THE FOURTH WAVE:
THE ETHICS OF CORPORATE DOWNSIZING

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Abstract While the business ethics literature has devoted a tremendous amount of discussion in recent years to the question of whether the corporate manager has obligations to parties other than shareholders, it has failed to apply any of its insights to particular ethical concerns. This leaves the corporate manager with almost no guidance for resolving particular dilemmas he or she encounters. I bridge the gulf between theory and practice by focusing on the issue of corporate downsizing. I argue that corporate downsizing is, in many instances, morally contentious.

I. The Issue

A survey of contemporary business ethics literature leads one to believe that the primary ethical questions facing businesses today concern topics such as affirmative action, sexual harassment, and the environment. While these are without a doubt weighty concerns, many workers, especially manufacturing workers, would place corporate downsizing—the closing of whole plants or divisions in order to increase profits—at the head of their list of ethically contentious business practices. Though the issue has provoked considerable debate in the popular press, the philosophical community has largely ignored it.

This oversight is curious given that downsizing is arguably the major business trend of our era. A 1988 survey of 1,200 personnel managers indicated that 35 percent of the respondents worked for a company that had downsized within the past 12 months. While there is evidence that the wave has begun to crest, news reports demonstrate that the practice is still common. More importantly, downsizing is now considered normal practice by the business community at large.

The statistics on downsizing's human costs are sobering. One study found that 15 percent of downsized workers lost their homes, and another that the suicide rate among laid-off workers is 30 times the national average. Despite the rosy picture of the economy painted by the popular media, where attention is constantly drawn to the growth of the stock market, evidence suggests that trends such as downsizing have led to a general decline in employee earnings, as well as a widening of the gulf between rich and poor in America. Added to this is the
fact that since the loss of jobs is concentrated in a relatively small geographic area, these closings affect the entire community. Businesses that rely upon workers' spending will feel the pinch, often leading to secondary layoffs. Consequently, communities as a whole have been devastated by such closings.\footnote{Downsizing also carries with it serious nonquantifiable harms. News of mass layoffs sends psychological tremors across the nation, leading to general worker apprehension about job security and less job satisfaction.\footnote{Worse yet, the anxiety of unemployment often leads to psychological symptoms such as depression, or expresses itself through a variety of unpleasant behaviors: i.e., crime, domestic violence, child abuse, and alcohol and drug abuse.}}

Though the business ethics literature contains a wealth of discussion on the question of whether corporate managers have obligations to parties besides shareholders—a theoretical issue having central bearing on downsizing's ethical status—these discussions have generally fallen short of practical application, with downsizing serving as a case in point. No wonder Andrew Stark laments that business ethics writing is without much value to the manager on the front lines of the corporate decision-making process.\footnote{Stark finds today's academic discussions too, well, academic—obsessed with abstract speculation to the exclusion of practical directives.\footnote{This is due, I believe, to two reasons. One, those who defend the view that firms have duties to parties other than shareholders—the stakeholder theory—fail to distinguish between different groups of stakeholders. Since each party is in a unique position in relation to the firm, the firm may have different duties to each. Thus, the blanket pronouncement that firms have duties to stakeholders says little about a firm's duty to individual stakeholders. I propose that we can circumvent this problem, and hence make considerable moral headway, if we narrow our focus to a particular group. In this case to workers. Two, abstract principles, even if they can be agreed upon, are often too vague to apply clearly to individual cases. I shall demonstrate that greater consensus can be reached if the debate is shifted to situations analogous to the ones actually faced by business managers.}}

The lack of engagement with downsizing on the part of the philosophical community has effectively left the debate in the hands of the popular press, and to journals specifically tailored to the business community. But the writers in these publications generally fail to appreciate the complexity of the issues that must be addressed in order to evaluate downsizing's ethical status. Because they normally lack a background in ethical theorizing, those who voice opposition to downsizing have usually articulated and defended their positions poorly. This has left defenders of the practice with rather easy targets, allowing them to dismiss downsizing's critics with a quip or a platitude. Thus, the discussion has remained on a superficial level, with critics of the practice finding themselves marginalized to the periphery of the political arena.\footnote{Moreover, the ethics instructor who wishes to cover the issue in her course finds a dearth of material from which to choose.\footnote{The ethical questions raised by downsizing are far too}
important for the philosophical community to remain on the sidelines of this debate; it is high time for a philosophically rigorous critique of the practice. Since downsized workers themselves have no real platform from which to air their concerns, those with the background and means to do so carry a special obligation to present their case to the public.

I will argue that acts of downsizing are very often morally wrong. I will begin by demonstrating that the business ethics literature has yet to identify a morally relevant distinction between the situation of the shareholder and that of the worker in relation to the corporation. This means that the corporate manager has no naturally greater duty to shareholders than to workers. I will make my case by examining, and dismissing, the various arguments advanced for privileging the interests of shareholders above all other parties. I then advance arguments against the moral permissibility of acts of downsizing. I will finish with a few words about how the concerns I raise might provide direction for future investigations into the ethical status of related practices, such as the replacement of full-time workers with part-time help.

II. The Moral Equality of Workers and Shareholders

Property Rights

First, it must be understood that one cannot justify the position that shareholder concerns take precedence over all other groups simply by appeal to the fact that the shareholders are the legal owners of the corporation. In that case, all one has done is provide a definition of the term shareholder: one has yet to provide a morally relevant reason for privileging the interests of that group. This is analogous to arguing that abortion is impermissible after viability because that is the point where the fetus could survive outside of the womb.

The natural tack at this point is to assert that a legal owner has property rights that allow her to dispose of her property in any manner she sees fit. But this justification skews the issue in the shareholder’s favor by appealing to a paradigm that does not apply in the case of corporate ownership. The term property rights conjures up images of property for personal use, not profit. For instance, property rights advocates normally worry about laws that place restrictions on the use of one’s homestead, such as laws regulating the appearance of one’s home. Similarly, militia groups who dig in and take shots at ATF officials never barricade themselves in their businesses, but rather their homes. We may harbor a deep-seated intuition that property is sacred, but that intuition is tied to property with which we are in some respect intimately connected, such as a home.

To avoid glossing over the distinction between property for private use and property for profit, we will need to narrow our inquiry to an example of property for profit. Imagine that I own an apartment which I have rented to a couple for ten or fifteen years (think Fred and Ethel from “I Love Lucy”). I discover that I
can make more money by dividing up the apartment and renting it to college students. My intuition is that I have a responsibility to the people who rent from me. At the very least, I should assure the couple, who might be frightened about the prospect of being thrown into the street, that I will not have them leave until they have procured similar housing elsewhere at a similar cost. I would also feel obligated to insure that their transition is as easy as possible by, for instance, helping them move. Moreover, the purpose of the money will have a bearing on the moral status of the act. The act is far easier to justify if it is needed to pay for my wife's extended medical care, than if it merely allows me to buy a longer sailboat. Thus, the general appeal to property rights breaks down when the property in question is for profit, and when we turn to scenarios closer to the practice of downsizing itself.

Fiduciary Duties

Many theorists and business managers defend the moral superiority of shareholders on grounds that corporate managers are bound by a fiduciary duty to their shareholders which trumps any competing duties. The burden of proof is then taken to fall on the shoulders of those arguing against this position to demonstrate that the manager has equally strong duties to others as well. Set this way, the objectors can only meet the duty to shareholders with a similar fiduciary duty to others, thus proposing what Kenneth E. Goodpaster terms a "multi-fiduciary" theory of managerial responsibility. Goodpaster considers the position incoherent because it saddles the corporate manager with conflicting responsibilities, much like a lawyer forced to represent both sides of a civil suit at once.

But this characterization of the issue misconstrues the lines of justification for the duties of an agent in a fiduciary relationship. The fiduciary duty does not establish the obligations of the agent; it is rather prior considerations pertaining to the nature of the relationship that determine the parameters of that duty. For instance, the fiduciary duty of a lawyer to her client is not the same as that of a realtor to his client. Thus, the fiduciary duty itself cannot establish the agent's obligations, since the obligations differ in the two cases. This means that we must look to the particularities of the relationship to identify the contours of the manager's duty to her shareholders. The term fiduciary duty is merely a label for whatever obligations the manager owes to the shareholder; it does not create those duties, and thus cannot justify them.

One important factor determining the nature of an agent's fiduciary duty is the reason why the principal requires the protection of that duty. That is, from what is the individual being protected? For example, much of the duty of a lawyer to her client involves not releasing information about the client to others. This can be justified on grounds that in order to mount an adequate defense, the client must feel free to speak candidly about his case. Thus, a lawyer's fiduciary duty to her client in criminal cases can be thought of as protecting the client
from the state by insuring the best possible defense. However, the fiduciary duty of the real estate broker is not of this sort, as here the protection is not from others, but rather from the real estate broker himself. The danger is that by knowing the seller’s intentions and financial situation, a broker might collude with a potential buyer, or an agent acting on behalf of that buyer, to rig an offer for a quick commission. Similar considerations have led to the recent creation of the “buyer’s broker” relationship. In the classic real estate relationship, the buyer’s agent works not for the buyer, but for the seller’s broker, something not always understood by the buyer. For this reason, the buyer’s agent is technically obligated to provide information about the buyer’s intentions and financial position to the seller’s broker if asked. This obviously undermines the buyer’s position. To correct the problem, a buyer working with a realtor can now sign a contract that places the realtor in a fiduciary relationship which obligates the realtor to refrain from divulging any information that might undermine the buyer’s negotiating position. In both instances, prior considerations serve to establish the requirements and boundaries of the fiduciary duty.

There is considerable evidence that the fiduciary duty of a corporate manager has been historically justified as a means of protecting the owner from that manager. The legal justification of this duty can be traced to the 1741 court ruling in The Charitable Corporation v. Sir Robert Sutton, where the court ruled that managers of corporations were “most properly agents of those who employ them.” Interestingly, the suit was brought against the managers of The Charitable Corporation for “self-dealing by executives, theft, failure of inventory control, and a huge unmet financial commitment.” Notice that the neglect of managerial duty cited involved not benevolent contributions to others, but rather acting in their own interest.

This theme re-emerged in the famous exchange between Merrick Dodd and A. Berle in the 1930s, which has been credited with initiating the debate about corporate social responsibility. Berle was arguing that managerial powers were held in trust by the stockholders as the sole beneficiary of the corporate enterprise, while Dodd was defending the position that these powers were held in trust by the entire community. However, Berle was arguing his position on grounds that shareholders require such protection in order to defend themselves from managers who would divert profits into their own pockets. Again, the protection is from the managers, and not from other beneficiaries of the managers’ actions. More recently, the American Law Institute printed a Principles of Corporate Governance, which included the stipulation that: “By assuming his office, the corporate director commits allegiance to the enterprise and acknowledges that the best interests of the corporation and its shareholders must prevail over any individual interest of his own.”

Hence, there is good reason to believe that the legal basis of fiduciary duties of corporate managers to shareholders has been construed as the obligation to not advance their own interests against those of the shareholders. Adopting this
view of the fiduciary relationship would mean that when a corporate manager takes into account the interests of stakeholders, even where that comes at the expense of profits, this does not conflict with a manager’s fiduciary duty to shareholders.

**Risk**

Ian Maitland provides two justifications for the position that corporate managers have duties to shareholders over those to other parties. The first appeals to the fact that shareholders have invested capital in the corporation. Why is this fact morally relevant? According to Maitland, shareholders have taken a risk in placing their money in the hands of the corporation, and are thereby due compensation in the form of having their interests given privilege over those of other parties. Maitland states that:

> As a practical matter, no stakeholder is likely to agree to bear the risk associated with the corporation’s activities unless it gets the commitment that the corporation will be managed for its benefit. That is logical because the stockholder alone stands to absorb any costs of mismanagement.¹⁹

It is strange, however, to think that the worker who loses his job has not absorbed any costs of mismanagement. Maitland’s point must be that while workers stand to lose their jobs due to corporate mismanagement, they only lose future potential earnings, whereas shareholders lose something they have placed into the corporation. However, workers too have placed something at risk when accepting a job. At the very least, the worker has bypassed other possible job opportunities, opportunities which may have turned out to be financially more rewarding. Also, some have gone to school in the hopes of pursuing a career in the field, thereby investing substantial sums of money (or accruing substantial debt) in the process. Even more importantly, many workers have purchased homes in the expectation of a steady income, and in this manner have risked their homes on the corporation. We can also add to our list the various ways in which workers plant roots in the community which are disrupted when they are forced to relocate, such as placing their children in local schools or having their spouses accept jobs. While the worker’s investment in a corporation is not of the same sort as the shareholder’s, it constitutes a risk nevertheless, and so the worker’s position is not dissimilar to that of the shareholder. The only difference between the risks taken by the two parties is one of degree, and the degree of that risk will depend upon the particular situation of each individual.

**Contracts**

Maitland’s second argument is that corporations are fundamentally a “freely chosen . . . nexus . . . of contracts” between its stakeholders, which establish both the “rights” and the “obligations” of each party.²⁰ These contracts stipulate that the worker will give the corporation her labor in return for a fixed wage, while the shareholder will receive all of the profits of the corporation in return
for investing capital in it. When third parties tinker with that arrangement, they
violate the right of self-determination of the members of the contract, who have
determined the terms of the contracts under “free,” “voluntary,” and “uncoerced”
bargaining circumstances.21

But Maitland cannot possibly mean that such contracts are explicit, for no
such document was signed by either shareholders or employees. He must there-
fore mean that some sort of implied contract exists between all parties involved.
For example, as a teacher, I never explicitly state that I will not allow a student’s
membership in a morally repellent organization to bias the grades I give him.
but this is certainly implied by the nature of our relationship.

However, Maitland’s picture of the corporation simply does not square with
reality. It turns out that most shareholders expect corporate managers to take
into account the interests of other constituencies when making decisions about
the welfare of the corporation.22 More importantly, shareholders tend to think of
themselves not as owners of the corporation, but rather as investors in it.23 This
rings true, for imagine that I were to describe a friend as a part owner of a major
corporation. My listener would assume that the person owns a substantial per-
centage of that corporation’s shares, and thus has a say in its operations. But if I
were to clarify that my friend has one thousand dollars invested in a mutual fund
with one percent of its holdings in Microsoft, my listener would now take the
comment as a rather weak joke. For the vast majority of shareholders, dabbling
in the stock market is thought of as one means among many of investing one’s
money, something chosen for its high rate of return, not in order to become a
corporate owner. Thus, it is hard to understand how the investor can be acting
under the assumption of an unstated contract between himself, management,
and the company’s employees. On the other side, employees have traditionally
assumed that taking a job meant having it for life as long as they perform their
duties well.24 Given these considerations, if we are basing such contracts on the
implicit understandings and expectations of the parties involved, the evidence
actually points in the very opposite direction to which Maitland argues.

Finally, one can raise serious doubts about the assertion that the worker/ man-
ger/shareholder relationship has been established under “free, voluntary, and
uncoerced” circumstances. For one, the parties are by no means in an equal bar-
gaining position. Despite Maitland’s insistence that the disgruntled employee
can always “fire his boss by resigning,”25 employees often find that they have
very few job options given their skills, the labor market, and the costs of moving
to another area. Shareholders, however, have thousands of companies from which
to choose, and a variety of mechanisms specifically designed to make move-
ment in and out of the stock market as easy as possible. Maitland does
acknowledge this imbalance, but claims that the situation “presumably reflects
the preferences of stakeholders as expressed in the marketplace.”26 But the view
that current corporate structure emerged as a result of market forces is implaus-
bible. It is far more likely that this structure is a result of unquestioned social
assumptions, passed from generation to generation, about how companies should be organized. It simply does not occur to the average worker living in the United States that this structure is negotiable, and thus the worker does not attempt to express preferences for alternate models.

**Other People’s Money**

Milton Friedman also advances two arguments against the position that corporations have a responsibility to parties other than shareholders. Friedman’s first objection is that “the corporation is an instrument of the stockholders who own it,” meaning that the manager is acting with other people’s money, and thus serving the public interest at the expense of profits is an impermissible use of that money. Another way to put it is that any action that diminishes profits to aid other parties constitutes a “tax” on the shareholders’ income.

However, such a use of the shareholders’ income is only impermissible if it is unauthorized, and as I have noted, most shareholders expect managers to take into account considerations beyond maximizing profits. Moreover, shareholders in a modern corporation can withdraw their money from that corporation with a simple phone call, and thus the manager who announces his intention to act for the public good gives shareholders plenty of time to remove their money before such a “tax” is levied. More importantly, it is a generally accepted principle that moral duties “transfer through” from principal to agent, such that if it is morally forbidden for me to do something, then it is forbidden for me to enlist an agent to act on my behalf. Thus, an act of downsizing cannot be morally justified in virtue of the fact that it is done in the interests of the shareholders of the corporation, since if it is wrong for the shareholder to perform that act, then it is equally wrong for the manager to do so for them. The fact that a manager is an agent of others cannot itself make the action morally right, and therefore the moral status of the act will turn on other considerations.

**Private vs. Public**

Friedman’s second objection is that requiring corporations to act in the social interest disrupts the private/public distinction which is at the heart of the free market system. Care for the public welfare, the objection goes, is properly the function of the state acting through officers specifically appointed for the task, not of businesspersons trained in other fields. Note that Friedman need not be against public welfare measures in principle, only those that place the burden of caring for the public welfare on the shoulders of corporations.

But this point can be met with at least two responses. First, one might argue with Dodd that corporations are best thought of as entities permitted to exist by the state because they serve the public good, not because individuals have a right to enrich themselves through them. Of course, corporate activities can end up doing both, but the issue concerns what justifies their existence, and in
fact there is considerable historical evidence that corporations were originally conceived as a means of advancing the public good. Thus, the objection requires a defense of the position that corporations must only be run for the private good of their owners. Second, the objection cannot be applied to the case at hand. Downsizing concerns a corporation terminating the employment of its workers. Thus, unlike providing food and shelter to those in need, there is no public sector analogue to the service being demanded of corporations. Unless Friedman is willing to concede that the government should be in the business of hiring all laid-off workers, which of course would eventually lead to a nearly entirely state-run economy—the very antithesis of the free market—then he will need to acknowledge that the business of employing people falls precisely on the private sector whenever possible.

Friedman also objects to the social responsibility position on grounds that it transfers too much decision-making power to the government, again disrupting the public/private split. In his mind, government interference in corporate profit-seeking objectives constitutes “police state” tactics. However, Friedman is conveniently forgetting the fact that the free market system which he so cherishes requires active intervention by the government in order to exist. For instance, if Friedman owned a corporation that had recently released a very popular home video game that was subsequently copied down to the last detail by a rival company, he would likely turn to the government for protection, since one of the government’s corporate life-sustaining activities is copyright protection. Similarly, if a radio or television station tries to broadcast on a competitor’s frequency, the FCC will prevent it from doing so since the FCC issues licenses to stations guaranteeing them sole access to their frequency. Once we add to this list the ordinary protections such as police, fire, and disaster relief (not to mention the billions of tax dollars spent on various “corporate welfare” programs), it becomes apparent that one cannot simply label any government intervention into business activities unjust. To do so mistakenly assumes a situation of complete non-intervention by the government as one’s moral baseline. But this assumption is untenable because the free market requires government support in a variety of ways. The government can thereby demand certain concessions to the community welfare in return. Ironically, Friedman illustrates his own position with a prime example of this point. He attacks price controls on businesses on grounds they would lead to “the destruction of the free-enterprise system and its replacement by a centrally controlled system,” and furthermore, would not even be effective because “what determines the average level of prices and wages is the amount of money in the economy.” But the primary factor determining the amount of money in the economy is the federal reserve interest rate, a government function supported by taxpayer money.

I have argued that no philosophically sound argument has yet been advanced for privileging the interests of shareholders over those of workers simply by virtue of the fact that they are shareholders. This is not to say that no such argument
may someday appear, but rather that in the absence of compelling reasons to the contrary, we must assume that the worker has an equal moral standing as the shareholder since they are, after all, both humans. Cast in this manner, the burden of proof in the debate runs contrary to what has been up to now believed by its participants. It has been tacitly assumed that it is the job of those arguing for the moral status of non-shareholders to establish their position, perhaps due to the earlier-mentioned view of fiduciary duties. But one of our most deeply felt convictions is that two human beings have equal moral status until morally relevant considerations can distinguish between them. Thus, it is really on the shoulders of those arguing for privileging the interests of the shareholders to make their case. This, I have argued, they have yet to do, leaving us to default to the presumption of equality.

*The Utilitarian Argument*

I now wish to examine the utilitarian defense of downsizing. It seems to me that once the moral equality of workers and shareholders has been granted, the only considerations that could justify acts of downsizing would be consequentialist in nature. At the very least, arguments currently advanced to justify acts of downsizing, when they do not rely upon the premise of a moral superiority of shareholders, have been utilitarian. Thus, if I can establish that the utilitarian case has yet to be made, I will have demonstrated that we have yet to find an adequate defense of downsizing.

Ronald Lieber argues for the rather startling claim that not only does the country as a whole benefit from downsizing, but so too do the downsized workers themselves. He begins by noting that 80 percent of the shares in Fortune 500 companies are held by personal stock holdings and retirement plans. Since nearly all retirement plans invest in mutual funds, the workers of these companies themselves own the shares. The remainder of his argument is sketched out in an accompanying graphic entitled “Virtuous Circle.” It begins at the top with an inquisitive-looking figure, representing a worker, investing in a 401K. We next see a stern-faced figure representing a mutual fund manager “put[ting] the screws to the company he invests in.” The third step involves the blank-faced (or perhaps contemplative) figure of the company’s CEO laying off sad-looking employees. This is followed by a graph containing a long flat arrow which suddenly shoots upward at the angle of anti-aircraft weaponry, representing the fact that Wall Street responds favorably to the news of these layoffs, and the company’s stock soars. Finally, the stock increase drives up the value of the 401K account and we come full circle to find the formerly glum looking employees gleefully smiling with dollar signs in their eyes.

Lieber, of course, ignores the fact that these employees are out of a job. It is highly unlikely that the lost wages made up for the increase in the value of the 401Ks, especially since mutual funds tend to diversify their holdings; thus, the rise in the fund’s value is likely to be minimal. In fact, there is no reason to
assume that the employee’s 401Ks have any money at all invested in that particular company. Perhaps Lieber is assuming that all former employees will soon find similar work elsewhere, but this optimism is certainly unwarranted.

Notice how Lieber is arguing that every single individual is made better off by downsizing, a claim so strong it would be surprising to find it defensible. But the classical utilitarian model does not require such bold conclusions. For utilitarianism is generally construed as the principle that the act which maximizes total utility is morally right. Thus, Lieber could argue that downsizing benefits the majority of the population, and though it leaves some individuals by the wayside, the benefit to the whole outweighs the harm to the few. The entire economy, it might be argued, is becoming more efficient. Moreover, the stock market has skyrocketed, benefiting all those who have investments in mutual funds.

But there is reason to doubt whether downsizing has generated a net gain in utility. A group of researchers recently concluded a fifteen-year study which found that when acts of downsizing are not accompanied by careful restructuring of the corporation—in other words, when people are simply laid off in order to lower costs of production without thought of how the remaining employees will sustain levels of productivity—downsizing has always hurt the corporation in the long run.\(^{35}\) Reich also notes that the downsizing trend has caused a general drop in employee loyalty in the United States.\(^{34}\) Workers are far less likely to go the extra mile for firms who treat them as disposable cogs in the corporate machine. While loyalty is not easily quantifiable, and thus does not show up in a corporate ledger, it will affect the company’s overall performance.

Second, the benefits from the performance of the stock market are by no means spread evenly across the board. Recall Lieber’s claim that 80 percent of the stock in Fortune 500 companies is held by personal stock holdings and retirement plans. This does not tell us how stock is divided between the two groups. Since the category “personal stock holdings” includes the wealthy, the benefits of the stock market might be primarily distributed to a relatively small group of investors. Thus, the trend might be benefiting a few at the expense of the many.

This view is supported somewhat by the aforementioned claim that the median wage of workers has declined in the past few years, while the fortunes of the very wealthy have grown considerably.\(^{35}\) It has also been argued that higher wages and economic security for workers increases profits for the shareholders, as it increases the consumption of goods that companies produce.\(^{36}\)

But even if the case could be made that downsizing improves the overall health of the economy, there would still be a gap between this fact and the conclusion that overall utility has risen. If the argument were to terminate at this point, it would be assuming that one can equate well-being with financial gain; however, far more things go into determining one’s well-being. For instance, it is indisputable that the anxiety from job loss has a profoundly negative influence upon one’s psychic health. The harm of unemployment cannot simply be measured by the total loss of income; it produces fear for one’s own well-being
as well as the well-being of one’s family, not to mention the anxiety experienced by those other groups themselves. When these factors are taken into account, it becomes clear that utilitarian considerations do not clearly point in favor of downsizing. It might in fact be determined that downsizing improves net utility in the long run, but the empirical evidence is inconclusive. Our position on the issue, therefore, will need to be informed by other considerations.

III. Arguments against Downsizing

Harming Some to Benefit Others

Up to this point I have argued only that defenders of downsizing have failed to establish that downsizing is morally permissible. Here I will present reasons for thinking that downsizing is often morally wrong. The first argument appeals to the widely held intuition that it is wrong to subject individuals to certain types of harms in order to benefit others. Consider the following example: a town has recently experienced a rash of murders, such that people are afraid to go out at night, or concern themselves with anything but the most critical of functions. Let us further assume that the sheriff of this town knows who has committed the murders and that the murderer has died in his sleep. But the sheriff cannot prove to the town that this individual is guilty (the townspeople would just assume that the sheriff is making up the story in order to shirk his duties). However, there is a drifter passing through town that the sheriff knows can be framed for the murders. Our sheriff performs the utilitarian calculations and determines that the gain in a feeling of security for the town outweighs the harm of going to jail for this one individual. and so frames him for the killings.

Here the individual is subjected to a great harm in order to produce a proportionally lesser benefit to others. I take it that no one would consider the act morally acceptable. This illuminates the widespread moral intuition that causing a great harm for a lesser benefit, even to a great number of people, cannot be morally justified. Most people would even consider it wrong to incur a great harm to a few in order to produce a great benefit to the many, such as removing the eyes from a sighted man and implanting them in two blind persons so that they can now see (with only a drop off in peripheral vision and depth perception distinguishing them from those with two eyes). There are even some who believe that no amount of harm to an individual can be justified on grounds that it will benefit others, since harms and benefits are incommensurable commodities. Given that statistics demonstrate that downsizing often leads to the loss of home and even suicide, it seems hard to deny that at least some downsized workers incur a significant harm from the practice. On the other side, since investors in a large corporation tend to diversify their assets, they incur only a minor benefit when any one stock price rises. Thus, if the act of downsizing is not done as a means of saving the corporation—preventing more workers from losing their jobs—but rather to increase profits, it involves causing a great harm for a minor benefit.
We can also draw a distinction within the practice of downsizing which will serve to amplify its wrongfulness in certain circumstances. Ask yourself if there is a difference in the moral status of the following two acts: First, a country involved in a just war bombs the other side's munitions factory in order to end the war, knowing that the bombing will also destroy a grade school bordering the factory and thus killing ten children. Second, a country in a just war bombs the school where the leaders of the opposing country send their kids in order to get them to end the war (accidentally destroying the neighboring munitions factory in the process). Most people would agree that the latter act is far worse than the former. The best way to explain this intuition is that in the latter act, the death of the children is a means to ending the war, while in the former it is an unfortunate byproduct of that means. The children in the second act are being used in a way that they are not being used in the former act.

Now consider the case where a CEO downsizes under the knowledge that the mere news of these layoffs will be greeted favorably by the stock market, and thus cause stock prices to rise (as Lieber himself notes), as opposed to the case where downsizing will improve profits by increasing productivity. Here the very act which harms the workers—the loss of their jobs—itsel produces the benefit to shareholders. Harm is not a simple byproduct of an act which independently brings benefit, but rather is the means to that benefit. This grates even more deeply against our intuitions that it is wrong to use individuals for others' benefit.

**Legitimate Expectations**

We might also approach the issue from the perspective of the legitimate expectations of the individuals involved. To illustrate this notion, consider the possibility that the federal government repeals the home interest tax break without any other modifications in the tax code. While I see no reason why homeowners, and not renters, deserve such a break, one could question the action on grounds that homeowners have made plans under the assumption that this break would continue. Those who lose their homes because of the change in the tax laws would have a legitimate complaint, even though there was never a written guarantee that current tax laws would remain forever unchanged. Similarly, workers have made plans under the assumption of a continued source of income. These are not simply plans for leisure activities such as vacations, but rather plans which impinge upon their fundamental well-being as well as the well-being of their families. There are, however, no similar expectations on the part of the shareholder. For one, shareholders know that stock prices are volatile and that they take a risk when entering the market. Thus, no reasonable investor backs her home on the future performance of her securities. Investors may expect a certain average rate of return, but this is over the long term and they budget accordingly. They do not bank important items such as their homes on the assumption of the continued unprecedented rates of return seen in the past few years. Surely, these returns are treated as "icing on the cake," and thus if
preserving jobs will diminish returns to the levels historically expected from the market, no critical expectations are thwarted. Also, as mentioned earlier, shareholders tend to consider the companies in which they invest to have obligations to parties other than themselves. Hence, one cannot plead that shareholders entered the market expecting that the company would be run solely for their own benefit.

**Fairness**

We may also appeal to the work of John Rawls to provide critical perspective on the issue. Rawls is, of course, best known for his mechanism of the “original position” as a means of generating principles of justice. However, this hypothetical construct has been much maligned on grounds that it is unclear what would emerge from such a radically foreign situation from our own. In order to avoid this objection, I will draw upon what I consider his more central intuition: that the arbitrary conditions of one’s situation ought not to count against one’s life prospects. The idea here is that the individual does not deserve the rewards or punishments that come via things for which she is not responsible. At the very least, these factors include genetic endowments and the social institutions of the society in which she lives.

This seems to me a very strong intuition, one that can account for a wide variety of common moral responses. Consider, for instance, the indignation fans often feel toward professional athletes who receive an exorbitant degree of compensation for their efforts. Physical talents have a considerable genetic component, meaning that much of a top athlete’s skill is due to choosing his parents more wisely than the average person. Moreover, these people were lucky enough to be born in a society that happens to value their particular skills, also not something for which they can claim credit. While they might have worked hard to develop their natural talents, there is no reason to think that they have put in more effort than the less talented; and any differences in effort are certainly not great enough to merit the incredible differences in compensation.

To apply the principle here, we would first note that the worker who loses his job does so through no fault of his own. Someone fired due to incompetence is not downsized. Downsizing does not involve a surgical removal of all employees in a firm whose work is not up to snuff; instead, whole divisions are removed by virtue of their overall profitability, with no effort made to determine if individual members of those divisions are at fault. In fact, if a division or plant is unprofitable it is most likely due to mismanagement on the part of those running the corporation. This is perhaps one of the reasons why downsized workers feel betrayed, as no attempt is made by management to judge their actual job performance. Downsized workers find themselves harmed due to forces outside of their control. Moreover, these forces have conspired to selectively harm them, since upper management tends to be insulated from these harms, by devices such as receiving a sizable “golden parachute” when dismissed. True, there are a variety of ways in which natural and social forces reward and punish arbitrarily,
but this does not make those harms permissible or release us from obligations to mitigate them.

On the other side, shareholders have done nothing to merit the sharp gains that downsizing produces. Perhaps they are owed good faith efforts at sound management by the corporation in virtue of their investment, but they cannot claim to deserve the special increases in the value of their investments due solely to laying off workers. The fact that we happen to live in a world where canning large numbers of workers is a quick means of increasing profits is not any of their doing. Note also that those shareholders who have invested through mutual funds have not themselves chosen to invest in this particular firm. These investors most likely have little idea as to which stocks their mutual funds actually hold, since one of the appeals of these funds is that they allow individuals to enter the market without the need to concern themselves with the intricacies of investing, or the day-to-day fluctuations of the market.

This argument may also be recast at the level of public policy. Many people have wondered if Rawls's second principle of justice—that rewards must be distributed so as to maximally advantage the worst-off individual—would so disrupt the economy that it would be impractical to apply. Nevertheless, one could yet appeal to it as an ethical ideal, and judge particular public policy initiatives on the basis of whether their net result is to move us toward, or away from, this goal. That is, the fact that downsizing redistributes income in a manner that moves the United States away from satisfying the second principle of justice provides reason for regulating it. While we may not be able to approximate an ideally just society, we are compelled to at the very least avoid actions which exacerbate an already unfair situation.

**IV. Applying the Results and Related Concerns**

In essence, I have argued for two theses in this work. First, the question of the ethical status of an act of downsizing will turn not on theoretical questions of the general responsibilities of corporate managers, but rather empirical considerations pertaining to the actual situation of the worker and shareholder. That is, features intrinsic to the worker/manager/shareholder relationship, the focus of most business ethics literature, will not help to resolve the issue of the morality of an act of downsizing. Business managers will need to examine the actual situations of their shareholders and workers, as well as that of the company, in order to ascertain if a decision to downsize is morally permissible. While this grants that some acts of downsizing may be morally permissible, simply establishing that corporate managers cannot lay claim to a special duty to shareholders which trumps any competing duties cuts against the grain of much of corporate America's current philosophy. For instance, in a speech to business representatives, David Rockefeller argued that corporations "have a responsibility to society beyond that of maximizing profits for shareholders." Yet he quickly qualified this position by stating that "let me add, before they come to retract my Chicago
degree, that making profits must come first." While many business persons would agree that corporations have some obligations to persons besides shareholders, all but the most socially conscious would likely consider anathema the position that these obligations stand on equal footing with obligations to shareholders.

The second thesis concerns the general methodology of most business ethics literature. The business ethics community's concern with debating the relative merits of general principles concerning business responsibilities, such as property rights and fiduciary duties, provides little aid in resolving the particular ethical dilemmas that business managers face. Even if agreement can be reached on these principles, they are often too vague to point in any particular direction when applied to a particular issue. The business ethics community would thus do better to focus instead on particular issues, and approach these issues by constructing structurally similar analogies to the situation under debate, where greater consensus can be built on the ethical status of these situations.

How might the corporate manager apply the insights gathered here to a particular situation? First and foremost, an act of downsizing that prevents the collapse of the corporation can be justified on grounds that the organism is saved by amputating a limb. However, we must keep in mind that bankruptcy does not always mean the complete shutting down of shop. Bankruptcy courts make every effort to find a way of restructuring the debts of the corporation to keep it in business. In fact, corporations have been known to use bankruptcy as a means of avoiding a court settlement. But an act of downsizing that merely increases profits, which seems increasingly the case, requires a careful analysis of the harms and benefits it will incur to the parties involved. For a small firm, such as a fast-food franchise with a single proprietor, the owner may be at greater risk than her employees. The owner most likely has a large percentage of her personal fortune wrapped up in the company, whereas the workers are usually (but not always) high school students just earning extra spending money. However, with a large corporation, the results are likely to be quite different. It bears mention that the corporate entity is grounded in the principle that a separation exists between the corporation and the personal finances of its owners, a device created specifically to minimize the risk to shareholders. Thus, the owner of a corporation is not personally liable for its debts; if IBM dissolves, shareholders need not fear that IBM's creditors will come knocking at their doors. Legal protection to the shareholder is built into the corporation's charter. More importantly, since investors tend not to risk money that is required for their sustenance, their losses do not normally affect their immediate well-being. By contrast, the worker who banks his home on his job places his immediate well-being, as well as the well-being of his family, in far greater peril. Finally, investors today diversify their assets through mutual funds which own shares in thousands of corporations. Thus, losses from one stock create only a minor shift in the fund's overall value. This means that acts of downsizing can cause great harm to a few for a minor benefit to the many, something which I have argued is not morally permissible.
Also, one can argue that the sole proprietor who has nursed the business from the ground up merits greater consideration than the mutual fund investor who may not even know that he or she owns shares in the corporation. Moreover, the worker who has purchased a home and started a family, based on the assumption of the continued source of income, is deserving of greater consideration than the investor who finds that unprecedented gains in the stock market allow him to extend his vacation to Aruba by a week.

Finally, the conceptual tools that I have developed here could be applied to other related practices as well, such as the explosion in CEO compensation. It is not coincidental that the downsizing wave has corresponded with an inordinate rise in CEO compensation, since businesses have been linking more and more of the CEO's compensation to stock earnings. In 1980, CEO compensation was 42 times that of the average worker; by 1995, the number had grown to 141. The 1996 Jury Award for CEO compensation went to Lawrance M. Coss, head of the Greentree Corporation, who received one hundred million dollars in 1996. The following sequence is not at all uncommon: a corporation with sagging profits hires a new CEO. The CEO's contract provides a few-hundred-thousand-dollar base salary and a bonus for increases in the share price. The CEO immediately dismisses whole divisions of the firm, even going so far as to cut the firm nearly in half. The stock market, as Lieber reports, reacts favorably to the news, and the company's share price rises, bringing a windfall in the many millions to the CEO (something Lieber neglects to mention). What are we to say about this practice? To put it baldly, but I think not inaccurately, the skill needed to lay off people is not terribly impressive, nor is it in short supply. It is hard to argue that the CEO deserves this level of compensation. Importantly, as noted earlier, if the corporate manager's fiduciary duty to his shareholders means anything, it entails that the manager is violating his duty when he runs the corporation for his own benefit. Thus, when an act of downsizing is initiated by corporate managers for the intent of enriching themselves, it runs contrary to the CEO's duties. Of course, this intent might be hard to establish in practice, but there is no reason in principle why courts couldn't take a variety of pieces of evidence together as indicating sufficient evidence of a CEO's intentions. In fact, such cases are now being brought up in civil courts (the CEO of Greentree being one). Moreover, the very fact that CEOs can enrich themselves in this manner raises a conflict of interest (and possible violation of insider trading laws), which the government might have reason to regulate.

Another major trend in business is the practice of replacing full-time employees with part-time help in jobs which pay only a fraction of that of full-time positions and provide no benefits at all. While employers have always used part-time help, more and more employees are finding that these positions are the only ones available to them, and are thus becoming permanent part-time employees. Ironically, academia provides a prime example of this movement, and it is curious that many academics who claim to be concerned for the working class feel
no compulsion to speak out on behalf of their own underemployed colleagues. The fact that younger faculty members often lack the opportunities that were available to older faculty members raises serious concerns of fairness. Finally, the practice of moving jobs overseas in pursuit of cheaper labor begs for philosophical scrutiny.

Why has the philosophical community ignored the issue of corporate downsizing? Perhaps this is due to the perception that challenges to the practice would strike at the heart of the free market system, and thus would likely emanate from a Marxist, or other similarly passe philosophical systems. But I hope to have demonstrated that the issue can be tackled with garden-variety moral intuitions, ones that appeal to nothing more exotic than principles pertaining to the fundamental moral equality of humans. These arguments may provoke objections, but they are intended to initiate discussion on a topic long in need of careful examination.

Notes

1I would like to thank Kristin Novotny, Robert Pepperman Taylor, Alan Wertheimer, Don Loeb, David Christenson, and a reviewer at Business Ethics Quarterly for their helpful comments on earlier drafts of this work. For those scratching their heads over the title, note that agriculture has been called the first wave in industrial development, manufacturing the second wave, and information the third wave (of course, "wave" has two meanings in the title).


3The very day these words were written, Xerox announced it would cut 10,000 jobs, despite enjoying a 20 percent jump in profits this year Burlington Free Press, March 25, 1998, 5A, by Ben Dobbin of The Associated Press.

4Bunning, op. cit., p. 70.

5Interview with Secretary of Labor Robert Reich in Challenge, July/August 1996, p. 4. Reich notes that while the average wage is up, the median wage (the wage of the individual in the middle) is down. The discrepancy is due to the unprecedented rise in compensation for top executives during the 1980s and 1990s.


This problem is by no means unique to business ethics literature. While the volume of paper devoted to explorations of liberalism's foundations could insulate a room addition, the pieces that apply these theoretical principles to practical matters would barely serve as an adequate coaster. Even Ronald Dworkin, who has done as much as anyone to advance understanding of liberalism's foundations, laments that political philosophy has had little impact on public debate of concrete issues because it has rarely been oriented toward those debates. See Dworkin, *Life's Dominion* (New York: Knopf, 1993).

Perhaps the only congressional official to demonstrate any serious concern for the issue is Bernard Sanders, Vermont's representative to the House of Representatives.

This paper in fact arose out of an interest in covering the issue of downsizing in an ethics course, but discovering no philosophical works on which to situate the discussion.


Goodpaster, op. cit.

Goodpaster and Holloran, op. cit., p. 425


Goodpaster and Holloran, op. cit., p. 434; emphasis added


Maitland, op. cit., p. 449.

Maitland, op. cit., p. 450.


Boatright, op. cit., p. 397

Reich, op. cit.

Maitland, op. cit., p. 451

Ibid

28I owe this insight to Don Loeb

29Dodd, op cit., p. 1148

30Friedman, op cit., p. 137. Of course, the view that regulations designed to improve the general welfare of the population constitute "police state" tactics would only be held by someone not actually living in one.

31Friedman, op cit., p. 137.


33Wayne F. Cascio, interview on National Public Radio, November 14, 1997

34Reich, op. cit.


36Dodd, op cit., p. 1152. It is perhaps telling that this argument was made in the nineteen-thirties, as there is one theory that the Great Depression was caused by a long-term drop in wages for the average worker, leading to an economy which could not purchase what it made

37I owe this example to Marcus Singer.


40For instance, Michael Ovitz, second in command at Disney, got a ninety million dollar check with his pink slip. See "Executive Pay," *CQ Researcher* 7, no. 26, July 11, 1997, p. 603

41Rockefeller, op cit.

42Brett Chase, "Investors Suing Greentree Over CEO's Compensation," *American Banker* 162, no. 26, February 7, 1997, p. 5. The reason for this, as it turns out, is that companies can claim the compensation they pay to executives in the form of stock options as a tax deduction.

43Chase, op. cit. Incidentally, Greentree is a corporation that specializes in making high-interest loans to mobile home owners who, due to their financial situation, are unable to get financing elsewhere. It was reported that Travelers Group chief Sanford I. Weill collected 220 million dollars in stock options in 1997 (*Burlington Free Press*, March 30, 1998)

44Chase, op cit.


46The Labor Department has certified that NAFTA has resulted in at least 132,972 lost jobs. *Burlington Free Press*, July 10, 1997