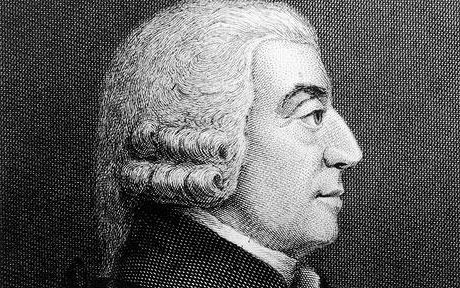
# The Ethics of the “Free Market”

Business ethics concerns issues that arise in **market economies,** where the overall production and consumption of goods is (mostly) determined by the decisions of individuals and firms. Market economies stand in stark contrast to **command economies,** where (most of) these decisions are made by a central authority. The most common examples of command economies are the USSR (which collapsed in 1991), and mid-20th-century China (which has since moved much closer to a market economy). In the contemporary world, nearly all major nations have adopted market economies, though the government still plays a prominent role in many areas of the economy (such as health care, infrastructure, education, and defense).

In some very general sense, many business ethics issues often concern cases of **market failure,** where markets (for whatever reason) fail to produce socially optimal optimal results, and where individuals, firms, and/or governments may need to act “counter” to market incentives. So, for example, this might include discriminatory hiring practices, environmental harm, insider trading, or many of the other things we’ve been discussing in this class. In this lesson, we’ll be stepping back to take a “big picture” look at market economies, and to consider some “foundational” issues related to them: Are markets *really* a good way to distribute goods? Are there certain characteristics of markets that are *inherently* unethical? What exactly should the role of the government be in a market economy, anyway? In order to do this, we’ll be looking at some of the market economy’s most important proponents, critics, and reformers.

## Adam Smith: The Wealth of Nations and the Invisible Hand

"As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it." (A. Smith, The Wealth of Nations)

**Adam Smith** (1723-1790) was a Scottish philosopher and economist who witnessed the beginning of the Industrial Revolution. His book *The Wealth of Nations* is often considered to be the first systematic defense of market economies, and the way that nations could use them to become wealthy. In general, Smith thought that many government actions of his time were actually counterproductive. Some of the more important arguments and ideas from the book are as follows:

**How Things Get Better: Division of Labor, Trade, and Markets.** Like many others, Smith was very impressed by the radical improvements in industry that occurred over the 18th century. He argued that this increased productivity was largely due to increased *division of labor,* where each person could focus on ever more finely refined tasks (which allowed them to work more efficiently). However, he noted that it only made sense for people to specialize in this way if it were possible for them to trade for things they *couldn’t* make on the free market. Among other things, Smith’s idea here (that specialization was at the heart of economic gains, and it could be increased only by opening up trade) cut against the **mercantilist idea** that nations could become wealthy by erecting trade barriers to try and encourage the sorts of native industry that would lead to positive trade balances. On Smith’s view, this sort of “zero sum” thinking is seriously mistaken, since it will leave the citizens of both nations worse off than they otherwise would have been.

**Letting the “Invisible Hand” Work.** Smith provided a detailed account of the market could find the “right” value for wages, prices, rents, etc. without any individual actually planning this, and even though the participants in the market had entirely private goals. Smith’s ideas are the basis of modern economics. For example, where demand for a good was high, “sellers” (landlords, laborers, etc.) will raise prices, which in turn provides motivation for increased supply, which will in turn meet the demand (and lower prices). Conversely, when demand is low, buyers will have greater leverage to demand reduce prices, which will (in the long run), lower supply, and so on. Smith argued that this dynamic showed that government attempts to help industry by “keeping wages low” (by suppressing their early forerunners of labor unions) was doomed to backfire. For this same reason, he opposed allowing business groups too much power over the government (such as the “East India Company,” which effectively used the publicly-funded British military and governmental power to advance private commercial interests). More generally, Smith thought that distant government bureaucrats should try to avoid overruling the judgement of those who were “closest” to the issue.

**So, What Should We Do?** Smith wrote two major books in his life: one on “private” moral judgement (*The Theory of Moral Sentiments),* and one on economics. However, he never really gave an account of how these connect up, or what this might mean for how society/government ought to be structured, all things considered (apparently, he’d meant to write this book at some point, but never got around to it). His various lectures and writings make it clear he thinks there is *some* role for government, both in regulating markets, and in helping the poor. However, he’s also clear that the government shouldn’t try to do too much, and that badly planned interference with markets can cause lots of problems. Where exactly the line should be drawn has remained as issue of debate for Smith’s many followers ever since.

## Karl Marx: Alienation, Exploitation, and the Coming REvolution

 “All these consequences follow from the fact that the worker is related to the product of his labour as to an alien object. For it is clear on this presupposition that the more the worker expends himself in work the more powerful becomes the world of objects which he creates in face of himself, the poorer he becomes in his inner life, and the less he belongs to himself. ... The worker puts his life into the object, and his life then belongs no longer to himself but to the object. The greater his activity, therefore, the less he possesses. What is embodied in the product of his labour is no longer his own. The greater this product is, therefore, the more he is diminished. The alienation of the worker in his product means not only that his labour becomes an object, assumes an external existence, but that it exists independently, outside himself, and alien to him, and that it stands opposed to him as an autonomous power. The life which he has given to the object sets itself against him as an alien and hostile force.” (K. Marx, “Economic and Philosophic Manuscripts”)

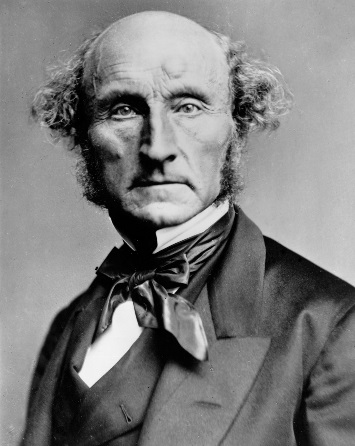
**Karl Marx** (1818-1883) was a German-born philosopher and economist. He is most famous for inspiring the “Communist” revolutions of the 20th century, but his work contains little/no guidance on command economies of this type. Instead, Marx is almost exclusively concerned with what he saw as the internal “contradictions” of the market economy described by Smith and later (mostly British) economists. Marx lived and worked in London for the last 30 years of his life, where he saw a much different aspect of capitalism than Smith did. Where Smith aimed to explain the vast improvements in productivity, Marx wanted to understand the origins of the inequality between the **bourgeois** owners of capital, and the **proletariat** that provided the labor (and who seemed to be no better off than they had been in pre-Industrial society).

**Commodities, Labor, and Alienation.** Marx defines a **commodity** as any good that can be exchanged in a market, and which has a use-value for humans. Like Adam Smith (but unlike modern economists), he goes on to identify the exchange **value** of a commodity with the amount of labor needed to produce it (the **labor theory of value**). Marx argues that there is sort of “fetishism” of commodities, where we begin to ignore the distinctive features of goods, and see them *only* in terms of their exchange value. The fact that market economies make commodities of everything thus presents a real problem, since workers become increasingly **alienated** from the products of their own labor. A practical example: Where Smith emphasized the great gains in productivity resulting from division of labor, Marx noticed that the new “jobs” created in factories were often repetitive, stressful, and boring. This made it ever-more difficult for workers to find meaning in their jobs; instead, they simply “worked in order to consume” (which itself fed the soul-crushing system by increasing the demand for commodities).

**Capital, Exploitation, and Inequality.** For Marx, **capital** (land, machinery, etc.) represented the “congealed labor” of all those workers that had helped construct or develop it. However, market economies allocate *control* of capital to a relatively few wealthy capitalists, who can use this control to **exploit** the workers who needed the capital to produce products, “steal” their excess labor, and reinvest these gains to increase their stock of capital. (So, for Marx, the *reason* stocks/bonds/real estate returned around 5% annually is because of theft of labor). Marx argued the logic of the market economy (with its regular cycles of booms and busts) would lead to ever-greater concentrations of capital, with fewer and fewer people having control of more and more of the capital. Eventually, the whole thing becomes politically unsustainable, and collapses when the proletariat (who now forms the huge majority) seizes control of capital. For Marx, this leads to the central contradiction of market economies—if they are simply “left to their own devices” (and if we assume that no new technology-related gains in productivity), they will self-destruct.

**What is a Just Society?** Marx famously predicted that a “Communist Revolution” would occur in the most developed capitalist societies of the day (such as Britain, or perhaps Germany/France/the U.S.), and that working classes would seize control of the highly-developed means of production, and use this productive power to create a more equitable society. This obviously didn’t happen, and it’s not entirely clear what Marx might have thought about the revolutions in Russia and China, which arguably weren’t even market economies when they adopted Communism. Marx’s analysis of market economies also proved to be overly pessimistic about both technological progress and the ability of democracies to act effectively to combat inequality. More generally, Marx (like Smith) doesn’t really say too much about what thinks society *should* look like, though he does (briefly) mention a “dictatorship of the proletariat,” that might succeed capitalism in the short-term. As is the case with Smith, there is considerable debate over what exactly Marx thought a “just” society would actually look like, and the extent to which his various followers have interpreted him correctly. In recent years (as gains in productivity have begun to slow down), economists such as **Thomas Piketty** have again began considering Marxist-style predictions about potential explosions in inequality, and the political problems this might eventually cause.

## John Stuart Mill: “Liberal” or “Libertarian”?

 “The object of this Essay is to assert one very simple principle, as entitled to govern absolutely the dealings of society with the individual in the way of compulsion and control, whether the means used be physical force in the form of legal penalties, or the moral coercion of public opinion. That principle is, that the sole end for which mankind are warranted, individually or collectively in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. He cannot rightfully be compelled to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinions of others, to do so would be wise, or even right. These are good reasons for remonstrating with him, or reasoning with him, or persuading him, or entreating him, but not for compelling him, or visiting him with any evil, in case he do otherwise. To justify that, the conduct from which it is desired to deter him must be calculated to produce evil to someone else. The only part of the conduct of any one, for which he is amenable to society, is that which concerns others. In the part which merely concerns himself, his independence is, of right, absolute. Over himself, over his own body and mind, the individual is sovereign.” (J.S. Mill, On Liberty)

**John Stuart Mill** was (arguably) the most important English-speaking political philosopher of the 19th century, and was one of the most important economists. His work attempts to provide something like a middle way between the **laissez faire** idea that government ought to avoid interfering in private markets at all, and the more radical attempts to dismantle the market altogether (such as communism). In some ways, his solution “won the day” against both groups, and modern-day “center-right” and “center-left” ideas about **mixed economies** (where a substantial governmental sector exists alongside private markets) have been influenced by Mill and his followers. Some basic ideas:

**Utilitarianism + Empiricism = Millianism.** Mill was among the most famous **utilitarians** in history, and he argued that the ultimate goal of governmental decisions should be to increase total happiness and decrease suffering (which he thought were the same thing). He was also an **empiricist,** who held that determining what actually “worked” required observation and experiment, and could not simply be deduced from pure reason. Mill thought that experience backed up many of Smith’s claims about the benefits of free markets, and he argued that governments should avoid acting in ways that economic theory suggested would be counterproductive. However, he also thought that economists were often too confident in their claims, and weren’t willing to recognize when their theories of how markets “ought” to work failed the test of real-world experience. As a utilitarian, Mill held that **private property** was an inherently social institution, as opposed to a “natural right” that the government needed to respect. So, for Mill, questions about taxation or regulation were essentially questions about what *worked.*

**What Governments Should NOT Do.** Mill’s utilitarianism led him to oppose slavery, and to support women’s rights, since he thought the harms to a great many people far outweighed any benefits to the relatively few. He also supported democratic institutions (though he wanted to give more weight to the vote of educated people). He famously defended the **Harm Principle,** which states that the ONLY reason that the government (or anybody else!) should interfere in other peoples’ lives is if their actions harm *someone else.* The Harm Principle means more than “the government shouldn’t arrest you”—it requires that we actually give people the space to express unpopular views (without trying to “shout them down”), or to lead lives that we find offensive (without trying to shame them). Mill used this principle to oppose laws (and social norms) that tried to control peoples’ sex lives (laws against polygamy, contraception, etc.). Right-leaning Millians (including many “libertarians”) have generally thought that governments are the major violators of the Harm Principle, while left-leaning Millians (“left-wing liberals”) have tended to focus on businesses, religions, etc. However, it is worth remembering there are also large numbers of non-libertarian conservatives (such as some religious conservatives) and non-liberal leftists (Marxists, some “progressives”) who do NOT accept the Harm Principle.

**A Role for Government Action: Education and Aid to the Poor.** Throughout his life, Mill tried to figure out how government could intervene *effectively* in the market to promote general welfare. In general, he thought the government should act only when free markets seemed unable or unwilling to solve problems. So, for example, it seemed obvious to Mill (and many others) that having a well-educated populace would be a good thing (it would improve people’s lives and drive business growth!). However, poor families often couldn’t afford to send their children to school (or were unwilling, since sending the children directly to work provided immediate money), and experience had shown that private donations by the rich simply weren’t enough to make up the difference. This is a clear case of a market failure, and Mill argued that it showed the necessity of public schools. However, Mill ALSO argued that the government should allow private schools, since imposing a mandatory, government-controlled curriculum would violate the Harm Principle (or something like it). Mill also worked extensively on reforming the **“**Poor Laws,”where tried to balance (1) making sure people had enough to live on and (2) making sure that they had a motive to work, and to not have more children than they could afford. Mill had a variety of ideas related to this: legalizing contraception, allowing women the right to vote/work/say “no” to their husbands, funding government “work” programs to provide *something* for the unemployed to do (even if these programs didn’t break a profit), and so on.

**Mill’s Complicated Legacy on Colonialism and International Economics.** In the years since his death, many of Mill’s ideas have been widely adopted (women’s rights, abolition of slavery, legalizing contraception, public education). When it came to international issues (especially with regards to Britain’s treatment of Ireland, India, and Nigeria), though, it seems as if Mill may have been too optimistic on the benefits of British rule vs. independence. Mill firmly believed that British rule (so long as corruption could be minimized) could/would introduce public education, free markets, democratic representation, and so on, which would (in the long run) benefit the people living in these colonies. In the Irish Potato famine, for example, Mill controversially pushed for land reform (to help future Irish farmers by providing them opportunities to own their land), instead of food aid (which would have helped those currently starving). This basic idea—that liberal, free-market institutions represent a uniquely *best* way of doing things, and that poor countries need to coerced/cajoled into implementing them—has been an issue of considerable controversy over the last 50 years. Much more recently, the Indian economist (and utilitarian) **Amartya Sen** won a Nobel Prize for his work on the economists of famine in developing countries, which he argued was often caused not simply by lack of food, but by market failures of various type. Sen, like other utilitarian economists, have built on generally Millian ideas to deal with cases that Mill either never thought of, or that he “got wrong.”

## Are We Missing the POint? Sustainable Development Models

While Smith, Marx, and Mill undoubtedly laid much of the groundwork for current approaches to thinking about the “market,” there are also a few other alternatives worth briefly mentioning[[1]](#footnote-1). These ideas are, in some broad sense, related to the idea that societies need to be **sustainable**, which may require we constrain free markets in various ways:

***Small is Beautiful: A Study of Economics as if People******Mattered* i**s a 1973 collection of essays by British economist E.F. Schumacher. In the book, Schumacher criticizes several tenets of conventional economic thinking (such as that of Smith, Marx, and Mill), particularly the assumption that increased economic productivity will increase human welfare. The book was a response to what Schumacher felt was a false but widespread view: namely, that the best way to address to problems such as poverty, starvation, and war was to increase the amount of goods and services that were being produced or (perhaps) to change the way they were distributed. Schumacher emphasizes the frequently ignored “costs” of increased economic productivity, such as the consumption of finite natural resources, the pollution of the environment, and the happiness of workers who are made redundant by deploying advanced technology. As an alternative to maximizing productivity, Schumacher argues we ought to focus our efforts on lowering consumption and on developing so-called “intermediate technology” that allows people (especially in developing countries) the opportunity to engage in meaningful work. Schumacher’s arguments in *Small is Beautiful* have proved to be enormously influential, and their influence has been felt in areas such as **sustainable development, environmental ethics,** and **organizational theory**. In particular, many scholars and policy makers have been influenced by Schumacher’s contention that things such as fossil fuels, the environment’s tolerance for pollution, and workers’ well-being are properly viewed as *capital* to be preserved and should not be treated as *income* to be spent.

**The Economics of Happiness?** In general, economic measures of a country’s success are expressed as **Gross Domestic Product** per capita (basically, the market value of all goods and services produced dived by number of people). This encourage a certain notion of what it means for a country to “succeed”: it should increase GDP/per capita. By contrast, **gross national happiness** is a non-quantitative measure of the overall quality of life of a nation’s citizens that takes into account both economic and noneconomic criteria. All other things being equal, a nation with a high gross national happiness is more “developed” than a nation with a low gross national happiness. The concept was first articulated in 1972 by the king of Bhutan, Jigme Singye Wangchuck, and the government of Bhutan has used it to assess their citizens’ well-being and analyze the effects of government policies. The concept of gross national happiness was developed in response to the perceived shortcomings with purely economic measures of development, such as gross domestic product (GDP). In addition to economic criteria, a country’s gross national happiness depends on factors such as the conservation of cultural heritage, equitable development, fair governance, and preservation of the natural environment. Proponents of gross national happiness often point out that once citizens’ basic needs are met, further increases in income make relatively small differences to how happy citizens are. Moreover, there are certain ways of increasing GDP (such as exploiting natural resources) that may actually leave citizens worse off, and thus decrease gross national happiness.

## Review Questions

1. Compare Smith’s and Marx’s view of the benefits/harms of the free market. What (if anything) does each thinker get “right” or “wrong”?
2. In very general terms, Smith seems to think that human wellbeing can be best improved by increasing market efficiency, which requires ever-increasing specialization of labor. Marx, on the other hand, thinks that human wellbeing depends on there being opportunities for meaningful work, which specialization of labor works against. Is there any way of achieving \*both\* goals?
3. To what extent would you describe your own views of society as “Millian?” Which of Mill’s ideas do you agree/disagree with? Why?
4. How, if at all, do you think that our current market economy might be altered to make it “better” (whether this be more productive, fairer, more sustainable, or whatever)?

1. I’ve adapted the descriptions in this sections from contributions I wrote for the following book: Arp, R (editor). 2013. *1001 Ideas that Changed the Way We Think*. Atria Publishing. [↑](#footnote-ref-1)