

“What Companies Owe Society”. A Contractarian Critique

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Abstract: This article discusses the book *Everyone’s Business*, by Amit Ron and Abraham A. Singer, suggesting an alternative account of the idea of social sub-contract and the role of contractarian business ethics.

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1. This commentary first explains why Ron and Singer’s book (2024) captured my interest and why it deserves attention from anyone interested in business ethics from an institutional perspective. In sections 3 and 4, however, I argue that the book misses an opportunity to properly elaborate on the role of business ethics (BE) from a social contract perspective, specifically the sub-social contract (in Ron and Singer words) governing economic institutions and business. This is due to a misunderstanding of the role of contractarian BE, which should extend well beyond complementing pre-established market rules. This obscures the implications of this perspective for economic democracy.

2. I believe Ron and Singer’s book is valuable because they take seriously the idea that BE always deals with situations involving the exercise of power. Even where legal regulations exist, discretion can play a role. A certain degree of discretion is inherent in management and entrepreneurial action. BE should orient this discretion. They further argue that if BE addresses market rules, regulations, and self-regulation in response to legal gaps and discretion, it is an ethics of *rules* and *not* of *character*. On this view, BE does not prescribe an ideal of the good in economic activities, but defends principles of justice constraining the abuse of power and discretion. On this, I fully agree.

An important passage of the book recalls Rawls’s political liberalism, by characterizing BE as *political and not metaphysical*, thus neutral with respect to individuals’ goals or preferences, whether as consumers or producers. Accordingly, one might expect a robust Rawlsian BE, subjecting business activity itself to principles of justice derived by “overlapping consensus” from public reason. This expectation is quickly disappointed: these principles do not govern business, but merely shield the political domain from business intrusion.

With unexpected, and perhaps excessive, gratification for the economist, these obligations are derived from treating perfect competition as a normative ideal to be

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approximated through ethical commitments. Explicitly indebted to Heath’s approach (Heath, 2014), the book takes microeconomics seriously and defines BE as a set of moral obligations to comply with market rules even when there are market deviations or failures, in order to implement the ideal of a perfectly competitive market and efficiency. Under conditions of perfect competition, individual behavior, maximizing the consumer or firm utility with the addition of other structural, cognitive and psychological assumptions, leads to Pareto-efficient market outcomes. However, there are *market failures* in which rational economic agents, acting in their own self-interest, do not achieve efficient outcomes because there is no competitive market. This is where BE moral obligations come into play: firms should act *as if* the market were competitive: refraining from deviations from efficient conduct (as defined when the market exists) and going beyond mere individual profit maximization, by adopting behavior that would generate the socially efficient outcome *as if* competition were effective. Consider, for example, a case where the market is monopolistically concentrated. The company should not exploit its monopolistic position (reducing quantity and increasing price) but produce the quantity at the price that would be generated under competitive conditions. Consider also a contract with information asymmetry. The more informed party (typically the agent) should not exploit its advantage to produce low quality at high prices and appropriate information rents, but should instead supply the level of quality what would prevail if the principal could observe the agent’s actions. Although I will later question this thesis, the book’s commitment to taking microeconomics seriously is remarkable for any BE scholar.

The book introduces a relationship between BE and the social contract based on the idea of a *social sub-contract*. Because of this, it is argued, private law is delegated to regulate economic relations between producers and consumers according to the model of perfect competition. The social sub-contract functionally differentiates and hence distinguish the constraints governing the market sphere from those of other social spheres and – as far as the economy is concerned – grounds the obligation to act in accordance with the market ideal, even when agents could deviate from it due to discretionary margins. BE requires compliance with standards that would be individually rational if the market structure were different from the one that actually exists (but in the current context implies the renunciation of some opportunistic advantages). This is important because it establishes a relationship between the social contract and private law. But it is toothless: the BE derived from the social contract does not make any additional or different demands on companies’ behavior in terms of social justice compared to the competitive model. The requirement is to act in such a way as to achieve the Pareto outcomes of competition, as if the only possible states of affairs were the ideal outcomes of perfect competition and the deviations from them.

While the obligations within the economic sphere are those requiring the approximation to the ideal of perfect competition, the qualification of BE as “political, not metaphysical” allows for the introduction of constraints that come from outside the economic sphere. BE is functionally differentiated from norms of other areas but must be complementary to them. Thus, there is a complementary relationship with political democracy, consisting in negative obligations preventing business from

encroaching on the democratic sphere. These include duties not to undermine the rule of law (for example by violating employees' rights to political participation or acting contrary to the constitution), not to corrupt democratic decision-making through improper influence or bribery, not to distort public deliberation via misinformation, and to promote democratic culture among employees.

3. I now turn to my comment on the thesis that a social sub-contract may delegate to private law the task of establishing perfect competitive markets and to BE the task of ensuring that, in cases of market failures, we act as if markets were well-functioning. This view assumes that inefficiency stems primarily from agents' deviations from competitive behavior and that, absent such deviations, desirable outcomes would follow. For example, if monopolists behaved as competitive producers, prices would fall and output would rise. However, perfect competition is a construct based on many structural and behavioral assumptions that do not depend on individual choice, such as atomistic agents, complete information, excludable and rival goods, the absence of cooperation, costless enforcement, and zero transaction costs. The problem is that when these assumptions are violated, there is no defined standard of behavior to follow "as if" the situation were one of perfect competition. Such situations are excluded from the model, which therefore fails to specify appropriate conduct or normative guidance in such circumstances.

Let us assume that market failure consists of the existence of public goods. How can an agent guided by BE adopt market behavior when goods, being non-excludable, *cannot* be priced and being non-rival in consumption, *should* not be priced, since they when consumed by a person can be simultaneously consumed by another without costs? This would mean giving up the benefits of public goods. As in the case of the commons, imposing a market standard would mean treating not excludable goods as if they were, thus imposing property rights on them. But this would undermine the many advantages associated with common goods, i.e. the positive externalities that, up to a certain threshold, their common use brings to participants (e.g. infrastructure). Considering these goods as "res nullius" (privately appropriable goods that are not yet appropriated), and therefore usable according to the criterion of maximum personal interest, means perpetuating the tragedy of the commons. However, Ostrom (1990) shows that socially efficient use in such cases arises not from competitive rules, but from governing resources as commons through cooperative agreements that guide use and temper individual egoistic maximization. How can we say that we are operating "as if" it was perfect competition? On the contrary, we are acting by considering a different situation, in which the institutional framework is cooperative and even the cognitive and psychological assumptions are alternative to the case of perfect competition. This means that the request to act "as if" there were a perfect competitive market and to redeem market failure bringing interaction back to market standards makes no sense where markets are not existent, or where markets are structurally inefficient. Alternative rules of conduct, aligned with cooperative rather than competitive institutions, are likely required.

Although common or public goods may seem peripheral to defining the firm's goals in BE, the same reasoning applies to the firm. Recommending behavior modeled on perfect competition is meaningless in this case, since in perfect competition the

firm's size is *zero*. There are no problems of internal organization and interaction (coordination, cooperation and just distribution) within the firm since there are not many agents inside it. Making a profit and appropriating it is one and the same, since the firm is like a single agent. By contrast, modern institutional economics and game theory conceive the firm as a form of strategic interaction in which team production takes place. Enabled by specific and complementary investments, and the complementarities between human and physical resources team production makes it possible – through the adoption of a joint plan of action – to generate a surplus above the status quo (representing the participation costs of the various players). To select such joint plan participants in the firm face a bargaining problem. Consider, in this regard, Nash's bargaining solution and its applications in the theory of the firm (Nash, 1950; Aoki, 1989; Blair and Stout, 1991; Sacconi, 2006; 2011a; 2011b).

In trivial cases of highly asymmetrical team production, where the surplus depends solely on one agent's investments – thus only she bears significant risk – the governance solution is simple: residual control rights and authority must be given to this agent. This already takes us a long way from the standard behavior of competitive markets. It entails the establishment of authority relations allowing the appropriation of actual surplus – which would be *zero* in the state of long run equilibrium of a competitive market. Yet, this solution is over-simplified. Normally, there are multiple participants in the team who make specific investments and are jointly responsible for generating the surplus. The firm therefore poses a problem of cooperation to produce the cooperative surplus. Unilateral appropriation reduces the incentive to cooperate for those who are excluded, as they perceive the distribution to be unfair.

Two distinct issues arise: even after a distribution principle is set, opportunistic deviations remain a risk, particularly where formal authority allows surplus appropriation; more fundamentally, any acceptable solution must satisfy both efficiency and fairness. Moreover, the establishment of an authority structure, required for joint production, must be legitimized by those in subordinate positions, raising the issue of consent and, with it, the problem of distributive justice on the terms of distribution of the surplus. The point is that market efficiency cannot be applied here, since in perfect competition such forms of cooperation are not envisaged. Nor does it suffice to reach any point on the Pareto frontier: a reasonable bargaining solution needs a notion of distributive equity. David Gauthier (1986) clearly saw the overall picture in the abstract terms of social contract theory, distinguishing the morally neutral (a-moral) sphere of perfect competitive market, where individual rationality aligns with collective efficiency, from the sphere of *morals by agreement*. In this case, while joint action can generate a cooperative surplus, it also produces distributive conflict, requiring a shared conception of fairness to agree on an effective cooperative plan. However, even when a fair and efficient agreement were settled, an additional problem remains: individual rationality and collective efficiency diverge according to the logic of the prisoner's dilemma, therefore morality by agreement risks not being implemented (this is the well-known distinction between *ex ante* and *ex post*).

This reasoning suggests that the domain of “morals by agreement” is the proper field in which BE would give its contribution, not the actualization of the unreal world

of perfect competition that makes ethics irrelevant. Consequently, the problem of *ex ante* agreement is one in which the ethical property of equity is central, but it does not exhaust the ethical problems that BE should try to address. The second ethical problem is that of *ex post* compliance with the agreement. Here, the task of BE should be to suggest stable solutions, compatible with the motivations of the agents, to the problems of cooperation and distributive justice in the firm, or other organizations. The book is silent in this regard since in perfect competition any Pareto efficient state is an equilibrium. But this oversimplifies the task. Not so in non-cooperative games that may represent the problems of compliance with agreement and also face the problem of divorce between the collectively efficient agreement and its incentive compatibility in terms of Nash equilibrium.

Microeconomic approaches to BE range from Gauthier's (1986) constrained maximization, through Binmore's (2005) egalitarian bargaining solution linking *ex ante* contract and *ex post* equilibrium selection, to reputation-based models that replace contractual commitments with ethical compliance under unforeseen contingencies (Kreps, 1990; Sacconi, 2000), to psychological games models in which impartial agreement on distributive justice shapes mutual expectations and preferences, and induces compliance through a Rawlsian "sense of justice" (Grimalda and Sacconi, 2005; Sacconi, 2007; Sacconi and Faillo, 2010). The last approach in particular shows that fair cooperation can be sustained in equilibrium thanks to the effects that an impartial agreement itself has on preferences and beliefs. This may explain the feasibility of businesses that are effectively socially responsible according to criteria of fair balance between stakeholder interests, without need of arguing that "being ethical is the most profitable strategy". Similarly, this approach explains the stability of economic organizations that appear incompatible with market standards, such as nonprofits or cooperatives that generate and sustain non-excludable, collectively owned goods, as well as ethical investment funds resistant to greenwashing.

4. I now offer my alternative account of the *social sub-contract* and its implication for democracy. In the relevant cases considered above, the role of BE is to address both the *ex ante* agreement and the *ex post* stability of cooperation among multiple stakeholders involved in producing and distributing a cooperative surplus. This means applying the contractarian approach at the level of the micro-social contract, namely the firm. One might ask what enables diverse stakeholders to sit at the micro-level social contract table of the firm. Given enormous differences in the distribution of property rights, capabilities, and control over capital, such a contract risks being pre-packaged, with distributive outcomes predetermined in favor of some parties and against others. It is here that the role of the idea of a constitutional and post-constitutional social contract enters the picture and, within it, the idea of a *social sub-contract* – as I understand it – that specialized the social contract with reference to the subset of principles and obligations aimed at regulating the company.

At the constitutional level, the specialized sub-section of the social contract aimed at regulating the company establishes the endowment of rights, liberties (permissions), resources, capabilities that will be used in the second step to establish the status

quo from which post-constitutional bargaining begins. Endowed with all of this, the various agents form cooperative enterprises and negotiate the efficient and fair distribution of the surplus they generate. While individual contributions matter at the post-constitutional stage, they are irrelevant at the constitutional level: prior to cooperation, no one has yet contributed anything and thus cannot claim contribution-based privileges. Constitutional endowments consist of entitlements to resources or capabilities not produced by the agents themselves, serving merely as preconditions for future contributions within specific cooperative organizations. At constitutional level the claim over these endowments concerns the precondition for being equally active participants in society understood as an “enterprise for mutual advantage”. Thus, at this level, one can only think of a bargaining game with an egalitarian solution or one that reflects a distributive criterion independent of contribution, i.e. proportionality with respect to relative needs (Sacconi, 2006; 2011b). Through the post-constitutional contracts, the parties may establish capitalist enterprises privately owned or public companies, workers’ cooperatives or non-profit organizations. Whatever the choice, this is done by agreement because all stakeholders are provided with rights and liberties, such as access to the means of production and natural resources, etc. Thus, the creation of a property regime for a given firm or organization, essential for some stakeholders, can only depend on their agreement. Every essential stakeholder has a say in the creation of the forms of enterprise and economic organization that concern them. So, they have a say in their system of ownership and control (their governance) and it is reasonable to expect that in every enterprise or productive organization affecting them essentially, they will retain a right of participation or at least supervision or information (Fia and Sacconi, 2019).

Clearly, my account of the partial social contract governing corporate law and forms of economic organization is far more reformist than that proposed by Ron and Singer. It is not a question of legitimizing private law, which constitutes economic relations according to the ideal of perfect competition. Rather, it is a question of reforming all forms of enterprise so that they can be the result of impartial agreements between stakeholders with equal rights and liberties, as well as access to resources and capabilities thanks to the distribution provided by the constitutional contract. It should be noted, briefly due to space limits, that the sharp rise in inequality over the past forty years can be traced to a neoliberal ideological hegemony that has distanced corporate governance and market regulations from this conception of the social contract. A remedy for inequalities, that extend beyond income redistribution to include pre-distribution of rights and freedoms of access to resources, finds in this vision its justification.

There are some important consequences for the discourse on democracy. Ron and Singer’s considerations on BE as a barrier to the encroachment of business into the sphere of political democracy remain valid. But a new page is opening. It is the chapter on economic democracy and forms of governance that allow all stakeholders in a firm or any other form of economic organization to participate in fundamental decisions or at least monitor them, to have a say by being informed through an adequate report so that they can react. This ranges from multistakeholder governance, ensuring

consultation and accountability to non-controlling stakeholders, to co-determination, in which workers and other stakeholders participate in boards of directors and works councils with co-decision rights. It involves extending these forms of democracy along supply chains and value chains, where otherwise new forms of subordination are formed. It also involves multi-stakeholder cooperatives in which property rights are shared – without forgetting the need of limitation of intellectual property rights on innovations and knowledge, which is required to prevent the concentration of power by few oligopolists of technology and digital platforms.

While many governance forms are compatible with the social contract, the doctrine of shareholder value maximization – understood as the exclusive primacy of shareholder appropriation – cannot be justified, as it could not arise from a post-constitutional contract grounded in a fair constitutional agreement.

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