

The Business System

(1) Industrial policy (regulatory) view: US should use industrial policies to promote cooperative problem solving of long-term economic issues (e.g., recession, inflation, job losses, environmental issues)

(2) Anti-industrial policy view: We should avoid the “peril” of government regulation, since centralized government planning goes against free market traditions, and is counterproductive

Ideology: “An ideology is a system of normative beliefs [i.e., values, ideals] shared by members of some social group” (129)

Value systems: tell us how society, the market, government, etc. *should* work

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Economic systems: Traditional, Market & Command Systems

Traditional system: Economic functions carried out by those in specific communal roles, according to custom

Command system: An authoritarian body (or individual) decides what is produced, by whom, and who gets it; it then communicates these decisions to other system members

Examples: China, North Korea, Canada/US during WWII, vertically integrated businesses

Free markets (Laissez-faire): No government or traditional involvement; economic decisions made solely by “free” decisions of individuals, corporations

Each firm makes its own decisions about what gets produced, etc. They then exchange goods to get the best possible prices

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There are no *pure* traditional, command or market systems

e.g., Pure market system has **no** constraints: Slaves, prostitutes, hard drugs are all tradable

In reality, every economy restricts what can be owned (slaves), what can't be done with one's property (pollution), what can't be sold (child labour, drugs), and also puts taxes on exchanges

So, every economy has some command system features: Public welfare, as determined by governments, regulates certain features of the economy

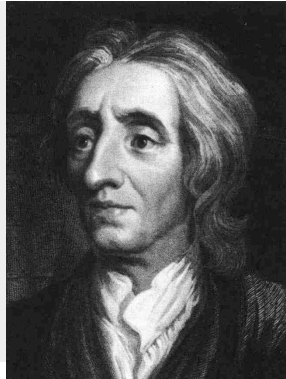
Two arguments for free markets: Locke's rights and Smith's utility
John Locke (1632-1704): We have basic “natural” rights to liberty and the fruits of our labours

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In Locke's terms, prior to civil society, human beings exist in a state of nature, a state prior to forming a legitimate government

In the state of nature, we have natural rights: e.g., the rights to struggle for survival, self-defence, and to protect what is ours

Locke: It is "self-evident" from nature "that being all equal and independent, no one ought to harm another in his life, health, liberty, or possessions" (130)



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So, if one "mixes" one's labour with an object one owns, the modification of the product is also one's own

Locke recognizes that the state of nature is very insecure, because many will not respect natural rights; so we will rationally form a social contract to protect our natural rights

So the government/society we create to protect our rights cannot legitimately remove them

So, no one should be forced from their natural state, and be subjugated to another; and cooperative ventures should be voluntary

Locke's view entails also free markets to allow people to voluntarily exchange their property and labour

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The American Constitution's Fifth Amendment (Jefferson) echoes Locke's language: "No person shall be...deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation" (131)

The American view about natural property rights is not universal; e.g., in Japan property rights are secondary, in that they can be overridden by the public good

Criticism of "Lockean" Rights

(a) What is the *proof* that individuals have natural rights?

Lockeans (Libertarians) have not generally provided arguments that rights to property and liberty are natural rights, beyond saying these are "self-evident"; Yet many rational people don't find these "natural" rights to be obvious.

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(b) Positive rights sometimes trump negative rights.

Why must liberty and property rights always trump others? E.g., why should my personal liberty always trump others' positive rights to food, medical care, etc.?

(c) Libertarian rights sometimes conflict with justice.

Free markets can create unjust inequalities. Those who already have considerable property have vastly more productive power and can use this power to widen the gap between rich and poor.

Without intervention, many will barely survive, while others will grow enormously rich

Evidence (133-5): in 2001, when US wealth was high, about 12 percent lived in poverty; 30 percent lacked health coverage; from 2.3 to 3.5 million people were homeless; 1/5 of American children were poor

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The top one percent owned 17% of total income, 47% of total financial wealth, and 38% of total US net worth, with a median household net worth of \$10.2 million

By contrast the middle 40% had 38% of total income, 10% of total financial wealth, and 16.5% of total US net worth, with a median household net worth of from \$61,000 to \$161,000

The gap between haves/nots has grown, inequality has greatly increased, etc. (Note: The largest changes began during the '80s and accelerated during the '90s)

(d) Locke's individualistic assumptions sometimes conflict with the demands of caring

Human beings are not naturally "atomistic" individuals, but are born into caring relationships

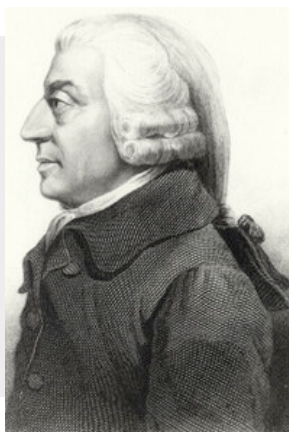
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In fact, instead of being initially free individuals, our personal liberties and property derive from our social situation and on skills we got from others, and cooperative work with employees, employers, etc.

We are morally required to nurture the caring relationships we have benefited from

The Utility of Free Markets: Adam Smith

Thesis: Unregulated markets and private property will produce greater benefits than will any regulated organization.



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Argument: With a free market and private ownership, buyers will seek what they want at the lowest possible price; so businesses that produce what consumers want, at the best price, will prosper. To keep prices low, businesses will seek to cut back on the costly resources they use; hence the free market produces what people want, at the cheapest price, with the most efficient use of resources.

Adam Smith's "invisible hand": "By directing [his] industry in such a manner as its produce may be of the greatest value, [the individual] intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end that was no part of his intention....By pursuing his own interest he frequently promotes that of society more effectively than when he really intends to promote it...."

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It is not from the benevolence of the butcher, the baker, and the brewer that we expect our dinner, but from their regard for their own self-interest. We address ourselves not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their own advantages" (136)

If so, the markets use resources in the most efficient way possible; and this means that to maximize utility, the government should keep out of the economy.

Von Mises and Hayek's elaboration: It is impossible in principle for governments to allocate resources as well as the market, since it's impossible for governments to have enough information and capacity to calculate consumer demands:

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"the agency would have to know from day to day what things each consumer desired, what materials each producer would need to produce the countless things consumers desired, and would then have to calculate how best to allocate resources among interrelated producers so as to enable them to meet consumer desires" (137)



Arguments for private property: Public (common) ownership is not as good as private property, since (a) people tend more carefully to their own things; but they shirk common responsibilities; (b) it's more efficient to have each person look after specific things; (c) people are more peaceful, if they have their own things (Aquinas)



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Criticisms of Smith's "Invisible Hand":

(a) **Instability of competition:** Smith's free-market model ignores monopolies, where prices need not move to their lowest level

(b) **Externalities:** Manufacturers (and consumers) typically don't pay for the total cost of the goods they use (e.g., health, ecological problems caused by pollution; resource depletion; the social costs of advanced technology, psychological effect of mechanization on workers, economic shocks of depleted resources (Nfld. fish; BC forests))

(c) **Harm to social virtues:** People are not only motivated by self-interest, but also by concern for others; even markets do better when people constrain their self-interest by honesty and fairness. Market ideology is making people less caring and causing them to lose their natural benevolence.

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"The Corporation": Purely self-interested humans are psychopaths; purely free markets create "psychopathic" organizations

Against von Mises and Hayek (empirical): Some economies that use planned elements have been quite efficient (France, Sweden, Holland)

Oskar Lange showed *theoretically* that "a 'central planning board' could efficiently allocate goods ... without engaging in impossibly elaborate calculations. ... the central planners [only need] to receive reports on the sizes of the inventories of producers and price their commodities accordingly. Surplus inventories would indicate that lowering of prices was necessary..." (139)



Still, planning is only possible as one component, within an economy largely based on the market

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The Keynesian Criticism of Smith

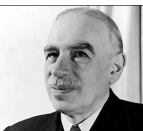
Adam Smith assumed that unregulated markets would automatically lead to full use of resources including labour



Say's Law: "Supply always creates its own demand."

That is, "in a free market, demand always expands to absorb the supply of commodities made from available resources (139)

Keynes's response: Supply often exceeds demand: The "aggregate" demands from the three sectors of the economy—households, business, and government—may be less than produced by an economy with full employment



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e.g. Households may choose to save their cash (liquid resources)

This leads to reduced supply, which leads to unemployment, household incomes fall, and the amount of savings falls. Eventually the economy reaches equilibrium but this equilibrium has many people unemployed and many resources not used.

Government can affect savings through monetary policy (interest rates and money supply), and by altering its tax rates. Further, government spending can itself increase demand (and inflation)

So, contra Adam Smith, government intervention can improve public utility

The stagflation of the '70s conflicted with Keynesian theory, since high employment was thought to produce inflation, and unemployment, deflation.

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However, in the '70s, there was both high inflation and unemployment; increased government spending was increasing inflation, but not employment

Diagnosis: The *neo-Keynesian*, John Hicks, argues that prices and wages were no longer controlled by competitive markets, but by agreements between producers and unions

Post-Keynesians still believe government spending can improve aggregate demand, but "must also curb the power of large oligopolistic groups" (141)

Social Darwinism: Ruthless competition produces the fittest people and the fittest business organizations; so, even if the free market doesn't maximize utility, it weeds out the weak and promotes the strong

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Criticism: Being the fittest in certain contexts may not be beneficial in more realistic, or otherwise preferred situations.

E.g., being the best at taking all the fish in Newfoundland leaves the Grand Banks with no cod.

Grammatical Clue: Fitness and efficiency are essentially *relative* expressions. We need to clarify: Fittest or most efficient *for* what?

Free Trade & Utility: David Ricardo

Free trade is advantageous between two countries even when one country has an "absolute advantage," i.e., can produce all its goods more cheaply than the other

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“Opportunity costs”: Given that any nation has limited resources, whatever it makes of one product, it must make relatively less of another

“Comparative advantage”: Where the opportunity costs (...in terms of other goods given up) or making a commodity are lower for one country than for another” (144)

While the “more expensive” country can’t compete on a product-by-product basis, it may have a comparative advantage in some products, in that it gives up less to make it than the other would have to



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So, globalization is actually advantageous for everyone

Criticisms of Ricardo: (i) Ricardo assumes that resources, such as labour, equipment, factories, don’t move, but modern corporations do just this

(ii) He also does not take “economies of scale” into account

(iii) Ricardo assumes that displaced workers can easily find new jobs, without huge costs, retraining, lost wages, etc., and

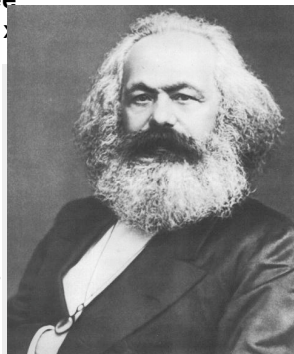
(iv) He ignores international rule-setting organizations, such as the WTO and IMF, which may harm weak countries in favour of the wealthier countries (or corporations)

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3.4 Marxist Criticisms of Free Markets & Trade Karl Marx (1818-1883)

During the Industrial Revolution, workers were forced to endure extreme working hours, lung diseases and early deaths, caused by unsanitary conditions

Seven year olds worked 12-15 hours a day; 30 seamstresses working in small rooms for 30 hours without a break



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Marx's thesis: Capitalism necessarily—i.e., working properly—produces inequality and exploitation

Argument: In capitalist systems, the only sources of income are labour or ownership of the means of production; since owners only pay workers a subsistence wage, workers do not get full value for their labour (Locke's theory of labour!). Profit is the difference between the value of the labour and the wage paid. Thus, in capitalism, owners continue to add to their income, while workers remain relatively poor.

Alienation: according to Marx, human beings should be helped to achieve their capacities for self expression (eating, drinking, buying books, going to the theatre, the pub, thinking, loving, theorizing singing, etc.)

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Further Thesis: Capitalism alienates people in four ways:

- (1) Capitalism alienates workers from what they produce by giving control of it to others, who then use this against the workers;
- (2) Capitalism alienates people from their natural work and forces them to do things they hate, just to survive;
- (3) Capitalism alienates people from their true needs, to make them into stingy economists, who store their treasures;
- (4) Capitalism alienates people from each other into antagonistic classes: the proletariat and the bourgeoisie.

Marx also thought that private property systems were wrong:

- (1) current private property systems give almost all property to a very few, so that most of us have very little or none

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- (2) contra Aquinas, private property is not necessary to make people hard workers, since the bourgeoisie have a huge amount of property, but are very idle

Historically, the actual purpose of government, Marx says, has been to protect the privileges of the ruling classes

Economic substructure of society

Forces of production: Materials used in production, such as land, labour, natural resources, machines, energy, technology

Relations of production: The social controls used to produce goods:

- (a) ownership of materials
- (b) ability to command

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Marx argues that the relations of production define the classes in any given society (e.g. lords/serfs; capitalists/workers)

Social superstructure: A society's government and its popular ideologies

Marx argues that the ruling classes always control the superstructure: e.g. in modern society, owners have the strongest choice on who governs, and these governors reinforce the power of the owners

"The ownership class, through its economists and its popularizing writers, inculcates the ideologies of free enterprise and of respect for private property....[so modern] government is not created by consent as Locke had claimed, but by a kind of economic determination" (150)

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Historical materialism: the view that material forms of production determine social substructures and superstructures

Immiseration of Workers: Capitalist exploitation of the working class (immiseration) contains internal contradictions: the system contains the seeds of its own destruction

Marx's proposed solution: *Communism*

1. Collective ownership of the means of production
2. A centrally planned economy to replace unregulated markets
3. Stages to communism: (a) "socialism": the dictatorship of the proletariat...(z) communism: the withering away of the state in a classless society

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Criticism of Marx: Immiseration did not occur, since workers in capitalist countries are much better off than their grandparents.

Reply: Lenin's Theory of Imperialism—Immiseration gets exported to the undeveloped world

Workers at home mollified by the profits from exploitation of third-world workers

Even at home, factory work is dehumanizing, unemployment and recession are recurrent problems, advertising corrupts our natural desires, & communities are breaking down

Free-marketeer replies:

- "Injustice" only means not paying people according to their contribution

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- although free markets naturally produce inequalities, they allocate resources without coercion
- Free markets don't undermine communities; they allow people to freely choose to which communities they will belong

Different values:

Rights to liberty and property vs. just distribution of social resources

Market efficiency vs. justice

Community and caring vs. individual rights

3.4 Conclusion: The Mixed Economy

Some people have claimed that the collapse of communism proves that capitalism is the best system (false dilemma?)

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Others argue that the success of planned economies such as Japan's proves otherwise

Mixed economy: An economy that keeps the market and private property, but uses government policies to mitigate the worst effects of the market system.

e.g. taxes to provide welfare, schooling, minimum wage laws, safety laws, labour laws, monopoly regulation, policing of firms, etc.

1. The US has much greater inequality than countries with (more) mixed economies
2. Over history, mixed economies have generally been more productive

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Next week: November 22: Ethics in the marketplace.

The ethical status of price-fixing, bribery, and other unfair business practices.

Readings

Velasquez, Chapter 4, "Ethics in the marketplace."

Case: Playing Monopoly: Microsoft (text, pp 194ff)

Case: Drug Company Monopolies and Profit (text, pp 178ff)

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