eyetwist/kevin balluff

2 Capitalism

Learning Objectives

After completing this chapter, you should be able to:

- Describe the main features of capitalism and socialism.
- Explain the three main aspects of Adam Smith's account of capitalism and Karl Marx's account of socialism.
- Assess the main criticisms of capitalism and socialism.
- Explain how various anticompetitive practices undermine capitalism.
- Describe the reasons and mechanisms for government regulation of the marketplace.

Chapter Outline

2.1 Introduction

In the spring of 2000, protestors took to the streets in Bolivia, South America's poorest country. The reason? The Bolivian government had leased the water rights of several regions in the drought-stricken nation to private companies. One was the U.S. engineering company Bechtel, which agreed to expand and bring efficiency to the water resources of those regions. This meant that all of the area's water resources fell within its domain, even the gathering of rainwater. Shortly after Bechtel took control, water prices in one city tripled, sparking major protests. The government declared martial law and police were called in, killing at least six protesters and injuring over 170 others. The Bolivian government subsequently canceled the water contract with Bechtel.

Bechtel was not an inherently evil corporation that intentionally entered Bolivia to extract money from a poverty-stricken population. In their defense, company executives said that the price increases were initiated by the local government, not by them. Bechtel was experienced in the managing of water resources and was simply there to do a job. Nevertheless, the company's involvement in the privatization of water became a symbol for capitalism's having gone too far. Once water was privatized, the Bolivians could not even collect rainwater for their own drinking without first obtaining a permit. This appears to be a situation of forcing private market solutions upon what are ultimately public-sector problems. Water access, it seems, is a public right, and when water becomes scarce, the task of managing those resources should fall to the government, whose primary task is to protect the public good.

Associated Press/Julie Plasencia

In this photo, a Bolivian man demonstrates against the privatization of water and subsequent rate hikes in his region. He holds a sign that says, "What is ours is ours and it cannot be taken away."

At the heart of many issues in business ethics, like the privatization of water, is the economic system under which businesses themselves operate; generally speaking, the two competing economic systems are *capitalism* and *socialism*. The one looks to the free market, the other to government control. In this chapter, we will look at the tension between these two ideologies, and the ethical implications of adopting one of these systems over the other. We will consider their essential features and the specific theories of their two most famous defenders, Adam Smith and Karl Marx. We will then examine anticompetitive business practices that undermine the free market, and the role of the government in keeping the market competitive.

2.2 Capitalism and Socialism Defined

There are no official definitions of either capitalism or socialism upon which everyone agrees. One reason for this is that these theories are so multifaceted and all-encompassing that they resist being distilled into a single formula. Another reason is that the concepts are at the center of an intense ideological battle, which often makes it difficult to avoid personal bias even with simple formulations of the concepts. Nevertheless, there are recurring themes with both of these notions, which can provide a starting point for discussion.

Capitalism

As an economic theory, **capitalism** maintains that

- personal self-interest, not community interest, motivates economic development;
- the major sources of society's economic production should be privately owned, not governmentally owned; and
- economic planning should be decentralized through market competition, not centralized through government policy.

To clarify, the first point maintains that the engine that drives all business activity is the desire for personal gain. This does not necessarily commit the capitalist to the radical theory of *psychological egoism*, which states that all human actions are selfishly motivated and that humans are psychologically incapable of performing purely altruistic actions. However, it does imply that, within the arena of business activity, all players do what they do in hopes of financial gain. Whether it is the venture capitalist, the private entrepreneur, the corporate executive, or the worker, the prospect of making money is the carrot that motivates.

In economics, this idea is expressed in the concept of the **profit motive**: The ultimate purpose of a commercial enterprise is to earn a profit. That is the reason that businesses exist. According to this view, it is a psychological fact that self-interest motivates economic activity, and from an ethical perspective, that is the way it *should* be. Throughout history, the flourishing of civilizations has gone hand in hand with vigorous economic activity—craftsmanship, industry, and trade with neighboring countries. Whatever gains societies make through economic development owe at least in part to this kind of self-interest.

One popular way of expressing this notion is with the idea that **greed is good**: With life in general and the business world in particular, the human drive of self-interest directs our energy and creativity. The term *greed* is not the most flattering way of depicting the idea of the profit motive; since the Middle Ages, greed has been listed as one of the seven deadly sins. However, by designating greed as morally "good," the implication is that this aspect of human nature can be redirected to motivate business activity in a proficient and positive way. In the words of the character Gordon Gekko in the movie *Wall Street*, "Greed, for lack of a better word, is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit" (Pressman & Stone, 1987).

The second tenet of capitalism is that the major sources of society's economic production should be privately owned, not governmentally owned. This includes land, raw materials, factories, retail stores, transportation services, communication networks, and any other major component of a country's economy. According to capitalists, all of these things function better when owned and operated by private individuals or organizations than when owned by the government. Part of the reason for this is efficiency: If you own your own business, you will be personally motivated to do everything in your power to succeed. You will be responsive to the needs and demands of consumers; if you are not, you risk going out of business. With government ownership, that element of personal interest is stripped away.

Another justification for private ownership is the very notion of the moral right to private property: The businesses that we create are part of our personal property, and we are entitled to keep them. While the political concept of the natural right to property is only about three centuries old, the human sense of entitlement to personal property is much older and part of human nature itself. At the purely animalistic level, it is a manifestation of territoriality, in the same way that birds own their nests and beavers own their dams. The Italian philosopher Niccolò Machiavelli vividly encapsulated the zeal we have for private property: A political ruler "must keep his hands off the property of others, because people more quickly forget the death of their father than the loss of their inheritance" (1532/1988). According to capitalists, a government's taking away our private property is one of the greatest moral violations.

Associated Press/Bikas Das

In this 2011 photo, activists from the Socialist Unity Center of India (SUCI) show their support for the Occupy movement that originated in the United States.

Concerning the third point of capitalism, that economic planning should be decentralized through market competition, this is the basic idea of **free market economics**. That is, businesses should be governed by the laws of supply and demand, not restrained by government interference. The idea of competition in a free market is often compared with the evolutionary notion of **survival of the fittest**. With the evolutionary notion, species with the best adaptations, such as long claws, win out over rival species that are less well adapted, such as those with shorter claws. The losers die out and the winners live to compete against future rivals. In business, companies are best adapted to a competitive marketplace when they can offer a higher quality product for a cheaper price. Companies that are nimble and can quickly seize new market opportunities are the ones that will survive; the losers will go out of business. In the process, products improve, consumers are happier, jobs are created, and wealth is generated. Contrast that with a situation where governments control or severely restrict business production and the ability to compete against rivals. Prices would remain fixed, quality would stagnate, and responsiveness to consumer demands would be low. According to capitalists, governments should simply stay out of the marketplace—as indicated by the adopted French expression **laissez-faire**, "leave it alone."

Socialism

We turn now to the concept of **socialism**, which holds the exact opposite of the three tenets of capitalism mentioned previously. That is,

- community interest, not personal self-interest, should motivate economic development;
- the major sources of society's economic production should be governmentally owned, not privately owned; and
- economic planning should be centralized through government policy, not decentralized through market competition.

Regarding the first point, socialists do not deny the place that self-interest holds in human motivation. We are clearly selfish creatures at many levels, and some of that selfishness may be unavoidable. However, we are not at our best when our actions are dominated by selfish inclinations and we behave more like animals. Within human nature there is another drive—a community-oriented one—that better reflects our true human character. Virtually every political philosopher for the past 2,500 years has acknowledged the social character of human nature: We cannot survive on our own, and we require a community of diverse members to meet our survival needs. We are not lone survivalists, fending for ourselves in the untamed wild; in fact, the human species was never like that. For the vast majority of our 500,000-year existence as a species, we lived in tribes as hunter-gatherers. These were small groups, typically extended families, and most tribal activity focused on the survival of the community. The concept of "every man for himself" did not make much sense in that context. It was only with the emergence of city life 12,000 years ago, during the agricultural revolution, that the opportunity even arose for an economic system that could be driven by personal greed.

That chapter of human history has not been a pretty one. Land and other resources have been plundered, workers have been exploited and enslaved. These and other morally heinous acts are the regular consequence of an economic system dominated by self-interest. Socialism, by contrast, involves shaping an economic system in a way that is more consistent with our community interests.

The second tenet of socialism is that the major sources of society's economic production should be governmentally owned, not privately owned. Private ownership of the economic base leads to the accumulation of wealth in the hands of a few powerful owners and the degeneration of society into a system of those who have and those who have not. The socialist writer Pierre-Joseph Proudhon made the famous statement that "property is theft," by which he meant that business owners steal profits from the workers. Workers are the ones who essentially create the wealth, but they are coerced into a working situation where they reap almost none of the rewards. To that extent, it is much like slavery. Further, with regard to private ownership, socialists believe that owners have too much control over how they manage their property, and that they can act in ways that harm society as a whole. Owners can wipe out natural resources, such as timber and even water. They can take the best land for themselves, leaving nothing of value to the masses of the poor. They can sell off the nation's food supply to foreign markets if that becomes profitable. All of these ethical abuses of property cease when the property is owned and managed by a government that sees its mission as the betterment of society as a whole, including all of the social classes it contains.

The third tenet of socialism is that economic planning should be centralized through government policy, not decentralized through market competition. Consider again the "survival of the fittest" metaphor of market competition. What capitalists emphasize is the lower prices and higher quality of goods that result from competition. What they sweep under the carpet, according to socialists, are the more negative aspects of survival of the fittest. For every winner there is a loser, and when a company goes under, it is the army of unemployed workers who suffer the most. They often have no financial safety net in the way that wealthy business owners do, and they often need to uproot their families and relocate in hopes of finding other employment. Further, when competition is stiff, there is pressure for a business to survive at all costs; owners will continually find creative ways to cheat, either in direct violation of laws or with unethical tactics that stay just one step ahead of lawmakers. All of these ethical problems are eliminated when a government itself plans the economy in response to consumer needs. Rather than have businesses claw each other to death as they fight to dominate every new consumer market, the government addresses those needs in an orderly way that causes the least amount of social upheaval.

Again, these descriptions of capitalism and socialism express recurring themes in these ideologies, and different proponents will have their own points of emphasis. Two economists are associated with the opposing systems of capitalism and socialism, namely Adam Smith (1723–1790) and Karl Marx (1818–1883). No capitalist or socialist accepts as truth every point that these thinkers made. But their writings are still held in almost scriptural reverence, and long after the words of contemporary defenders of those rival ideologies are forgotten, the writings of Smith and Marx will remain as blueprints for the economic systems that they forged. We will look at highlights of their respective views next, particularly ones that are as relevant today as they were in the two men's lifetimes.

2.3 Adam Smith's Capitalism

The Scottish philosopher Adam Smith was a professor of moral philosophy at the University of Glasgow and the author of two important works in ethics and economics: *The Theory of Moral Sentiments* (1759) and *An Inquiry Into the Nature and Causes of the Wealth of Nations* (1776). Although Smith's theory of capitalism is detailed, there are three concepts central to it:

1. The economy is driven by selfish desire for luxury goods;
2. economic balance is achieved through a self-regulating invisible hand; and
3. the government's role in a nation's economic system should be limited.

We will look at each of these concepts.

Selfish Desire for Luxury Goods

Selfishness, according to Smith, is a fundamental driving force of human conduct. Although Smith did not go so far as to say that *every* human action arises from selfish motives, he believed that selfishness is the foundation of an important segment of our public actions. It drives each person to take "proper care of his health, his life, or his fortune," which are among the most important moral duties that we owe to ourselves (Smith, 1759/1982, 4.2.3). It is also the fundamental motive that determines how we acquire from others what we need for our survival and success. I cannot survive on my own, and my most basic needs for food can only be met through the cooperation of others. To get you to help me, though, I cannot rely on your kindness. Rather, I must find some way for you to personally benefit before you will consider assisting me. Smith wrote:

> Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own 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 advantages. (1776/1981, 1.2)

To get what I need, it will always come down to the old adage that I will scratch your back if you scratch mine.

Just as selfishness drives me to acquire life's necessities, it also motivates me to acquire luxuries, improve my position in society, and climb the ladder of financial success. According to Smith, a poor person envies the easy and comfortable lifestyles of the rich, wants that for him- or herself, and works diligently and with great difficulty to acquire it. The person devotes years to education, acquires a marketable skill, and struggles to build up a client base, often working for people he or she hates. Throughout life, the person is driven by the selfish belief that achieving an opulent life with wealth and disposable luxury goods will bring happiness. The fact is that it will not necessarily make the person happier, and in the end the person will probably be more miserable for all those efforts: "Through the whole of his life he pursues the idea of a certain artificial and elegant repose which he may never arrive at, for which he sacrifices a real tranquility that is at all times in his power" (Smith, 1759/1982, 4.1).

Smith's point is that we naturally desire luxury items that appear to be a means of happiness, and thus we block out the thoughts of toil and misery that go along with acquiring and maintaining those things. If it looks like it will make our lives happier, we will want it and pursue it, even if on balance that effort will make us unhappier. It is this desire for luxury that drives the economy, and the irony is that it is grounded in a natural deception. Smith wrote:

Lan Cheng sz/Imaginechina

According to Smith, the desire for luxury drives the economy. In this photo, a pedestrian walks past a Max Mara luxury store in Shanghai.

> It is this deception which rouses and keeps in continual motion the industry of mankind. It is this which first prompted them to cultivate the ground, to build houses, to found cities and commonwealths, and to invent and improve all the sciences and arts, which ennoble and embellish human life; which have entirely changed the whole face of the globe. (1759/1982, 4.1)

In sum, selfishness motivates our desire for both necessities and luxuries, and we get what we desire only by appealing to the selfishness of others. Also, the selfish desire for luxuries is what drives the whole economy.

The Invisible Hand

The second component of Smith's theory is perhaps what he is most famous for, namely the idea that by pursuing our self-interest, we indirectly promote the good of society as if directed by an **invisible hand**. There is a natural tendency towards self-regulation in economic systems, which creates economic balance within society. Smith used the expression "invisible hand" only twice in his economic writings, emphasizing a different point each time. First he described how the wealth of the rich will be automatically distributed to poor workers. As we accumulate our wealth, there is still only a limited amount that any one person can consume, and the remainder of that wealth will ultimately make its way to workers who make our wealth and lifestyle possible. He wrote:

> [The rich] consume little more than the poor, and in spite of their natural selfishness and rapacity . . . they divide with the poor the produce of all their improvements. They are led by an invisible hand to make nearly the same distribution of the necessaries of life, which would have been made, had the earth been divided into equal portions among all its inhabitants, and thus without intending it, without knowing

> it, advance the interest of the society, and afford means to the multiplication of the species. When providence divided the earth among a few lordly masters, it neither forgot nor abandoned those who seemed to have been left out in the partition. These last too enjoy their share of all that it produces. (Smith, 1759/1982, 4.1)

According to this view, economic growth flows down from the top to the bottom, indirectly benefiting those at the bottom. To support their luxurious lifestyles, the rich need a network of workers to produce goods and provide services. This occurs when, for example, a rich farmer employs laborers to grow crops and maintain the property. It also occurs when the farmer buys luxury goods, thereby giving work to carpenters, clothiers, artists, and book publishers who might live a hundred miles away or more. This automatic spreading of wealth throughout society is an important moral good.

Royalty-free

Adam Smith's theory of capitalism contains three central concepts: (1) The economy is driven by selfish desire for luxury goods, (2) economic balance is achieved through a self-regulating invisible hand, and (3) the government's role in a nation's economic system should be limited.

Smith's other description of the invisible hand involves international trade; he supported what we now call **free trade**, namely the concept that trade across national boundaries should take place without interference from the respective governments. In Smith's day, as now, individual countries typically tried to acquire more wealth than rival countries. The formula for doing this is to increase one's exports while, at the same time, decreasing one's imports. Governments have used a range of protectionist policies to achieve these goals, such as placing taxes and caps on imported items. Smith rejected these protectionist policies and argued that if we just allow businesses to follow their own self-interest, their country's economy as a whole will improve. I, as a businessperson, know that my company will perform better when the economy of the whole country thrives. I will thus be naturally inclined to support the domestic economy, even when my principal aim is to increase my own business. Smith wrote:

> 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. I have never known much good done by those who affected to trade for the public good. (1776/1981, 1.2)

Although these are the only two instances where Smith used the expression "invisible hand," in this quote he indicated that "in many other cases" the concept of the invisible hand applies, and a larger moral and social benefit is achieved when we pursue our own interests.

Limited Role of Government

The third component of Smith's theory is that, although the presence of government is sometimes necessary in the economic development of a society, its role should be limited and, when possible, it should allow private industries to assume tasks. Governments often take on the kind of activities that private industries and organizations do. They own and operate post offices, energy services, water utilities, transportation networks, educational institutions, and even religious establishments. Smith argued that there are three fundamental duties of governments, and that beyond those, private industries are better suited to take on tasks. The first governmental duty is defense, the use of military force to protect society from violence and attack from rival countries. The more advanced the society is, the more expensive its weaponry will be, and there is no avoiding those costs to the public. The government's second duty is to run a judicial system that protects "every member of the society from the injustice or oppression of every other member of it" (Smith, 1776/1981, 5.1.2). The costs of running a judicial system, Smith argued, can to a large extent be defrayed through court fees.

Even among the most extreme critics of big government, there is little dispute about the government's fundamental role in defending the country and operating a judicial system. However, according to Smith, there is yet a third area of legitimate government involvement, and that involves public works and institutions that are of great benefit to society but too unprofitable to be taken on through private industry. These, according to Smith, fall into three categories:

1. First, there are public works and institutions that are necessary for businesses to operate effectively, including the creation of roadways, bridges, harbors, and other parts of the transportation infrastructure. Smith also mentioned post offices and foreign embassies as institutions that are essential for commerce. Much of the cost of these commerce-based projects can be covered through tolls and user fees, without placing a burden on general public funds.
2. Second, there are government programs devoted to public education. The government has a strong interest in educating "inferior ranks of people," who, Smith said, seem to be "mutilated and deformed in a still more essential part of the character of human nature" (1776/1981, 5.1.3). Through education, people will be less prone to superstition, and therefore to public disorder. Also, when properly educated, the masses are "less apt to be misled into any wanton or unnecessary opposition to the measures of government" (Smith, 1776/1981, 5.1.3). Costs of public education, Smith argued, can be paid for through student fees or educational endowments.
3. Third, there are public institutions that are responsible for religious instruction. The United Kingdom, in Smith's day as now, had a

What Would You Do?

You are a congressional representative. Up for debate is whether several popular government programs should continue to be funded through tax dollars or instead be privatized and run as for-profit businesses. The central issues are the social importance of these programs, the question of whether they could be economically viable if privatized, and your moral responsibility to your constituents.

1. Would you privatize the interstate highway system and have motorists pay for its use through tolls?
2. Would you privatize NASA, and essentially make space exploration a for-profit venture?
3. Would you privatize all K–12 school systems, thereby permitting them to be for-profit companies?
4. Would you privatize Social Security, thereby making Social Security retirement benefits vulnerable to poor investment decisions and market volatility?

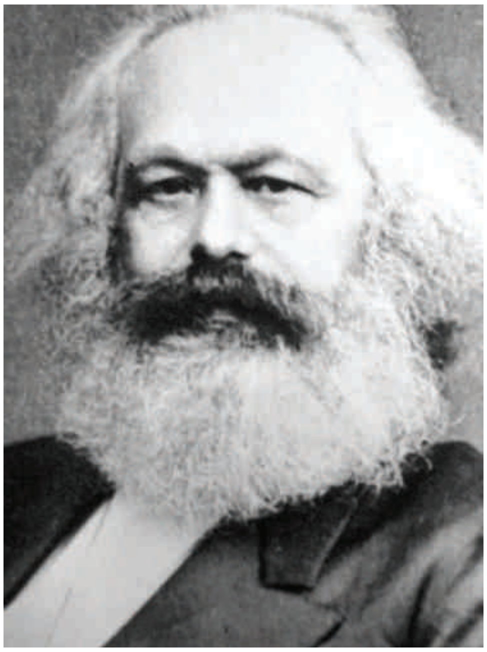
state-funded religion, namely the Church of England. Smith's view on the public funding of religion was rather radical. The worst part about religion, he argued, is that it perpetuates fanaticism, superstition, and civil unrest. State-supported religions are particularly bad at this, he argued, and the United Kingdom's state-run church was responsible for the deaths of thousands through religious persecutions. According to Smith, religion would be more moderate if churches were run privately in a competitive free market, where each church would of necessity learn to be tolerant of its rivals. Although state religions should be abolished, according to Smith, the government should create programs to reduce religious superstition even further. For example, the educated class could be required to study science, which, he said, "is the great antidote to the poison of enthusiasm and superstition." The government should also publicly fund "painting, poetry, music, dancing" and other forms of art that Smith believed help remove the gloominess of religious fanaticism (Smith, 1776/1981, 5.1.3).

All three of these roles of government, according to Smith, aim at enhancing the well-being of society in ways that private industries are incapable of doing by themselves.

2.4 Karl Marx's Socialism

Born in Germany, Karl Marx was trained as a philosopher, but he is best remembered as a political activist and champion of the theory of **communism**, a radical form of socialism that aims to abolish all social classes, private property, and even government. Although Marx was a prolific writer, his two most famous works are *The Communist Manifesto* (1848), a document calling for workers to launch a revolution, and *Capital* (1867–1894), which critiques the capitalist economic system. Like Smith's theory, Marx's view of socialism is detailed, but there are three main features of it that we will examine:

1. In a capitalist system, workers are alienated from their labor;
2. in capitalism, there is a class struggle between the working class and the business owners; and
3. workers must improve their situation by revolting against capitalist forces in society.



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Karl Marx's theory of communism contains three main features: (1) In a capitalist system, workers are alienated from their labor; (2) in capitalism, there is a class struggle between the working class and the business owners; and (3) workers must improve their situation by revolting against capitalist forces in society.

Alienated Labor

Like Smith, Marx believed that egoism is a strong motivating force for people's conduct and that people are naturally driven to seek their own benefit in economic matters. But, he argued, our egoistic tendencies are a distortion of a more inner and essential part of human nature that is community oriented. Through our community nature, our choices and actions are connected with others around us, not in conflict with others. But according to Marx, capitalist societies and economic systems have embraced the egoistic, dog-eat-dog part of human nature, and this egoism is evident in the so-called natural rights that countries like the United States and France have embraced.

The right to liberty gives us a private sphere of conduct in which we can do what we want in isolation of others. Marx wrote, "The right of man to liberty is based not on the association of man with man, but on the separation of man from man. It is the *right* of this separation, the right of the *restricted* individual, withdrawn into himself" (1843/1926). The natural right to private property works the same way: It allows us to accumulate wealth for our own selfish needs, "without regard to other men, independently of society" (Marx, 1843). The natural right of equality simply says that each person is equally entitled to live and act in isolation from others. Still worse is the natural right to security, which states that governments and their policing power are established to protect us as we exercise our liberties for our own benefit in isolation from others.

Marx argued that when our entire social and economic systems are directed towards egoistic needs, then we as individual people become fractured and alienated from our inner community nature. This is most evident in how the vast majority of workers are forced into job environments in which they become mere tools for the egoistic benefit of the owners. Take a typical factory job. I need money to survive, and my only employment opportunity requires me to labor in a textile factory, performing specific tasks on a textile loom all day, all for the financial benefit of the owner. Although I get paid, I have no choice in what I do, no personal stake or say in what happens to the products that I make, and, most importantly, no opportunity to connect my labor to the community in a meaningful way. This is Marx's notion of **alienated labor**: I become alienated from my true inner nature when I am forced to give my labor away to the factory owner. Workers have nothing left to sell to survive but their own labor. Marx argued that this is much like prostitution: Out of financial desperation, the prostitute sells off a critical part of her identity that she would otherwise reserve for the intimate bonding with her spouse. In a more perfect economic environment, I would not be coerced into prostituting my labor for a measly paycheck. I would be more in control of what I produce and how I use my labor to bond with the larger community.

For Marx, here is what happens when our labor is not alienated and, instead, our job routines are in accord with our true community nature. Suppose that I have a cottage industry in which I design and manufacture shirts within my house.

1. First, when I produce a shirt through my labor, I impose my creative identity on the world. Who I am as a person in some sense becomes transformed into the physical world, and I can take pleasure in seeing the physical expression of my creative personality with my own two eyes.
2. Second, when you need a shirt and buy it from me, I can take pleasure in the fact that I have satisfied a specific human need that you have.
3. Third, I become the social mediator between you and your human need, and because of that you acknowledge my role in completing a necessary part of your identity.
4. Finally, the shirt that you now wear becomes part of your identity. Through the creative expression of my life, then, "I would have directly created your expression of your life" (Marx, 1844).

The end result is that through my creative expression, I connect with my community. In Marx's words, "in my individual activity I would have directly *confirmed* and *realized* my true nature, my

Xie Zhengyi/Imaginechina; Associated Press/Hadi Mizban

Why is the relational level of communication especially important in building customer relationships?

human nature, my *communal nature*" (1844). The financial exchange between you and me will still be part of the transaction, and I will still need your money in order to survive. However, the financial component will be more of a secondary issue, and the primary issues of our transaction will be self-expression and community bonding. This removes the alienation of labor and places economic transactions on a higher moral level.

Even today we see this community bonding with craftspeople who have a love for their trade and enjoy sharing their goods with others. But this unalienated approach to labor is very difficult to achieve in modern capitalist and industrial work environments. Businesses do what they can to get their workers to identify with their products and the benefit that they bring to society. The more hierarchical terms *employee* and *supervisor* have commonly been replaced with the more group-oriented terms *team member* and *team leader*. In a sense, this acknowledges Marx's assessment of worker psychology: We do not want to feel like prostitutes in our jobs, and we want some creative input. The critical issue, though, is whether the reality of one's job can live up to the managerial jargon of "team membership," which Marx would undoubtedly say it cannot do.

Class Struggle

Within the typical capitalist system, then, workers are coerced into prostituting their labor, they are alienated from their true communal nature, and, as a result, they are very unhappy. This leads to the next major component of Marx's theory: **class struggle**. Throughout history, societies have evolved through conflicts between the social classes of those who do the work and those who are in charge and benefit from that work. The class conflicts that occurred throughout history were not simple ones involving bad worker attitudes; rather, they often resulted in great social upheavals and revolutions. Marx wrote:

> The history of all hitherto existing societies is the history of class struggles. Freeman and slave, patrician and plebeian, lord and serf, guild-master and journeyman, in a word, oppressor and oppressed, stood in constant opposition to one another, carried on an uninterrupted, now hidden, now open fight, a fight that each time ended, either in a revolutionary re-constitution of society at large, or in the common ruin of the contending classes (1848/1967).

For Marx, the class struggles throughout history revealed a very noticeable pattern between oppressors and the oppressed workers. In Roman times there was a major class struggle between masters and slaves. Tensions grew, which included slave rebellions, and in time, that system of slavery was replaced by a slightly different social hierarchy in the Middle Ages, between nobles and serfs. That tension was eventually replaced during the Renaissance with the emergence of the middle class. But the oppression still continued, as the middle class gained financial strength and formed a capitalist economic system that continued to oppress workers.

Marx witnessed firsthand the 19th-century industrial revolution, which radically transformed the manufacturing of coal, iron, textile, and glass. This was the first time that nonaristocrat business owners controlled major industries, and to that extent, it was a social triumph. However, this new class of large-scale business owners—the **bourgeoisie**, as Marx called them—were as oppressive to workers as previous members of the ruling class had been. Working conditions were ghastly, pay was minuscule, and workers had next to no political representation. Charles Dickens's novels, such as *Hard Times*, give us a glimpse of the oppressive working conditions during the 19th century that Marx was reacting against. In many ways, the economic realities of the industrial revolution made working conditions even worse for workers than they had been in previous eras. Manufacturing facilities became larger and, through division of labor, work tasks became more tedious:

> Owing to the extensive use of machinery and to division of labor, the work of the proletarians has lost all individual character, and consequently, all charm for the workman. He becomes an appendage of the machine, and it is only the most simple, most monotonous, and most easily acquired skill, that is required of him. Hence, the cost of production of a workman is restricted, almost entirely, to the means of subsistence that he requires for his maintenance, and for the propagation of his race (Marx, 1848/1967).

Workers must sell themselves for the performance of these tedious tasks and become one more commodity in the economic system. Like articles of commerce, they are "exposed to all the risks of competition, to all the fluctuations of the market" (Marx, 1848/1967). The situation for workers gets progressively worse as their value in the market decreases.

Revolution

Marx argued that the time for change had come, and in the next phase of social progress, workers would once more rise up against their oppressors. But this time it would be different. In previous phases of social history, changes in hierarchy did not end oppression: The bosses changed, but the exploitation of workers remained the same. With this next phase, the workers would overthrow the ruling class, seize control of the economy, and destroy the institution of private property, which has always been the principal source of exploitation.

For Marx, the long-term goal of the revolution was communism, which, as indicated before, involves the creation of a society without private property, class division, or government. To achieve that ultimate goal, however, Marx argued that after the revolution, society must go through a transitional phase of socialism where the government takes control of major economic resources within society and enacts policies to reduce class distinctions between the rich and poor. Marx recognized that the ruling class would be horrified at the idea of revolutionaries abolishing private property, but, he continued, in existing capitalist societies, "private property is already done away with for nine-tenths of the population" (1848/1967). The abolition of private property cannot come about through reforms of existing governmental policies, since governments are so embedded with the interests of the ruling class. Only a full-scale revolution will make it possible—one country at a time. This, he believed, is inevitable.

Once the working class has control, Marx argued, the process of abolishing private property will differ somewhat from country to country, but the more advanced countries will follow a common path. That is, a transitional system of socialism will be put in place, which, step by step, will dismantle the social framework of capitalism and replace it with a more community-oriented set of policies. Here, in Marx's words (1848/1967), are the steps that he envisioned, now referred to as the **Ten Planks of Communism**:

1. Abolition of property in land and application of all rents of land to public purposes.
2. A heavy progressive or graduated income tax.
3. Abolition of all right of inheritance.
4. Confiscation of the property of all emigrants and rebels.
5. Centralization of credit in the hands of the State, by means of a national bank with State capital and an exclusive monopoly.
6. Centralization of the means of communication and transport in the hands of the State.
7. Extension of factories and instruments of production owned by the State; the bringing into cultivation of waste-lands, and the improvement of the soil generally in accordance with a common plan.
8. Equal liability of all to labor. Establishment of industrial armies, especially for agriculture.
9. Combination of agriculture with manufacturing industries; gradual abolition of the distinction between town and country, by a more equable distribution of the population over the country.
10. Free education for all children in public schools. Abolition of children's factory labor in its present form. Combination of education with industrial production, etc.

The socialist revolution, as Marx envisioned it, constitutes a thorough moral transformation of society that eliminates the alienation and oppression of workers and makes social benefits available to all people equally. For Marx, when the residue of capitalism has been thoroughly scrubbed away, society will enter an era of true communism. All class distinctions will disappear, since there will no longer be a class of workers that is distinct from a class of owners. Without private property, economic conflict will also disappear, at which point the government's role in social organization will become unnecessary and the government will eventually die out.

Associated Press

This 1950 poster, which was displayed in Moscow, urged citizens to vote for candidates such as Joseph Stalin. The poster reads, "A human being has the right to study, rest, and work."

2.5 Assessment of Capitalism and Socialism

The theories of capitalism and socialism have both been hotly debated since they were first forged; we will look at some of the standard criticisms of each. As complex as both theories are, we cannot expect simple criticisms to decisively refute either of them. Further, over time, defenders of both theories have attempted to address problems posed by critics and revise their theories accordingly. Those revised theories are often even more resilient to standard attacks. Nevertheless, general criticisms do reveal potential weak links in the theories.

Criticisms of Capitalism

The fundamental criticism of capitalism is that competitive markets have a built-in bias towards private interests rather than public ones. There are several manifestations of this bias:

- Capitalism leads to dramatic economic inequality and introduces class divisions between the rich and poor, which is precisely what was of concern to Marx.
- It is a system in which the worker's labor is a commodity to be bought and sold, which often leads to dreadful working conditions. It is true that many companies today realize the value of people and have spent considerable effort and research to create job satisfaction. Nevertheless, job satisfaction remains low among workers in unskilled and semiskilled jobs, such as laborers, packagers, food preparers, cashiers, stockers, and servers (Smith, 2007). And for many workers in foreign countries who manufacture products sold in the United States, their situation is not much different from that of laborers in Marx's day.
- It fosters environmental destruction and has no built-in incentive for environmental stewardship.
- It tends to be politically undemocratic by enabling large businesses to use their enormous wealth to lobby the government against consumer interests in favor of their own financial well-being.
- It cannot be trusted to shape national policy in the interests of the public, as witnessed by the elimination of public transportation systems throughout the United States and the movement of manufacturing facilities overseas.
- It creates antisocial motivations in both buyers and sellers. Buyers take advantage of return policies and are quick to sue companies for even honest mistakes. Sellers mislead buyers about the quality of their products and services. Buyer and seller become more like adversaries in the market, rather than partners.

There are countless examples of how capitalism is inherently in tension with moral responsibility to the public, and most of the problems and famous examples covered in this book arise from that tension. In a sense, the entire study of business ethics is a testament to the fundamental problems of capitalism.

Criticisms of Socialism

Turning next to socialism, we find three main criticisms. First, we cannot restrain our motivations of personal self-interest in the manner that socialists advise. Although socialists agree that it is impossible to fully eradicate human selfishness, they recommend subduing it to the point that our community-oriented motivations guide how we develop society's institutions and economic structure. But even that might be asking too much. Personal self-interest drives us to devote time and energy to better our situation, and without some substantial personal reward, we might not be willing to devote that kind of effort to the greater social good. Personal ambition has been at the forefront of technological innovation and personal progress, and socialists have not adequately explained how we can transfer that drive to public interests.

A second and related criticism of socialism concerns the difficulty in significantly scaling back on private property, as more extreme socialists advise. Like human selfishness, property ownership is deeply ingrained in human nature—even monks, who take vows of poverty and live their entire lives in communal monasteries, still own their own toothbrushes. In a sense, socialists attempt to impose a prehistoric model of communal society on modern economy. According to socialists, just as primitive tribes held their major resources in common, so too should we in modern society hold ours in common. But according to critics, the fit does not work very well in the modern setting. We have moved beyond our hunter-gatherer roots, and through the complex demands of urbanization, we have reinvented ourselves and found a new way to flourish based on harnessing our private desires for wealth and property. The tie that binds together tribal societies is daily contact with each other; the life and activity of one tribe member immediately overlaps with those of others, like a large family. But modern society is too large to be like a real family; it is a mere abstract concept that does not allow for the same bonding experience that is possible in small tribal groups. As the size of society grows, so too does our impulse towards private property.

Finally, socialist policies of centralized planning are ineffective ways of structuring the economy, as the failed efforts of the former Soviet Union with centralized planning teach us. Banking, industrial production, and distribution of goods and services were organized and carried out based on a master plan devised by the Soviet government. The principal problem with such centralization is inefficiency: It creates unpredictable deficiencies and surpluses. As hard as the Soviet government tried to predict how much bread or toilet paper its citizens needed on a daily or weekly basis, there would nevertheless be great deficiencies in some cities on some days and great surpluses in others. Breadlines were a common occurrence, where people would stand outside a bread store all night to buy as much bread as permitted the next morning before supplies ran out.

Moderate Versions

These are just some of the standard arguments against both socialism and capitalism, and again, defenders of each of these ideologies certainly have rebuttals. But when assessing the respective merits of both ideologies, it is important to recognize that there are both extreme and moderate versions of each, which fall along a spectrum from the most extreme capitalism to the most extreme socialism. Very few theorists espouse the most extreme versions, and in the real world, very few if any countries have ever implemented their economies in such extreme ways. Adam Smith himself recognized the need for the government's involvement in the national economy, such as to provide armies, roads, and schools and to undertake certain commercial ventures. Marx himself acknowledged that during the transitional period of socialism, there still would be some private ownership of the country's economic base.

More moderate versions of capitalism and socialism each aim to allow at least some market-based economy while at the same time providing a social safety net to citizens. One such position on the capitalist side of the spectrum is **welfare capitalism**, a term that originally referred to social-welfare services provided by employers in the early 20th century, such as paid vacations, medical benefits, and pensions. More recently it has come to refer to economic systems that are capitalistic but have social programs that the government runs, such as national health care and government-run child care.

On the socialist side there is **market socialism**. This term originally referred to worker-owned cooperative enterprises that operate within free-market systems but are set up in ways that

Dapd/Michael Probst

Originally founded in Sweden, Ikea is a home-furnishings company that features Scandinavian-designed products. Sweden is an example of a country that adopts elements of both capitalism and socialism. On the capitalist side, their system allows for private ownership of businesses large and small. On the socialist side, their high tax rate of around 50% funds government programs of free health care and education.

prevent worker exploitation. Today it refers to economic systems that are socialist in terms of government ownership and control of major economic enterprises, but at the same time incorporate some capitalist policies, such as relying on supply and demand in the market to set prices.

Just as there are a variety of theoretical models of both capitalism and socialism, in the real world there are a variety of capitalist and socialist systems throughout the world. There is a benefit to this variety, in that each country functions like a laboratory experiment in economic policy that others throughout the world can observe and learn from. What are the failures and successes of these countries, and how might this knowledge help us improve our system?

2.6 Anticompetitive Practices

Economists classify the economic system of the United States as a type of welfare capitalism, similar to those of Australia and the United Kingdom. For countries like the United States that are committed to capitalism as an economic system, efforts are needed to keep the marketplace competitive and fair, and to prevent the free market itself from being destroyed. We will look at some of the most notorious anticompetitive business practices that must be guarded against.

Monopolies and Oligopolies

A natural outcome of competition in the marketplace is the emergence of **monopolies**, where a single company controls all or nearly all of the market for a given type of product or service. Suppose that a new market opens up for a 3-D TV, and 10 companies manufacture the product. In the normal course of competition, some companies will go under for having inferior technology or poor marketing. Other companies will merge, and in time, only one may be left standing. This scenario has played out again and again in the last few centuries, with notable examples from the past including Western Union, Standard Oil, U.S. Steel, and AT&T controlling the telegraph, petroleum, steel, and telephone markets, respectively. In more recent years, we have seen movement towards monopolies with De Beers and the diamond trade, Microsoft and computer operating systems, and Monsanto and the commercial seed market.

What, though, is so bad about monopolies? If a company wins fairly in its battle for market share, does it not deserve its position of dominance? Critics argue that monopolies destroy the very competitive markets that first created them, and in the process they eliminate the two key benefits of a capitalist economic system. That is, competition is no longer present to drive down prices and improve quality. For example, when AT&T dominated the telephone industry, prices were comparatively higher than they were after the company was forced to break up, and consumers had fewer options than after the breakup. Imagine what using the phone would be like today if AT&T were the only game in town. The almost infinite variety of cellular-phone applications that we have come to rely on would likely be only futuristic dreams.

But the companies accused of holding monopolies tell a different story. In the 2001 court case against Microsoft, for example, the software company argued that its dominance in the market had enhanced rather than harmed the innovation process throughout the entire software industry. Consumers, it argued, had also benefited from the low price of its operating system, its free applications, and the impact Microsoft had had in accelerating computer-software innovation more generally. It would be difficult to demonstrate that all monopolies will lead to a decrease in innovation and higher prices; however, there is a realistic fear that at least some monopolies will do so, and that is enough to make a monopoly a potentially anticompetitive practice.

Similar to a monopoly is an **oligopoly**, where the market is dominated by a small number of businesses that collectively exert control over that market's supply and prices. The petroleum, telecommunication, automobile, and soft-drink industries are the clear examples, but with other products, oligopolies are more concealed. There are, for example, dozens of national brands of laundry detergents on the market, but the vast majority are produced by only three companies. As with monopolies, the question remains whether the dominance of an oligopoly in a given market will of necessity harm innovation and result in higher prices.

Associated Press/J. Scott Applewhite

In this 2011 photo, Jeremy Stoppelman (left), CEO of Yelp, testifies at a Senate hearing held to determine whether Google used its power unfairly to expand into services and markets other than search-engine services. Nextag CEO Jeff Katz (center) and former Justice Department antitrust director Thomas Barnett (right) are also shown.

Two mechanisms that can lead to both monopolies and oligopolies are mergers and acquisitions. A **merger** is when two companies of roughly the same size agree to combine as equals to form a new company. An example is the 1989 merger of Time Inc. with Warner Communications to create Time Warner, one of the world's largest media companies. An **acquisition**, by contrast, is when a larger company buys a smaller company, which is then swallowed up and loses its identity within the larger one. Nothing is inherently anticompetitive about mergers and acquisitions, and they are in fact a normal part of business transactions. But when these mechanisms are used repeatedly within a given market and produce monopolies and oligopolies, they may create a potentially anticompetitive situation.

Price Fixing, Bid Rigging, and Price Gouging

Whereas monopolies and oligopolies are only *potentially* anticompetitive, other business practices are anticompetitive by their nature and are both unethical and illegal. One such practice is **price fixing**, where business competitors conspire to set their prices at a fixed point. In usual cases, the businesses set their product prices high; without cheaper alternatives available, consumers are forced to buy at the high price. Price fixing often occurs in markets that are dominated by oligopolies, where the small number of competitors makes it easier to enter into price-fixing agreements. For example, in 1999 six major vitamin manufacturers reached a settlement to pay over $1 billion in a price-fixing lawsuit, which was the highest amount paid in an antitrust case up to that point. Although the six companies do not have commonly recognizable names, among them was F. Hoffmann-La Roche of Switzerland, the maker of the popular tranquilizer drug Valium. During a 9-year period, the companies controlled 80% of the wholesale market for vitamins A, C, and E, which they supplied in bulk to almost 1,000 food companies—including Coca-Cola, General Mills, and Kraft Foods. These companies, in turn, used the vitamins as ingredients in food products such as breakfast cereals. The six companies conspired to artificially inflate the prices that they charged, and these inflated prices were then passed onto consumers.

A variation on price fixing is **bid rigging**, where competing businesses agree that one of them will place a bid on a contract at a predetermined price. Often this is done in rotation, where the conspiring businesses take turns offering the lowest bid. A notable case involved several dozen electrical equipment companies, including General Electric and Westinghouse, which engaged in a bid-rigging conspiracy during the 1950s for products such as power transformers and generators. Every 4 weeks, the companies would rotate who would place the lowest bid, ensuring that each would have a turn. What gave them away was that many of the high bids were identical to each other, which would not likely occur by accident. In one case, 12 of the bids quoted the same delivery price, despite the fact that driving distances from the respective factories varied greatly. In total, 29 companies were found guilty in this "Great Conspiracy," as it was called, and 30 executives received jail sentences. In addition to criminal fines, customers brought over 2,000 lawsuits against the companies, resulting in hundreds of millions of dollars in damages.

A final type of unfair competitive practice is **price gouging**, which occurs when a business sells a product for a price that is much higher than is considered reasonable or fair or sustainable in a truly competitive environment. Price gouging often occurs when there are too few competitors in a given market, which would otherwise drive prices down. The pharmaceutical industry is notorious for this, and two factors make it particularly so:

- *Drug patents grant a temporary monopoly*. When a company produces a new drug, it is granted a legal monopoly on the sale and manufacture of it for approximately 10 years. In many cases—with breakthrough drugs—there is no competition whatsoever. The purpose of drug patents is to encourage innovation by financially rewarding companies that invest in the research and development of new drugs. But the patent itself creates a temporary monopoly until the formula is released into the public domain, when competitors can make generic versions of it.

- *Demand for a product does not change according to the price*. With normal products, price and demand are directly connected. If I charge $100 for a can of cola, the demand for my product will be very low. But if I charge 5 cents per can, demand will be high. Economists call this relation *elasticity*. But with pharmaceuticals, the relation between price and demand is *inelastic*: If I need a drug to stay alive, price is no consideration. Whether it costs 5 cents a pill or $100 a pill, I will pay for it.

Here are a few examples. When the AIDS epidemic emerged in the mid-1980s, the first available treatment was the antiretroviral drug AZT, which came with an initial price tag of $7,000 a year. After intense pressure by HIV-advocacy groups, that price was eventually lowered to $3,000. The manufacturer justified the original cost on a couple grounds. First, it was initially approved for a comparatively small market of 50,000 patients who were seriously ill with AIDS—although it was later approved for anyone who tested HIV positive. Second, since AZT was not a cure and would only delay death by about 1 year, the market was literally short-lived.

Another case involved the tranquilizer Valium. The active ingredient cost the manufacturer $50 a kilogram. They sold to subsidiaries at $23,000 a kilogram, and eventually to customers at the equivalent of $50,000 a kilogram. A third case involved an antiworm drug for sheep called levamisole, manufactured by Johnson and Johnson. When new research found that the drug was an effective treatment for colon cancer, the company made it available in drug stores at a cost to patients of around $1,200 a year, whereas farmers could buy the same quantity for their sheep for $15. The research linking levamisole with colon cancer treatment was funded by the federal government at a cost of $11 million, and the research was freely given to the drug company. In all of these cases, the monopoly on the drug allowed the manufacturer to dramatically inflate prices, with full knowledge that desperate patients would still pay them.

2.7 Regulating the Free Market

To preserve a truly competitive state within the free market, the government must sometimes step in to prevent anticompetitive practices and unfairness. The free market is not so much a natural state of affairs for business transactions, but is instead more like a game where participants agree to follow established rules and the government stands by like an umpire to assure that the process runs smoothly. To that extent, a pure capitalist system does not seem possible; any functioning free market will involve government intervention of at least some sort.

Reasons for Government Regulation

In the face of the many problems inherent in capitalist economic systems, the solution of choice is **government regulation—**that is, rules and policies imposed by the government on various aspects of commerce within a country. The underlying justification is that responsibility in the business world comes about only through legislating it. Here is a simple example. Some financial investments, such as stocks, are regulated by the U.S. **Securities and Exchange Commission (SEC)**, whereas other investments, such as collectible stamps, are not. A respected stamp dealer was recently called out for making exaggerated claims about his stamp investment plan. One financial analyst explained:

> Reading the marketing material made me shiver. It highlights how careful investors have to be when buying unregulated products—like stamps and other collectables[*sic*]. If I tried to sell investments like this to my customers I'd be shut down by the regulator . . . . [The stamp dealer] uses every trick in the book to make people part with their money. There is no attempt to explain the risks involved, or detail potential downsides, like early exit charges. (Ian Lowes, quoted in Simon, 2011)

In this quotation, the financial analyst indicates how important investment regulation is for the protection of consumers. Investment markets without such regulation create opportunities for investment businesses to act irresponsibly.

There are three fundamental justifications for governmental regulation within capitalist economic systems. First, regulation aims to protect consumers, workers, minorities, the environment, and any other interest or group of people that could be exploited in a competitive marketplace. The example of stamp investments shows how great the temptation is for financial-investment businesses to misrepresent their products, and, thus, how great the need for rules of transparency and for enforcement of those rules. A second justification is to assure that business markets remain competitive, by guarding against monopolies and prohibiting anticompetitive practices such as price fixing.

Associated Press/Bebeto Matthews

The notion of government regulation of the financial industry came up again recently. In this 2011 photo, we see the JPMorgan Chase building in New York. Lawyers seeking to win back money for the victims of fraudulent financier Bernard Madoff claimed that e-mails and other documents showed that JPMorgan Chase executives were complicit in Madoff's crimes.

There is a third and more controversial justification of government regulation, which is to help redistribute the wealth of society. As the gap between the rich and poor grows, society risks becoming stratified into two classes. At least some efforts at governmental regulations attempt to address this. Minimum wage is a case in point, and the need for government involvement here is demonstrated every few years when Congress debates minimum-wage increases. In 1938, the year of its inception in the United States, the federal minimum wage was set at 25 cents per hour, and it has been increased around 30 times since then. The longest period without an increase was 10 years, between 1997 and 2007, and during that time the prices of consumer goods rose considerably through inflation. Each time the issue was before Congress—and 2007 was no exception—business groups lobbied against an increase for the simple reason that increasing wages harms the bottom line. Like the minimum-wage regulation, government regulations that require health-care insurance for workers, worker's compensation, and Social Security all aim at preventing an impoverished underclass.

Mechanisms for Government Regulation

There are two approaches to government regulation, one direct and the other indirect. **Direct governmental regulation** occurs when specific regulatory policies are established by an actual branch or agency of the government, such as Congress or the SEC. The indirect variety involves **government-mandated self-regulation**: In lieu of direct government involvement, the government mandates that a private self-regulatory organization set policies in a given market and the government then defers to that organization. For example, within the financial market, the Financial Industry Regulatory Authority is the private self-regulatory organization that operates in concert with the SEC to assure that the securities industry operates fairly and honestly. Although it is not itself a government agency, it nevertheless operates under the oversight of the SEC.

Another example vividly illustrates the relation between the government and self-regulatory organizations. In the 1980s, the U.S. Senate held committee hearings about the need for warning labels on music albums that would help alert parents to songs with violent or sexually explicit lyrics. While the Senate committee itself did not want to be accused of censoring artists or creating federal guidelines for the warning labels, they pressured the Recording Industry Association of America to create a labeling system. One senator made the direct threat that "unless the [record] industry 'cleans up their act' . . . there is likely to be legislation" (*Record Labeling*, 1985). The outcome of this hearing was the parental advisory label for music CDs that bears the words "Parental advisory—explicit content." Music lyrics and financial investments are just two examples where self-regulatory organizations fill some important gap in the absence of direct government regulation. Many business professions have some type of self-regulatory organization, with notable ones being the American Medical Association, the American Dental Association, and the National Association of Realtors.

Antitrust Acts

Two laws are particularly important for setting the parameters of the free market in the United States. One is the **Sherman Antitrust Act of 1890**, the first federal law to outlaw price fixing and restrict monopolies. In the language of the statute, "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony" (Sherman Antitrust Act of 1890, Section 2). The aim of the law is to punish not businesses who become monopolies through fair competition, but only those who do so through anticompetitive misconduct. Monopolies themselves are not illegal, but the abuse of a dominant position is.

The second law is the **Clayton Antitrust Act of 1914**, which restricts specific types of business practices that might potentially lead to anticompetitiveness, such as mergers and acquisitions that aim to create monopolistic power. Both of these laws laid the groundwork for antitrust policies in the United States that continue to the present day.

The Federal Trade Commission (FTC)

The government agency that is directly responsible for combating anticompetitive business practices is the **Federal Trade Commission (FTC)**, founded in 1914. The initial purpose of the FTC was to prevent unfair methods of competition in commerce that led to monopolies and oligopolies—which at the time were called *trusts*. Since that time, Congress has given the agency greater authority to police anticompetitive practices. To this end, the FTC performs three central tasks:

- reviewing mergers and acquisitions, and challenging those that would likely lead to higher prices, fewer choices, or less innovation;
- seeking out and challenging anticompetitive conduct in the marketplace, including monopolization and agreements between competitors; and
- promoting competition in industries where consumer impact is high, such as health care, real estate, oil and gas, technology, and consumer goods ("Federal Trade Commission," n.d.).

Regarding the first point, the FTC does not scrutinize all mergers, but only those that risk undermining market competition. The FTC has the authority to bring civil cases against offending businesses, and when the situation is bad enough, they work with the Department of Justice to bring criminal charges against offending businesses.

What Would You Do?

You are the chair of the Federal Trade Commission, and you are reviewing a possible merger between Subway and McDonalds, the two largest fast-food restaurant chains in the United States. At issue is whether the merger would create an anticompetitive environment in that industry.

1. Would you block the merger? If so, what would be your rationale?
2. Suppose these two companies were also seeking to merge with Starbucks, Pizza Hut, and Burger King, the next three largest fast-food restaurant chains. Would you block that merger? Why?
3. Suppose the 100 largest fast-food chains wanted to merge. Would you block that? Why?

2.8 Conclusion

Winston Churchill famously said, "Democracy is the worst form of government, except for all the others." This may apply equally to capitalism: Capitalism is the worst economic system, except for all the others. Undoubtedly, capitalism has advanced society in remarkable ways, and the long history of capitalism in the United States has made for the world's strongest national economy. But these successes do not mean that capitalism is without serious problems. We have seen that an unregulated marketplace will lead to anticompetitive practices that can destroy all that is good about capitalism. With the profit motive as strong as it is, it is unrealistic to think that businesses will regulate themselves out of a sense of duty to society at large. For lack of any better regulatory mechanism, the government must assume that responsibility.

This often places businesses and the government in an adversarial relationship, where businesses lobby against virtually every proposed regulation and, what is more, for the repeal of important regulations that are already in place. If businesses achieved everything they wanted with their antiregulatory lobbying efforts, unfair and anticompetitive business practices could reach epidemic proportions. Although the regulatory relationship between business and government is imperfect, it is an important safeguard for capitalism's health. In our opening example, we saw that Bolivia's experiment with privatizing water led to massive protests. Marx warned that it could get much worse: Workers might launch a full-scale revolution in reaction to being systematically exploited by capitalist business owners. This worst-case scenario has played out in dozens of countries within the last century, and the stakes are too high to risk that happening in the United States and other welfare capitalist countries. This may well be a situation in which doing the ethical thing in business requires the acceptance of government involvement.

Summary

We began this chapter looking at three key features of capitalism and socialism, respectively. For capitalism they are, first, that personal self-interest, not community interest, motivates economic development; second, that the major sources of society's economic production should be privately owned, not governmentally owned; and third, that economic planning should be decentralized through market competition, not centralized through government policy. By contrast, the three main features of socialism are, first, that community interest, not personal self-interest, should motivate economic development; second, that the major sources of society's economic production should be governmentally owned, not privately owned; and third, that economic planning should be centralized through government policy, not decentralized through market competition.

The most famous advocate of capitalism is Adam Smith, who argued for three main points. First, selfish desire drives the economy. To get what I need to survive, I cannot rely on your kindness but must find some way for you to personally benefit before you will consider assisting me. Second, by pursuing our self-interest, we indirectly promote the good of society as if directed by an invisible hand. Third, the presence of government is sometimes necessary for society's economic development, but its role should be limited. Among the government's main responsibilities are national defense, the judicial system, and public works that benefit society but are too unprofitable for private industries to take on themselves, such as roads, public education, science, and the arts.

The leading critic of capitalism and defender of socialism is Karl Marx, who held three principal positions. First, capitalist systems put workers in a position where they become separated from their true inner nature when forced to give their labor away to the factory owner. Second, history involves a succession of class struggles between those who do the work and those who own the business or industry. Third, the current class struggle between wealthy business owners and exploited workers will end in a revolution that will ultimately put an end to all private property, social classes, and government itself.

The leading criticism of capitalism is that it creates a bias towards private interests rather than public ones. Socialism, by contrast, is faulted for underestimating the importance of personal self-interest, private property, and free-market economic planning. Moderate versions of both capitalism and socialism attempt to strike a middle ground and thereby avoid the problems associated with the more extreme versions of each. Within free-market economies, some business practices are potentially hazardous to capitalism and must be monitored, namely monopolies, oligopolies, mergers, and acquisitions. Other anticompetitive business practices are so damaging to capitalism that they are illegal, namely price fixing, bid rigging, and price gouging. To keep markets competitive, the government can help control business activity by either directly regulating it through laws and policies or requiring that a private self-regulatory organization establish policies within a given market.

Discussion Questions

1. Adam Smith argued that self-interest is a critical element in a society's economic development. Karl Marx, by contrast, argued that society functions better when each of us is more community oriented. Explain each of their views on this issue, and discuss when greed and selfishness in businesses go too far and become a hazard to society.
2. Adam Smith is remembered for his view of the "invisible hand," the idea that by pursuing our self-interest, we indirectly promote the good of society. Smith himself provided two examples of this, but said that the invisible hand is also evident in "many other cases." Explain Smith's two examples, and speculate about other situations in which the concept of the invisible hand may be valid.
3. Smith held that, even within a capitalist economic system, the government plays a critical role in supporting or running important public projects that are too unprofitable to be taken on by private industry. Among these are roads, public education, science, and the arts. In the United States, the government indeed funds these projects, and many more. What are some of these other projects, and would they, or the projects that Smith himself mentioned, be best left to private industry?
4. Marx argued that, in capitalist economic systems, workers become alienated from their labor in the sense that they forced to give their labor away to the factory owner, with no personal stake in the products they make and no meaningful connection to the community. What are ways in which business owners today try to reduce this sense of alienated labor among their employees? Do those methods work?
5. Marx was convinced that worker exploitation would inevitably lead to revolution: It happened in the past with slave and peasant revolts, and it is just a question of time before it happens with workers in capitalist societies. Even in the United States, there are regular protests against unequal wealth distribution; the Occupy movement is just one example. How bad would it have to get in the United States before peaceful protests would turn into full-scale revolution?
6. Monopolies and oligopolies are potentially harmful to free-market capitalism, and for that reason the government sometimes breaks companies up or regulates them in some significant way. Think of an example of a monopoly or oligopoly—such as Microsoft, Monsanto, or Coca-Cola and PepsiCo—and discuss the benefits and harms of their dominance over their specific market.

Key Terms

acquisition When a larger company buys a smaller company, which is then swallowed up and loses its identity within the larger one.

alienated labor Labor that a worker is forced to give away to a factory owner.

bid rigging When competing businesses agree that one of them will place a bid on a contract at a predetermined price.

bourgeoisie Karl Marx's term for a class of large-scale business owners that oppresses workers.

capitalism The economic theory that maintains that (1) personal self-interest, not community interest, motivates economic development, (2) the major sources of society's economic production should be privately owned, not governmentally owned, and (3) economic planning should be decentralized through market competition, not centralized through government policy.

class struggle The socialist view that throughout history, societies have evolved through conflicts between the social classes of those who do the work and those who are in charge and benefit from that work.

Clayton Antitrust Act of 1914 U.S. federal law that restricts specific types of business practices that might potentially lead to anticompetitiveness, such as mergers and acquisitions that aim to create monopolistic power.

communism A radical form of socialism that aims to abolish all social classes, private property, and government.

direct governmental regulation When specific regulatory policies are established by an actual branch or agency of the government, such as Congress or the SEC.

Federal Trade Commission (FTC) U.S. federal agency established to prevent unfair methods of competition in commerce.

free market economics The view that businesses should be governed by the laws of supply and demand, not restrained by government interference.

free trade The concept that trade across national boundaries should take place without interference from the respective governments.

government regulation Rules and policies imposed by the government on various aspects of commerce within a country.

government-mandated self-regulation When, in lieu of direct government involvement, the government mandates that a private self-regulatory organization set policies in a given market and defers to that organization.

greed is good The view that, in the business world, the human drive of self-interest directs our energy and creativity.

invisible hand The view proposed by Adam Smith that, by pursuing our self-interest, we indirectly promote the good of society as if directed by an invisible hand.

laissez faire French term; literally "leave it alone," expressing the free market idea that governments should stay out of the market place.

market socialism Socialist economic systems where governments own and control major economic enterprises yet incorporate some capitalist policies, such as relying on supply and demand in the market to set prices.

merger When two companies of roughly the same size agree to combine as equals to form a new company.

monopoly Control by a single company of all or nearly all of the market for a given type of product or service.

oligopoly Market domination by a small number of businesses that collectively exert control over that market's supply and prices.

price fixing When business competitors conspire to set their prices at a fixed point.

price gouging When a business sells a product for a price that is much higher than is considered reasonable or fair or sustainable in a truly competitive environment.

profit motive The view that the ultimate purpose of a commercial enterprise is to earn a profit.

Securities and Exchange Commission (SEC) Agency of the federal government that regulates stocks.

Sherman Antitrust Act of 1890 First U.S. federal law to outlaw price fixing and restrict monopolies.

socialism The economic theory that (1) community interest, not personal self-interest, should motivate economic development, (2) the major sources of society's economic production should be governmentally owned, not privately owned, and (3) economic planning should be centralized through government policy, not decentralized through market competition.

survival of the fittest The evolutionary notion that species with the best adaptations will win out over rival species that are less well adapted.

Ten Planks of Communism Karl Marx's set of 10 policies to transition into socialism.

welfare capitalism Social programs in market economies that the government runs, such as national health care and government-run child care.