended social concerns, economic efficiency will win the day. But economic efficiency is not the same thing as effectiveness for the society in terms of its economic needs, a point we have argued that both Smith and Friedman in fact realized, despite the sometimes simplification of their positions by others. Gross Domestic Product (GDP), a key measure of economic contribution, is not the same thing a "societal wellness" anymore than the absence of disease is a complete measure of a person's good health. For example, GDP grows when more persons are incarcerated in prison, or when local disaster clean-ups occur or when 'cheap' handguns are manufactured. But are such expenditures a measure of a community growing healthier? Most folks would say "not" and argue instead that their common good is something far more complex.

To understand business and market contributions from a social contract standpoint, the triple bottom line of outcomes—financials, positive social impact and ecological sustainability should probably be measured—i.e., profit, people, planet (Bhattacharya and Korschun 2008). Understanding such desired societal outcomes from business activity in multiple markets seems a strong first step in coming to grips with the ultimate purpose of economic systems.

The rationale for wanting "healthy" markets that are efficient *and effective* in their operations is to create and promote economic wealth consistent with society's common good (Laczniak and Lusch 2016). We define the elusive "common good" *as including* all the necessary steps to create and maintain markets which have the capabilities to assure a flourishing community of stakeholders. The basic logic chain, in summary, is as follows: Societies require healthy markets to optimally develop. There are defensible characteristics that comprise markets that can be designated as "healthy. The protection of certain basic rights for all stakeholders contributes to such markets, which again are essentially instrumental because they allow for exchange mechanisms that serve the greater "good" of society by contributing to both economic rewards for business and positive social outcomes for society. Long term economic wealth (shared profits) is the reward for doing these tasks well. Added to this is the idea that most business executives, consistent with the motivations behind Smith's *Theory of Moral Sentiments*, should want to help steward a fairness that flows from the brotherhood of all men and an inherent sympathy to that reality.

Further we suggest that the implicit social contract between business and society includes:

1. Promoting human flourishing for the common good. The full measure of an economy is found in more than its GDP but in how it enhances the *quality of life* for all its participants

and its sustainability for the society (e.g., the availability of an assortment of jobs that pay a living wage; protection of the physical environment for future generations; how an affluent economy treats is poorest citizens).

2. In a market economy the common good involves helping to create *healthy markets* that are characterized by: (a) a greater sensitivity to differences in consumers' needs, wants and preferences, (b) higher quality goods and services, (c) greater innovativeness, (d) higher productivity, and (e) greater economic growth. This requires looking at the healthiness of the business system not merely from the financial perspective of individual players but also from its social/environmental (i.e., macro) dimensions and their interactions. This is a lesson often lost in an ideological reading of Friedman or a too narrow reading of Smith.
3. In a market economy the common good cannot be fully achieved through endogenous market processes but requires the development and fostering of the eight fundamental *rights of market exchange* that often must be guaranteed by government regulation: (a) the right to safety, (b) the right to be informed, (c) the right to choose, and the (d) the right to be heard. Other rights that are often needed for a market economy to operate in a healthy manner are: (e) private property protections, (f) relatively unconstrained personal freedom, (g) freedom from coercion, and (h) fairness oversight.

These rights and considerations, which protect and constrain business actions, are hopefully guaranteed by the laws according to which Friedman advocated individual business must abide. In addition, Adam Smith's "invisible hand" is not alone sufficient for healthy markets; free enterprise should more correctly be understood as *constrained* enterprise formulated for a common purpose—i.e., the provision of needed resources to the community via a financial incentive system aided by self-interested businesses. And neither is Friedman's "profit maximization" a sufficient condition for society's economic health since the rights of healthy markets outlined above will often not occur without governmental protections.

## Conclusion

We have argued for a change in how we portray the free market "at its best." We think the prevailing perceptions of an unfettered, unregulated market as being best as been exacerbated by a misreading of Adam Smith and Milton Friedman. Rather than simply focusing on how well the economic game can be played, we suggest that a move from "economic efficiency" to "market effectiveness" would better reflect a focus on the societal common good. The market is a tool to generate, proliferate, and manage the resources we need to flourish as a society. Even allowing that the free market can efficiently generate a multitude of goods, market success alone is not a desirable end goal. Thoughtful policy-making with an eye toward the common good can create an environment where responsible business practices are not only economically efficient, but effectively advance society's higher interests.

In this paper we have attempted to, first and foremost, help set the table for rational, reasoned discussion when it comes to the intersection of economic policy and ethics as perceived by Adam Smith and Milton Friedman. We looked at only a sliver of what Smith and Friedman had to say about economic efficiency, albeit some of their most salient and frequently quoted points—the invisible hand metaphor and the call for management to be dominantly focused on profit maximization. Certainly, there is much to be discussed in this sphere, and we have entered the fray with certain assumptions—namely the priority of the

common good when it comes to good policy-making aiding societal welfare. Even so, we cannot begin to have a fruitful discussion about "good" economies if we do not take a serious look at the foundations behind our thoughts. The deserved legacies Adam Smith and Milton Friedman are a vital part of that foundation, and it is imperative that we be able to read, discuss, and apply their thoughts and ideas in good faith. Just as importantly, we hope that managers and policy makers will not be bound by dogma. Smith and Friedman are not above reproach, and though we have attempted a spirited dissection of their ideas in a balanced fashion, we cannot be afraid to move beyond them. There is much work still to be done. Particular policy recommendations are well beyond the scope of this paper, but we hope to have helped move the discussion forward by laying a general foundation for what constitutes market effectiveness for the common good and how that may differ from economic efficiency.

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