9. THE MARKET AND SOCIAL CAPITAL

The world is now dominated by different types of market economies. They can be highly productive. They provide freedom for people to choose their occupation and to change jobs, even to start up their own businesses. There are many stores among which to shop for things consumers want. And market economies tend to be innovative of new products and to foster technological progress.

Adam Smith, in a famous passage in his book, THE WEALTH OF NATIONS, said that we do not need to depend upon the good will of the butcher or baker to be provided for, because it is in the butcher and the baker's economic self interest to supply some of our needs. He generalized the example to say that in a market economy people's economic self interest leads them, as by an invisible hand, to produce the things that other people want to buy. Private economic interest and social interest are thus made to coincide. That is a matter of very great importance.

However that is not the whole story about a market economy. For everyone knows that profit can also be obtained in our market economy by fraudulent scams at the expense of unknowing people. Who has not been taken advantage of at some time, and has not at least bought something that was not as good as it was advertised to be. It turns out that private interest and social interest do not always coincide automatically as by an invisible hand. Indeed Adam Smith knew that well enough. In a passage seldom quoted, he noted that whenever business men get together even for lunch they are apt to be hatching a plot to take advantage of consumers.

It is true that we can depend for the products we want on the self-interest of business firms. But we also need to depend upon them not to cheat us. The market economy does indeed depend for its smooth functioning upon general adherence to a common standard of morality. When that breaks down, somebody can be taken advantage of. Sometimes such breakdowns are front page news.

The fact of the matter is that the market functions as well as it does because there are ethical rules that are generally observed. Many a business deal is sealed with a handshake, or even a phone confirmation. One can usually trust that the contract will be fulfilled satisfactorily.

To be sure, that is not always a safe procedure. Before one relies on it, one should be fairly certain of the reliability and trustworthiness of the business. Often it is safe to assume this. Why? And what about when it is not safe? Well, long before governments enacted laws to ensure that contracts were observed, and provided legal procedures if they were not, in the days when a market economy was still in its infancy, the law merchant was devised by business interests and enforced by them in their own courts.

Now government regulation of business is extensive, much of it developed in order to provide limited protection for either business or household buyers against defective products or some outright scams. However, it is clear that we cannot fully legislate a satisfactory level of business morality. As consequence, we have to depend sometimes upon the level of business morality being adequate. For a long time we could count on this being provided by our religious ethical traditions. There were some things most businesses would not do to make additional money.

This moral framework within which much business operates was part of what is sometimes called the social capital of the market system. It ensured a quality of economic life that was very important, quite apart from the the fact that it increased efficiency by eliminating the extra paper work and litigation that would otherwise be necessary to carry on business transactions.

But more recently the hold of traditional religion has weakened in the business world. Indeed in many quarters it has disappeared entirely and has been replaced with the notion that “business is business” and ethical considerations have no proper place in it. It is assumed that profit maximization is the proper objective of business, whatever the effects on some other people. Anything that increases profits is o.k. & unquestioned.

In the early days of the industrial revolution, it was not uncommon to have people working 12 hour days in dirty places at unsafe machinery. There was tremendous resistance in the business community to reducing the freedom of employers to subject people to such conditions. Even economists opposed factory reform legislation with the mistaken prediction that reform would raise costs so much that business would be unprofitable and the jobs would disappear. Business profits despite regulatory laws, but usually stays within their limits in practice.

This does not preclude business from trying to pas self-serving laws that allow it to do whatever might be profitable, and opposing laws that protect the environment or improve working conditions if they raise costs. Much money and effort does indeed go into both such efforts. When it can’t write laws to deregulate business completely, it tries to appoint its henchmen to the regulatory agencies.

To oppose Federal regulatory legislation it is argued that it should be left to states on the theory that each state may need to have different provisions. But each state legislature can be played off against its neighboring states on the ground that any state that spent more and so taxed more or set higher regulatory requirements than its neighbors would lose businesses to them.

This may sound to some readers like an anti-business essay. It is nothing of the kind. No American in his right mind could be anti-business. As Calvin Coolidge is reported to have said--the business of America is business. We all depend entirely on business for our livelihood. We all have a huge stake in the success of business in general and in the proper operation of our capitalist market economy. Its proper operation depends among other things on what is called social capital, the ethical framework in which it operates at its best. It also requires some government regulation to protect ethical business from being undercut by competition of those with fewer scruples.

As the 21st century opens, there is increasing fear in this country that some changes are taking place in our economic system that are aggravated but not explained by the recession. In much of the past it was true that the country's large middle class could count on stable jobs with the businesses they worked for. Our economy was known for having produced a quite large, stable and prosperous middle class. Worker loyalty to the business and business loyalty to the worker were like inseparable twins. However, middle class employees, both blue collar and white collar, have now become increasingly insecure. Millions of good stable jobs have been eliminated, and often replaced by labor treated as part-time "independent contractors" at lower pay. Perhaps this is due to continuous pressure from Wall Street to cut costs and raise stock prices. That may also be a factor in the widespread accounting scandals that were uncovered. In any case, it would be quite a change in our business economy if the stability of the middle class were to come to an end at the same time that the vast majority of income gains for the nation were taken by the top few percent of income receivers. It is hard to understand federal tax reductions largely going to the top few percent in view of all this.

There is no way that it can be properly argued that the public must leave everything to the market. The market sometimes produces deplorable results that can only be remedied by a combination of government regulation of business and some revival of the business conscience and business morality. Neither can alone do the entire job of improving economic conditions that is sometimes needed.

It took Upton Sinclair's book, THE JUNGLE, to get government action in the 20th century to improve conditions in the Chicago slaughtering firms and make it less likely that meat we bought would make us sick. In our own day we have problems again because clothing sweatshops have reappeared. And there are deplorable conditions in the Maquiladoras along the Mexican border, which are factories established there by U. S. firms.

To get back to Adam Smith's invisible hand, the problem is to get private profit making confined to instances where it serves the social well-being without harming it in any way, so that private and social interest do coincide fully, and thus to eliminate profit from doing things that are in any respect contrary to the public interest.

Even business is aware of the fact that it may be possible to make a profit in the short run in ways that prevent their continuing to be profitable in the long run. To continue to make profit in the long run it may be necessary to treat customers well in every short run. If a firm takes undue advantage of them in the short run, they will not return if there are competitors who treat them better. Consumers are stakeholders whom it pays to treat well. So profit maximization is not as simple as it first appears.

The financial press does not seem to recognize that the most important stakeholders in American business are the employees who actually produce the goods and services that business sells and the communities in which businesses are located and which depend upon their good behavior. It says that the purpose of business is to “create value” for stockholders, i.e. to raise stock prices. It is not possible to raise stock prices continuously. Can that be defended as THE purpose of business?

Once only the owner of property was thought to take proper care of it. Once stockholders were thought of as owners of corporation property. But stockholders are not liable for corporation debts, most could not function as owners, are not either interested in acting as owners nor competent to do so. In the recent stock market boom, many bought stock for the first time, not so much for dividends as attracted by the prospect of capital gains. It was not wise if they put in more than they could afford to lose. Most stockholders also are speculators, hoping to make capital gains. There is a lot of stock trading, none of which furnishes business any money at all, only new stock issues do. By far the largest part of new business capital (some 82% in a recent year) comes from profits. Some new business capital comes from borrowing (some 14% in a recent year). Only a tiny fraction comes from new stock issues (4% in a recent year). So not all profit is paid to stockholders either.

But if a business does not hit whatever it may arbitrarily set as its target rate of profit, we appear to think that it is legitimate for the business to shut down, whatever the consequences for all the other stakeholders in the business, including the community it leaves, and to seek its target rate in some other endeavor at some other location.

That may affect adversely many others who have a big stake in the successful operation of the business in the community. The employees may not be able to get other jobs in the community. They may have to move with their entire families, if they can manage it, to some other city to try to find employment again for which they are suitable. They may or may not find it. The community in which the business was located may be hard hit as well, if it was a major employer in the area. The customers who depended upon it will probably be able to find another seller. If we were not so wedded to the idea that firms had to make some arbitrarily predetermined rate of profit, it might dawn on us that everyone was being well served so long as the firm was producing something useful to the community, treated its employees and its suppliers well, and covered all its costs. Major stakeholder interests would be better served than by leaving in the hope it could do better elsewhere by its stockholders, largely temporary speculators in its stock.

Indeed that is not the worst violation of common decency in the name of profit maximization. Bartlett and Steele in their book, AMERICA: WHAT WENT WRONG?, recount quite a list of instances where the public interest was violated. Among the worst were instances where, with Wall Street's aid, those who raided and took over firms received millions of dollars for doing so, and in the bargain saddled the captured firms with debt they could hardly pay. If Wall Street cannot get an American to engage in the takeovers, they can and do encourage Japanese to take over American firms.

We ought to be clear about one thing. The increased inequality in incomes and wealth in America cannot be justified when some individuals are making millions out of such financial manipulations at the same time that many people are still living in poverty, some of whom are even working full time producing things we need. Why should anyone have the ability to command millions of dollars worth of output while others cannot claim enough to live decently on? Indeed, our multimillionaires are unable to live up all their income, so they try to invest it to make still more income that they can't even use.

Which brings us to the question of how much saving can be profitably invested, year after year, in producing more goods when there is not enough purchasing power spent on consumer goods because of the millions siphoned off to produce more of them. The issue is often framed as incentives vs. markets. Business talks as though there was always a need for more high income incentives to induce investments. But a market economy needs strong markets to provide the basis for investments to produce more output. If markets for products are not strong enough, income incentives do not induce investment. And if markets are strong, almost any positive reward for investment will induce it.

We should also realize that, in considering who is warranted in taking what income as a reward for their economic contribution, both popular theories and professional economic theory is wrong. It is popularly held that the CEO deserves his high rewards because it is he who produces them. Without him they would not be there. He creates the jobs and the profits. Never mind that CEOs take huge pay even when they are behaving busily in ways that are bankrupting their firms. Never mind that they take credit when the economy booms and they ride the wave, but not the blame when the economy declines and so does their business. The fact is that, even if they are performing well, most of the actual work of production that is reaping rewards is being done by their employees, without whom the CEO would also be worthless. And it is consumer purchases, if they have enough purchasing power, that keeps the whole business going.

As for the economist, he argues that each factor of production, the laborer and the CEO for that matter, are paid their marginal productivity. That is, they are paid what their own efforts add to the net revenues of the firm. And, it is said, that is the way it should be, and in any case that is all the firm can afford to pay them. Their marginal productivity determines their rate of pay. It is an odd theory, considering that many a CEO can virtually write his own pay check, bonus and stock option, so long as his largely handpicked board of directors does not think it is too outrageous. But as for wages, they could be determined by anything under the sun, and it would still be true that labor would be hired only up to the point where the marginal product of the laborer equaled his wage. Marginal productivity determines the amount of labor hired, given a wage determined somehow; it does not itself determine the wage rate.

If one wonders why there are working poor, they are so unskilled that they cannot earn a living wage. There is another answer that makes more sense. Although it would be desirable that they obtain skills that would be more highly rewarded, making scarce skills more plentiful would reduce their wage rate too, so this is not enough of an answer.

The fact of the matter is that bargaining power matters in the market, and some people have little of it, while others have a lot. In the days of John L. Lewis, a union leader of the United Mine Workers Union, many mines were not unionized, and wages were very low there for very hard, dirty and dangerous work. The price of non-union coal was consequently low. When Lewis tried to unionize the other mines it was said that it would be ruinous to the mine companies. They could not afford to pay higher wages because they were already paying all the unskilled miners were adding to their net revenues. But Lewis persisted and unionized the mines, and wages were raised by strikes and threats to strike. Bargaining power raised miners wages, and lo and behold the price of coal went up enough so that the miners were still being paid their marginal product which was now higher in dollar terms. Middle class people found they now had to pay something closer to a living wage to miners to get their coal. At worst the middle class could not afford as many luxuries now. Indeed the mines began to be mechanized, and miners began to produce a larger volume of coal.

Some participants in a market economy may need help to make a decent living when others can take an inordinate share of the output. Indeed there are always some who through no fault of their own are at least temporarily unable to pay their bills---either their jobs have disappeared and they have not yet been able to find others, or they have been hit by illness that disable them and by medical bills they cannot meet, or they may have reached old age without having been able to save enough to meet its expenses. Economic insecurity can hit anyone, except the very wealthy, harder than they can handle it. For many years these people were left at the mercy of private charities or to their fate in public poor houses, but these were very poor answers to their problems and became increasingly unable to handle the case load. So private and public insurance came to the rescue.

Private insurance suffices to cover all those insurable economic risks for people whose incomes are adequate to buy the insurance. Unemployment is not a privately insurable risk, and many do not make enough income to save adequately for old age or for every conceivable medical emergency. Hence social insurance. Because everybody is at risk, everybody can be forced to contribute, and when everybody does, instead of only those who would choose to do so, the cost per person can be kept relatively low.

We still have not learned that in the case of medical insurance, including appropriate long term care in old age. So we have a very inadequate medical insurance system which leaves many people uninsured. Some mistakenly think they are always going to be healthy, or rich enough to meet their medical bills. Others are judged by private insurance companies to have pre-existing conditions which might require more medical treatment than healthy people, so they are rejected for insurance. Many businesses are saddled with the cost of insuring their employees and often their families against medical expenses. The logic of this is faulty. Business should be required to carry only those medical costs which are due to occupational accidents and diseases.

But the political battle over reform of the medical insurance system was marked by so much misrepresentation of the issues that it is a cause for despair about democracy's ability to handle any real social problem rationally.

And we have yet to adjust our Social Security properly so that it remains financially sound, though there are a number of ways that this could be done. But the idea of simply returning it to individuals to protect themselves ignores both some people's inability and others' improvidence. It ignores the real success of our social safety net system which is well described in John E. Schwarz's book, AMERICA'S HIDDEN SUCCESS.

Robert Kuttner wrote in the magazine The American Prospect, "The American Republic has long had a set of public and nonprofit institutions that enrich our democracy by demonstrating that society is more than a mere market." It is clear that we do not have a market for spouses, or for children, and have no notion that all things in life are valued properly by the market. The market has its place, a very prominent place, but it does not determine all human values, nor provide all our needs in life. Instead we have to establish our value system independently of the market, and judge the market partly by that value system.

Some of mankind's finest accomplishments were not great market successes. That includes some of our greatest musical, artistic and literary masterpieces. And our public parks and libraries were often due primarily to the public spiritedness of generations past. Indeed their lack in some places is due to the lack of such public spiritedness and the more exclusive concentration upon making it individually in the market. Civic responsibilities are not a part of the market system. Voluntary organizations through which many people work cooperatively to accomplish something important for the common good are part of the social capital upon which society and even the market economy itself depends heavily.

It is hard to overestimate the importance of the public school system in providing a common educational background for our citizenry, well supplemented though it is by private education. That it is in trouble because of miseducation by TV and sometimes by lack of sufficient parental control of and assistance in education of their children is not to be cured by draining funds from it. Schooling is not a highly profitable undertaking, so market competition is no remedy for its real ills. It is a prime example of a consumer good, a producer good, and a public good where the external benefits exceed any private monetary returns.

Economists tend to provide a role for a government sector in market economies only in the cases of what they call "market failure". It exists wherever it does not pay to leave something to the market, and to each person's private purchase, to determine the amount of it that would best serve the public interest. So we do not have all roads as toll roads. Nor do all neighbors have to get together to determine that they shall have a street or police or a fire department available to them. Each neighborhood does not then have to pay whatever these things would cost each of them in a market. Government paves the roads, and it requires utility companies to serve newly developing neighborhoods as well as the profitable old ones. We have also decided that not all parks should be private enterprises to make or fail to make a profit. And it does not seem to be a good idea that we should see if the market would provide a satisfactory system of meat inspection. We don't trust it to do so, perhaps with good reason. Some things we do at the local government level, some at the state level, and some at the federal level, usually a matter of what level is needed to get the job done best. And taxes pay for these things. Some of them would not exist if left to the market, while others would cost more and be harder to get.

With a little thought, it will be apparent that this list of things in the government sector of the economy, or in the role of government as a regulator of the market, could be continued for quite some space. There is always room for a legitimate question of whether something should be in the government sector of the economy, or in the market sector, or in the informal private or social sector of the economy. Likewise there is always room to question whether government regulation of the market is desirable or undesirable in principle or as sometimes practiced. There are horror stories of stupid regulations, and of regulations that serve corporate rather than the public interest. These present a challenge to the political process to regulate intelligently and only in the public interest.

But a philosophy that all government is bad and everything should be left to an unregulated market is obvious nonsense. Moreover, such a philosophy is usually only a rationalization for wanting unlimited opportunity to use the market in ways that are not always going to serve the public well and will sometimes serve it very badly indeed. The idea that "that government is best that governs least" is equally nonsense. Very little federal government was needed when this was a nation of largely self-sufficient farmers. But with an economy like ours is now, no one in his right mind would want to reduce government to what it was in Jefferson's day. That is not to say that every government expenditure now is justifiable. Everyone knows, or should know, of the so-called "pork barrel". The government budget gets loaded with special favors of one sort or another for some firms in almost every Congressman's district or Senator's state. And it is politically hard to cut these, but the pork barrel clearly should be what is cut.

To go back to the market, let us consider advertising. It is necessary to inform people of what they are buying and what the price is. Yet most of our advertising is not properly informative. It often misleads or misinforms. It often treats the buyer like Pavlov's dog, to condition her to want the product, trying to rob her of her real freedom. Profits need not depend on such advertising. When advertising aims merely to make a person feel good, or appeals to one's feelings or needs, without offering any real information about the superiority of the product over competing brands, it is not really helpful in making a rational choice among brands. The economy would not collapse if sellers' consciences led them to the put in advertising only what the seller would tell a spouse or his or her own child or a close relative to help them decide what to buy.

Advertising, as it is, requires each of us to distinguish between what is said in the interest of the seller and what we ourselves need to know.

More generally, in our actions as buyers or sellers, as consumers or producers, as participants in voluntary organizations, as writers or speakers, as voters or politicians, indeed in everything we do or decline to do, it is very desirable that we think about and act in the general public interest rather than in ways that are against it. When we do that we are helping provide the social capital that makes the whole economy and the whole society function well. It is anti-social activity that is the problem, whether it is violent crime or white collar crime, or simply the more common pursuit of special interest at the expense of the public.

To be sure, special interest is not always at the expense of the public. It is contrary to the public interest when a business merger enables someone to make millions out of the merger while saddling a firm with a heavy debt. It is not contrary to the public interest when the special interest is constituted by the poverty stricken, or those without medical insurance, or others who need a better safety net, or those often discriminated against. We would have a much stronger economy, as well as much more social well-being if ways were found to remedy the problems of those in real need. There is no need to provide more opportunities for those already doing too well.

How does all this add up? Market economies are better for us than any alternative if they are properly regulated in the public interest. So you and I need to support good government regulation of the economy. We should not leave it to business lobbyists to determine government policies, nor should we leave it to those politicians whom we can sometimes see represent them rather than representing the public. We need to support every effort that gets business to serve all its stakeholders, everyone it affects, and not merely its stockholders, the majority of whom are speculators. And since we never know when economic disaster, either job loss or crippling medical bills will hit us, we need to protect and strengthen the social safety net because we too might need it. It is desirable, but not sufficient to save what we can. We need to vote, but to do so carefully, intelligently, and with a social conscience.