

Rethinking Corporate Social Responsibilities

By *Inoki Takenori*

Are Business Corporations Rational Entities?

To a scholar such as this writer doing research on corporate skill development and personnel nurturing, business firms seem to be instruments for selecting human resources while educating and training them. Put another way, I regard business firms as organizations endeavoring to realize 1) maximum productivity through the optimum combination of human resources they possess at a given time, and 2) an optimum portfolio of human resources by nurturing them over the middle and long term through competition and selection mechanisms. In fact, firms had been defined as rational entities having a clear, single will, whatever their internal structure was.

The same is true of consumers. Each consumer possesses full information about his/her own preferences and constraints. He/she acts while solving "problems of optimization," that is, pondering what will bring maximum satisfaction. This act emerges in markets in the form of "demand." On the other hand, in traditional economic theories, the optimization of firms defined "supply" behavior, while demand and supply meet and are adjusted in markets before market prices and quantities are determined.

Lately, there are growing views among economists that such understanding of corporate and individual behaviors is well refined as an economic theory but can hardly serve as an adequate guide when considering real-world problems. Let's consider, for example, consumers' possession of all the information on their preferences and constraints as mentioned above. As is often the case, there are differences between what one thinks today and what one will think tomorrow.

Despite this problem, known as "dynamic inconsistency" in economics, consumers and firms are supposed to constantly share the same utility functions and production functions, that is, consumer preferences and production technologies were supposed to have been granted exogenously, not endogenously formed as a result of their behavior.

Research on dynamic inconsistency focuses on the question of how humans will act to solve inconsistency given the fact that what a person is today is different from what he/she will be tomorrow. In other words, the research grasps social institutions as instruments for steadily ensuring social consistency and rational social behavior, while individuals' or firms' ways of thinking change with time or while entities' preferences and constraints change according to outer environments. Researchers regard social institutions not as a factor hindering the rationality of economic entities but rather as a condition for ensuring their rationality.

Take, for example, the case of exchanging New Year's greetings or expressing New Year's resolutions. We tend to consider that there is no rationality at all in such a custom. But researchers see in the custom a force which works to ensure a kind of dynamic consistency. The New Year is a calendrical arrangement, but researchers regard it as an institution for individuals to reflect on the past and rethink their plans. They find in the institution a function to guarantee rational behavior and consistency by constraining what humans do, rather than finding rationality in the institution itself. Such an academic interest has emerged as a reflection of the excessive narrowness of the concept of "rationality" considered by traditional economics.

Moreover, there was a problem with the assumption that there exists a "single entity" that makes a rational choice. It is supposed in economics that when a corporate chief executive officer (CEO) decides to make maximum profits, his/her profit motives will percolate down through all the employees and his/her choice will be realized. Actually, this is not so. Profits are decidedly an important element for CEOs. But in most cases, the lower an employee's position is in the corporate hierarchy, the less profit motive he/she has. This being the case, economists have begun to realize that while it is effective, as a first approximation, to simplify firms as single decision-making entities, such simplification is greatly limited when it comes to considering specific problems. In practice, CEOs cannot act as captains of ships do. A CEO's decision can have an impact on employees to a certain extent, but he/she can hardly get involved in finding solutions for all problems in the workplace.

Business Firms as Social Existence

To make my explanation more specific, let us consider the cases of firms playing roles which can hardly be explained in terms of the maximization of profit motives. For example, companies have to shoulder payments of withholding taxes and pay part of their employees' fringe benefits. This is a good example of firms playing a social role as proxies of public agents, but there is no clear answer to why companies have to handle these jobs.

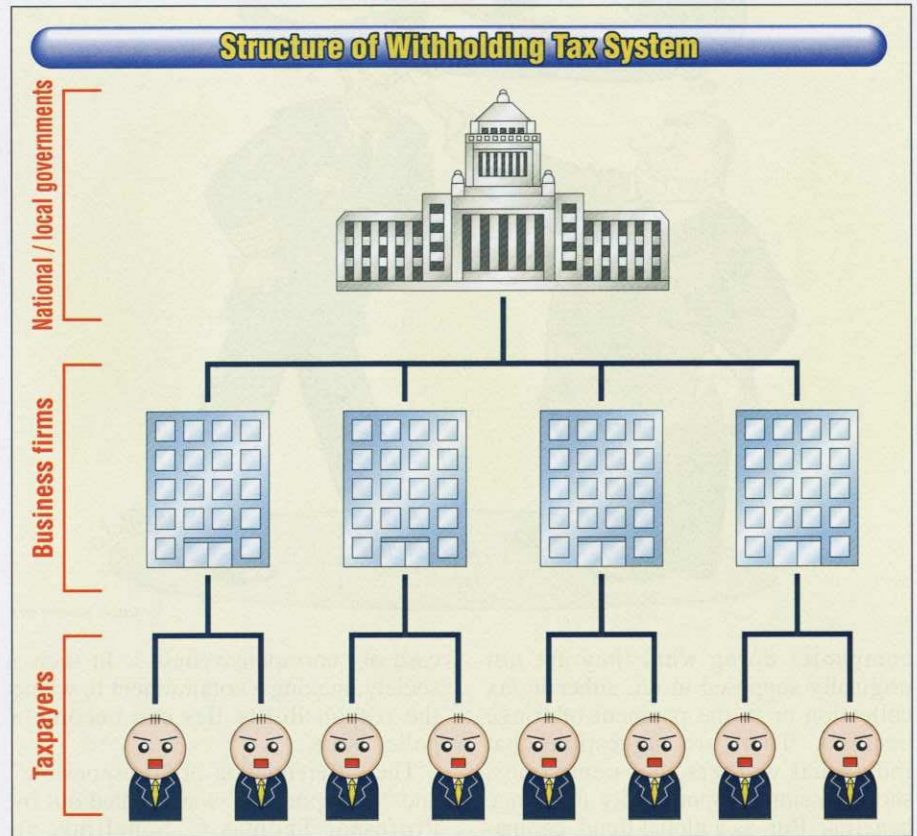
Withholding tax is a system in which third parties (mostly companies) collect taxes from taxpayers for payment to state or local governments. Ordinarily, third parties deduct a certain percentage of their employees' salaries as income

tax and pay the amount to state coffers within a certain period of time. Under this system, salary payers have a legal obligation to deduct tax from their employees' salaries.

Withholding tax is a system introduced in various countries. However, Japan's "year-end adjustment" scheme, under which salary payers even do the final calculation of tax amounts, is not globally practiced, except in the United Kingdom, Germany and a few other countries. As far as withholding tax is concerned, Japanese companies are commissioned with substantially important roles as a social instrument.

Withholding tax has benefits in that 1) it is a reliable tax collection method, 2) it can save tax collection expenses, 3) it can omit procedures for income tax returns, and 4) it makes tax payment easy through installments. It has some shortcomings, such as its inability to handle comprehensive income taxation, but under this system, companies play entirely public roles, being commissioned with the work of collecting tax.

Shouldering a part of fringe benefits is another important social role that firms play. The amount, ratio and increase rates of fringe benefits that firms pay as labor costs besides salaries in cash vary according to the size of the company and the line of business. But fringe benefits have steadily increased by a big margin both in Japan and foreign countries. Though international comparison of labor cost data is problematic, surveys on the ratio of non-wage labor costs (NWLC) to total labor costs in six Organization for Economic Cooperation and Development (OECD) member countries over the past 20 years show that the ratio of NWLC has risen in all countries. In European countries such as France, Germany and Italy, the ratio has already topped 40%. Japanese companies are generally thought to pay all fringe benefits, but the NWLC ratio in Japan is as low as 20%, indicating that the country is not necessarily advanced as far as corporate fringe benefits are concerned. The contents of fringe benefits and the definition of labor costs differ from coun-



try to country. Corporate welfare systems also differ from country to country due to differences in social welfare systems as well as historical and social conditions, which makes it difficult to make an international comparison of labor costs and fringe benefits in direct numerical terms. Even so, a rough comparison shows that the ratio of NWLC (such as legal fringe benefits, extra-legal fringe benefits and retirement allowances) to per-capita labor costs is higher in Europe than in Japan.

Comparing welfare costs in Japan and foreign countries spotlights interesting characteristics of Japanese fringe benefits: 1) there are wide differences in extra-legal fringe benefits according to corporate size, and 2) housing-related expenses account for a large portion of fringe benefits. Of the housing-related expenses, only current expenditures for maintaining and managing company houses for married employees and dormitories for single employees are ear-

marked in the budget. Accordingly, if services, prices of land and other stocks are counted as fringe benefits, differences according to corporate size expand further.

Fringe benefits exist mainly for two reasons. The first is the effect of tax saving in that, in most cases, firms can save tax payments when they pay compensation to workers in the form of fringe benefits, whereas they have to pay tax when they pay compensation of the same amount in the form of cash. The second is the "effect of scale" in the payment of labor costs by companies, that is, compensation in the form of fringe benefits give workers more value than in the form of cash. Only big companies own cafeterias or beach-side villas for employees, and thus can give employees fringe benefits of high value. The larger the company, the lower the fringe benefits cost it pays for each employee.

As such, there are increasing cases of



Illustration: Iwasawa Akio

companies doing what they are not originally supposed to do, either in tax collection or in the payment of fringe benefits. There are suggestions that individual workers, not companies, should assume responsibility for fringe benefits. But, as a global trend, companies take care of a large portion of their employees' lives, including health care, post-retirement life and the education of employees' children.

What are Corporate Social Responsibilities?

When we take note of corporate social roles, we are naturally led to make an issue of the concept of corporate social "responsibilities." Companies are held "responsible" for socially undesirable results deriving from their behavior or choice, whether or not it was intended. I put the word "responsible" in quotation marks because the concept of responsibility is always ambiguous. "Irresponsible" (failure to perform responsibility even though one has responsibility) must be differentiated from "unresponsive" (having no responsibility). In modern industrial society, there are a growing number of cases in which no one knows where the responsibility actually lies, as in the

case of "unresponsiveness." In such a society, making a commitment to where the responsibility lies can become a policy issue.

The differentiation of "irresponsible" and "unresponsive" was pointed out by Professor Thomas C. Schelling, an American strategic expert, in his book *Choice and Consequence* (Harvard University Press, 1984). Schelling differentiated "inherent responsibility" and the "responsibility which someone has to assume even though it is not clear where the responsibility lies." He explained that the latter's case involves the building of a mechanism in which responsibilities are hypothetically assigned as a way of settling problems. More specifically, responsibilities are assigned to particular persons, who will be rewarded if they have performed their responsibilities. This is where the latter's case differs from the former's case, according to Schelling. To put it simply, the former is an ethical issue and the latter a policy issue.

As an example, Schelling cited the issue of aircraft hijackings. Since the Sept. 11 terrorist attacks in the United States, inspection of baggage at airports has become extremely stringent. But the problem is whether baggage inspection should be the job of airlines (pri-

vate corporations) or the job of the immigration authorities (the state). In this case, crimes, which must be controlled by the state, and safety, which must be dealt with by airlines, are two sides of the same coin, and it is not easy to define who should be ultimately responsible for the problem.

Considering who will assume responsibility for the incompleteness of precautionary measures when a hijacking occurs, airlines will prefer to see that legislation will be enacted, whereby another organization will assume responsibility for anti-hijack precautionary measures. They will not be willing to make profits by taking responsibility for safety and making it their selling point. In fact, it is difficult to hold only the CEO of an airline ultimately responsible when an airline's plane is involved in a hijack. We tend to think a hijacking involving an airline can be solved if its CEO apologizes and resigns. But even when the CEO apologizes, he/she might not have been convinced of what he/she was doing. He/she might have been thinking that he/she had to apologize only because he/she happened to be in the post.

When we consider issues related to corporate "social responsibilities," we must differentiate the responsibility which individuals in firms are supposed to assume, and the responsibility which must be assigned by contract. At present, however, CEOs are supposed to assume all responsibilities in both senses. We should discuss more seriously whether such a mechanism is desirable for the market economy and the free enterprise system. The more complicated technologies and societies become, the more difficult it becomes to clarify accountability. Just as not all problems necessarily have answers, cases could arise in which nobody can be held responsible or it is not clear where responsibility lies. In these cases, we may have to be prepared to expediently hold someone hypothetically responsible in order to settle problems.

Self-Command by Intermediate Organizations

When corporate activities are subjected to social criticism, critics often assert that problems lie with the profit motive or the capitalist system itself. But such an argument basically confuses matters. For example, it has transpired that environmental disruptions in socialist economies, which are not based on the profit motive, are worse than in capitalist economies. Environmental protection does make progress with economic growth. Environmental disruptions are not related to economic systems. Those who attribute environmental disruptions to free market economies are seriously confusing matters.

The important thing is that there have been "excesses" in profit motives, and legal measures and policies for correcting the excesses and improving the environment must be considered. In the process of correcting the excesses, it is important to return to the mean. It is an ethical matter. The profit motive itself is not in itself bad. Rather, it is human pride. We cannot overlook the fact that humans were able to create wealth because of a desire for profit. The problem is that the profit motive was "excessive." "Excesses" did occur in socialist systems as well, in the form of political nepotism and horrendous power struggles. Ethics here is basically concerned with how to correct the "excesses." As Aristotle said, ethical "goodness" is a peak which stands in the mean between two vices – excesses and shortages. Ethics have deteriorated not because of the free enterprise system but because of "excesses" or the "ill feeling against dire shortages," which all humans possess.

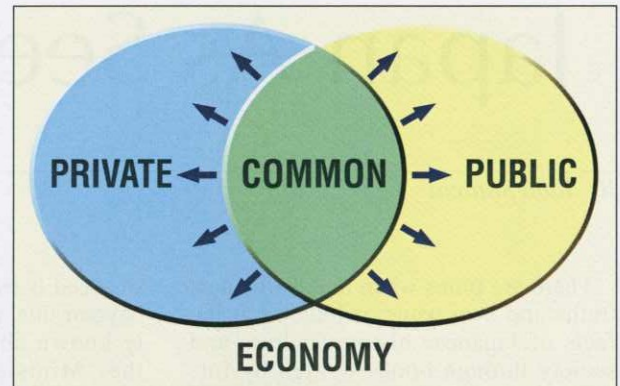
Then, how can such "excesses" be corrected? The best way seems to be to create a framework in which humans command themselves neither through voluntarism nor coercion. For example, there were cases of intermediate organizations, like business lobbies, engaging in ethical activities by having aroused firms' awareness of environmental issues or having restrained eco-

nomc activities which could have led to environmental disruptions. Companies need a self-command framework, in which they compete while commanding each other and suffer a loss if they disobey the rules.

Contemporary economics often pays scant attention to the functions and actions of intermediate organizations like companies, more often characterizing highly industrialized society as a dual structure in which "competition" based on "individualism" conflicts with "control" by the "state." Given the actual moves in economic society and policy problems, it should be emphasized that such dualistic characterization is not necessarily appropriate. Individuals' "independent" choice and the concept of "competition" are merely a model simplified by economists for analytical purposes. Although economists argue that individuals act in such a way as to maximize their own utility, quite often each individual's way of thinking can change or produce internal conflicts.

As the economist John Maynard Keynes emphasized in his *The End of Laissez-Faire*, the world is not ruled by Heaven in such a way that individual interests and social interests agree all the time, even if individuals' pursuit of profits, which is the maximization of self-utility, can be given clear meaning. Economic theories hardly explain accurately whether enlightened self-interest can work to realize such agreement. Even in liberal democracies, governments do not necessarily possess the capability to harmonize individual interests and public interests all the time. Rather, it is a fiction to think that governments have such a capability.

Those who overestimate or attach excessive importance to competition based merely on self-interest would misread the essential characteristics of modern society, which include such factors as "cooperation" and "combina-



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tion" by intermediate semi-autonomous bodies. Those who praise competition or conversely focus only on the wrong side of competition are missing the essential characteristics of economic freedom, which is the ideal of contemporary economic societies. As Keynes aptly pointed out, the ideal scale of ruling units or organizational units lies somewhere between individuals and the state.

Companies, labor unions, vocational and consumer organizations are moving to harmonize their members' interests with public interests. Market economies can hardly ignore the functions of this harmonization. The roles these intermediate entities play in democracies and market economies will become extremely important in the future. The biggest reason perhaps is that the whole domain of contemporary economies, which have grown huge and complex, can no longer be divided merely into private and public phases. Some parts of contemporary social life are becoming neither private nor public, and can no longer be controlled as such. They might as well be positioned as a common "intermediate domain," and be used as a tool for the expansion of the public interest. JTI

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