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AN EXCUSABILITY PRINCIPLE FOR FIRMS UNDER THE MARKET FAILURES APPROACH

Espen Dyrnes Stabell[1]

A COMMENTARY ON Richard Endörfer and Louis Larue (2022), "What's the Point of Efficiency? On Heath's Market Failures Approach," ***Bus Ethics Q***: 1–25, https://doi.org/10.1017/beq.2022.21

ABSTRACT

Endörfer and Larue (2022) argue that Joseph Heath's Market Failures Approach to business ethics (MFA) implies a *demandingness dilemma*: under conditions of imperfect competition, they argue, the MFA is either too demanding, if requiring that firms should seek to generate Pareto efficiency or "social optima", or not demanding enough, if it gives up on social optima and focus instead on incremental Pareto improvements. I argue the MFA can be combined with an excusability principle to overcome the problem of over-demandingness. Since this means the MFA can hold on to the obligation to promote social optima, the under-demandingness problem too is avoided, and the dilemma is solved.

ENDÖRFER AND LARUE (2022) argue that Joseph Heath's (2014) Market Failures Approach to business ethics (MFA) implies a *demandingness dilemma*: under conditions of imperfect competition the MFA is either too demanding, if requiring that firms seek to generate social optima – "Pareto-efficient distributions that result under conditions of perfectly competitive markets" (Endörfer and Larue 2022: 9) – or not demanding enough, if firms are to abandon the aim of producing or promoting social optima and instead should aim

[1] Western Norway University of Applied Sciences (HVL).
Email: espen.dyrnes.stabell@hvl.no

at incremental Pareto improvements—or what Endörfer and Larue (2022: 9) refer to as "constrained efficient distributions."

In this Commentary, I argue that even if the MFA implies that firms have an obligation to promote efficiency or the social optimum, this does not necessarily make the approach over-demanding. The reason, I suggest, is that the MFA can be combined with an *excusability principle*, which implies that agents can be relieved from blame if they fail to promote social optima, as long as they have a reasonable excuse for this failure.

I develop the principle in analogy with doctors failing to promote the health of their patients due to uncontrollable features of the circumstances in which they operate. Central to the argument is the idea that whereas the excusability principle relieves agents from blame in cases where they – for good reasons – fail to promote social optima or efficiency, it does not remove the obligation firms have to promote efficiency or social optima. Hence, there is no need for the MFA advocate to abandon the duty to promote social optima—meaning that the under-demandingness problem too is avoided. This resolves the demandingness dilemma posed by Endörfer and Larue (2022).

The over-demandingness objection

Endörfer and Larue's (2022: 9) argument that the obligation to promote social optima is over-demanding is, briefly summarized, that the obligation imposes "excessive epistemic burdens onto market participants." Their objection is based, one could say, on the principle of "ought implies can": firms cannot be morally required to do something which they cannot in fact do:

> [I]f the MFA permits market participants in an imperfectly competitive market to engage only in transactions that promote a social optimum, it requires them to know and exclusively exchange at market-clearing prices. But this is not possible, because only a perfectly competitive market ultimately reveals these prices. The MFA hence demands from market participants to know and act on what they cannot know in an imperfectly competitive market (Endörfer and Larue 2022: 11).

How could the MFA advocate respond to this? One option is to hold that the approach doesn't imply that firms should aim directly at the social optimum. Rather, it tells firms to engage in market transactions under the constraint of the "efficiency imperatives" (Heath 2014: 20), also referred to by Heath (2014: 41) as the "Pareto conditions."[2] Since this doesn't require information about optimal prices – it requires information only about the content of the imperatives – the epistemic problem creating the demandingness disappears.

On the other hand, it is a central tenet of the MFA that the duty of managers is grounded in the aim of promoting efficiency, or what Endörfer and Larue refer to as social optima. For example, Heath (2014: 31) writes:

> [I]f we ask what the obligations of managers are, the answer can be provided quite directly. The function of the market economy is to produce the most efficient use of our productive resources possible. This can be done, roughly speaking, by achieving the price level at which all markets clear. The role of the firm in that economy is to compete with other suppliers and purchasers for profits in order to drive prices to that level.

It is thus reasonable to assume that – in spite of some remarks by Heath (2014) that might be taken to indicate otherwise[3] – firms have an obligation to promote efficiency or social optima; it is just that this obligation is best fulfilled by following the efficiency imperatives, or more specifically: to "maximize profits" (Heath 2014: 31) under the constraints of the efficiency imperatives, thereby to "create the conditions necessary for private enterprise to generate an efficient allocation of goods and services in the economy" (Heath 2014: 39).

On this interpretation, however, the MFA runs into the challenge posed by the "general theory of second best" (Lipsey and Lancaster 1956), or what Heath (2014: 39) refers to as the "second best theorem," which implies that following the efficiency imperatives in the non-ideal situation of imperfect competition might not minimize market failure, and may even exacerbate it (Heath 2014; Steinberg

[2] The "efficiency imperatives" or "Pareto conditions" are derived from the conditions which must, according to neoclassical economics, obtain for markets to be perfectly competitive (Heath 2014). Three central imperatives are that firms should not create or take advantage of negative externalities, should compete only through price and quality (avoid market power), and should not exploit information asymmetries. See Heath (2014: 37) for an extensive list of imperatives.

[3] See, in particular, the following remark, which is quoted by Endörfer and Larue to support the under-demandingness objection: "In day-to-day life, this [social] optimum is irrelevant. Every voluntary exchange generates a Pareto improvement. It is through these tangible, incremental efficiency gains that the private market system has established its merit" (Heath 2014: 40).

2017; Moriarty 2020). In light of this challenge, Heath (2014: 41) suggests the efficiency imperatives (or Pareto conditions) are treated as “heuristics, allowing us to determine what type of conduct, in general, is likely to constitute an illegitimate source of gain.” Nevertheless, the second best theorem implies there will be cases where following the imperatives does not minimize market failure and promote efficiency. What does this mean for the moral evaluation of the acts and decisions of firms?

The excusability principle

I suggest the MFA can be combined with an *excusability principle* to deal with this problem: if firms fail to minimize market failure or promote efficiency while acting according to the efficiency imperatives – either because of epistemic uncertainty or the more structural problem posed by the second best theorem – they should be excused for this failure.

I’ll start with an analogy. Consider the case of a doctor who, because of epistemic uncertainty, might have trouble diagnosing a disease, but still has to operate. Since it cannot be expected that doctors always achieve the aim of promoting the health of their patients in such situations, there should be room for excusing them if they fail to do so—given, of course, that they have done what is (morally and professionally) required of them as doctors.

In a similar manner, managers engaged in market transactions will often find themselves in situations where an important business decision has to be made, but under great uncertainty about the effect of their choices on efficiency. Since it cannot be expected that managers always make decisions that minimize market failure under such conditions, they should be excused if they fail to do so.

For example, suppose company C1 sees an opportunity to gain monopoly over product x. The right thing to do according to the MFA, is to forego this opportunity, since gaining monopoly is to exploit a market failure—namely, that of market power. As it happens, however, achieving market power in this particular case offsets another, even more harmful market failure: it pushes company C2, which produces x with massive negative externalities in the form of pollution, out of the market. Suppose further that C1 has no way of knowing about this effect of achieving market power, and chooses to act according to the imperative not to seek market power. In this case, C1's decision will not increase efficiency. However, since C1 could not know this, it seems fair that C1 should not be held to blame for this failure.

Importantly, however, just as the excusability principle for doctors doesn't relieve them of their duty to promote the health of their patients, the excusability principle for managers does not imply that firms or their managers are relieved of the duty to promote Pareto efficiency or of minimizing market failure. What it means is that firms should not be held to blame for failing to promote efficiency, to the extent that they have a reasonable excuse for this failure, such as an inability to foresee the effects on efficiency due to deep epistemic uncertainty.[4]

Conclusion

The moral requirements of the MFA are, as Heath (2014) himself points out,[5] very demanding, even if the epistemic problem posed by Endörfer and Larue (2022) is diminished by the heuristic approach. This is the case also when the MFA is combined with the excusability principle. Nonetheless, the excusability principle makes the MFA less "onerous in principle" (Endörfer and Larue 2022, 9; cf. Heath 2011: 38), in that it provides relief from blame in those cases where agents fail (for good reasons) to live up to the high standards of the approach. It thus contributes to countering Endörfer and Larue's charge of over-demandingness—without pushing the MFA into the trap of under-demandingness by giving up on the obligation to promote social optima.

This resolves the demandingness dilemma posed by Endörfer and Larue (2022). More generally, the excusability principle means the MFA can remain a demanding moral theory for business agents, while not risking the placement of undue blame on agents for not living up to its requirements in cases where doing so is too demanding. In sum,

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[4] Note that the excusability principle does not imply a denial that firms might, under certain circumstances, have a further duty to correct or compensate for their failure. Cf. Duus-Otterström (2023) on the relation between being exempted from a duty not to emit greenhouse gases in cases of so-called subsistence emissions, and the duty one under certain circumstances may nevertheless have to correct or compensate for such emissions.

[5] Heath (2014: 200) refers to the MFA in one place as an "extremely demanding deontology."

the principle makes the MFA more plausible as a theory of business ethics under non-ideal circumstances.

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