CHAPTER 4

THE NATURE OF CAPITALISM

INTRODUCTION

OCTOBER IS OFTEN SAID TO BE A BAD MONTH FOR stocks. This was certainly true in 2008. On Friday, October 10, 2008, the Dow Jones Industrial Average capped the worst week in its 112-year history with its most volatile day ever as the index swung 1,019 points in one trading session. In the weeks that followed, the gyrating stock market calmed down. As the dust settled, however, stockholders and mutual fund investors—many of them employees diligently saving for retirement—were forced to come to terms with the cold reality that their portfolios were worth only about half of what they had been a year before. And what was true of Wall Street was also true of Hong Kong, Mumbai, Tokyo, Johannesburg, Frankfurt, and London as stock markets around the world bottomed out. Capitalism is a worldwide system, and what happens on Wall Street reverberates around the globe, and vice versa, because the economies of all capitalist nations are intricately interconnected and their markets tightly intertwined.

THE COLLAPSE OF THE U.S. subprime mortgage market, following the bursting of the real estate bubble, had been causing financial jitters since early in 2008.

In this case, it was the United States that pushed the world economic system into crisis. The collapse of the U.S. subprime mortgage market, following the bursting of the real estate bubble, had been causing financial jitters since early in 2008. But only that autumn did it become clear that a number of once rich and haughty U.S. financial institutions were floating perilously on an ocean of debt. In an effort to maximize profit, they had underwritten loans that left them with potential liabilities thirty to forty times greater than their underlying assets. With that kind of exposure, it doesn't take much to bring the whole house of cards down. And that's what began happening.

When AIG, the world's biggest insurer, began tottering, the U.S. government rushed to its assistance, fearing that its collapse would wreak havoc throughout the financial system. The government had already facilitated the sale, first of Bear Stearns, the investment bank and brokerage firm, and then of Washington Mutual Bank to JPMorgan Chase because both institutions were about to go under, and it had also effectively nationalized the mortgage giants Fannie Mae and Freddie Mac in order to keep them afloat. Now, after rescuing AIG, the U.S. Treasury Department and Federal Reserve Board were worried that they were sending the wrong message to the business world, namely, that they were prepared to rescue any financial firm that needed help. So, a few days after bailing out AIG, they decided to let Lehman Brothers, a global financial services firm that was in deep trouble, go bust. The rapid demise of Lehman Brothers and the government's willingness to let it happen, however, immediately caused credit markets to panic, the movement of capital to freeze, investors to flee, the stock market to plunge—and the world economy to begin sliding inexorably into recession.

Governments around the world moved quickly to try to stabilize financial markets and free up credit by lowering interest rates and propping up their banks and other financial institutions. The United States pumped money into its financial system on an unprecedented scale—taking over bad assets, guaranteeing debts, and pouring new capital into private capitalist firms. Anyone predicting even a few months earlier that liberals and conservatives in Congress would rapidly unite to approve a bank bailout of over

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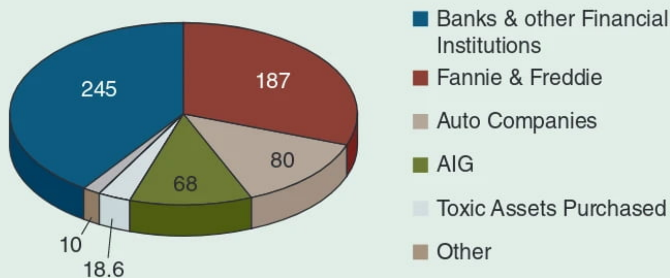
$700 billion—that's more than $2,000 for every man, woman, and child in the country—would have been dismissed as a lunatic. But that's what happened. Moreover, a few months later the government bailed out General Motors and Chrysler, which were floundering, and oversaw their restructuring.

Although these emergency operations could not stave off the worst economic slump that most Americans had ever seen, they probably prevented the financial meltdown of 2008 from turning into a 1930s-style depression. After the crisis, as most of the loans it had made were repaid with interest and the assets it had acquired were sold, the government eventually recovered 97 percent of the money it had dispensed. But its unprecedented economic intervention may have changed the face of capitalism forever.

But what exactly is the nature of the economic system called capitalism? What are its underlying values, principles, and economic philosophy? What has it accomplished, and what are its prospects for the future? This chapter examines these and related questions.

TARP Outflows (in Billions of Dollars)



President George W. Bush signed into law the Troubled Asset Relief Program, or TARP, to address the financial meltdown resulting, primarily, from the subprime mortgage crisis. Under his administration and that of President Obama, TARP funds were used to bail out a number of American banks and other companies, thus helping to stabilize the economy.

SOURCE: http://www.propublica.org/ion/bailout

Looking back in history, one must credit capitalism with helping break the constraints of medieval feudalism, which had severely limited individual possibilities for improvement. In place of a stifling economic system, capitalism offered opportunities for those blessed with imagination, an ability to plan, and a willingness to work. Capitalism must also be credited with enhancing the abundance and diversity of consumer goods beyond Adam Smith's wildest dreams. It has increased material wealth and the standard of living and has converted cities from modest bazaars into treasure troves of dazzling merchandise. In light of such accomplishments and the acculturation process that tends to glorify them, it is all too easy to overlook capitalism's theoretical and operational problems.

LEARNING OBJECTIVES

This chapter attempts to identify some of these problems and their moral ramifications. It provides some basic historical and conceptual categories for understanding the socioeconomic framework within which business transactions occur and moral issues arise. In particular, the following topics are addressed:

1. The definition of capitalism and its major historical stages
2. Four of the key features of capitalism: companies, profit motive, competition, and private property
3. Two classical moral justifications of capitalism—one based on the right to property and the other on Adam Smith's concept of the invisible hand
4. Fundamental criticisms of capitalism—in particular, the persistence of inequality and poverty, capitalism's implicit view of human nature, the rise of economic oligarchies, the shortcomings of competition, and employees' experience of alienation and exploitation on the job
5. The problems facing capitalism in the United States today—in particular, the decline of manufacturing, along with job outsourcing and the trade deficit; an excessive focus on the short term; and changing attitudes toward work

CAPITALISM

Capitalism can be defined as an economic system that operates on the basis of profit and market exchange and in which the major means of production and distribution are in private hands. The United States, which has the world's largest national economy, is a capitalist country. All manufacturing firms are privately owned, including those that produce military hardware for the government. Almost all other businesses—small, medium, and large—are also privately owned, including banks, insurance firms, power

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companies, and transportation companies. Although the government itself expends money on many things, no central governing body dictates to these private owners what or how much of anything will be produced. For example, officials at Apple, Caterpillar, or Ford Motor Company design their products and set their own production goals in anticipation of consumer demand.

SUMMARY
Capitalism is an economic system in which production and distribution are in private hands, operating on the basis of profit and market exchange. Socialism is an economic system characterized by public ownership of property and a planned economy. Worker control socialism is a hybrid, market-oriented form of socialism.

The private ownership and market aspects of capitalism contrast with its polar opposite, socialism. **Socialism** is an economic system characterized by public ownership of property and a planned economy. Under socialism, a society's productive equipment is owned not by individuals (capitalists) but by public bodies. Socialism depends primarily on centralized planning rather than on a market system for both its overall allocation of resources and its distribution of income; crucial economic decisions are made not by individuals but by government. In the former Soviet Union, for example, government agencies decided the number of automobiles—including models, styles, and colors—to be produced each year. Top levels of the Soviet government formulated production and cost objectives, which were then converted to specific production quotas and budgets that individual plant managers had to follow.

A hybrid economic system advocated by some socialists (and once approximated by the former Yugoslavia) is **worker control socialism**. Individual firms respond to a market when deciding what to produce and acquiring the necessary factors of production. However, the workforce of each enterprise controls the enterprise (although it may elect or hire managers to oversee day-to-day operations), and profits accrue to the workers as a group to divide in whatever manner they agree on. Although the workers manage their factories, the capital assets of each enterprise are owned by society as a whole and not by private individuals.

HISTORICAL BACKGROUND OF CAPITALISM

What we know as "capitalism" did not fully emerge until the Renaissance in Europe during the fifteenth and sixteenth centuries. Before the Renaissance, business exchanges in medieval Europe were organized through guilds, which were associations of individuals involved in the same trade.

Today if you want a pair of shoes, you head for a shoe store, where you find an array of shoes. If nothing strikes your fancy, you set out for another shop, and perhaps another, until at last you find what you want. Or, if still disappointed, you might ask the store clerk to order a pair in your size from the manufacturer or its distributor. You certainly wouldn't ask the clerk to have someone make you a pair of shoes. Under the guild organization, shoemakers were also shoe sellers and made shoes only to fill orders. If they had no orders, they made no shoes. The shoemaker's sole economic function was to make shoes for people when they wanted them. His labor allowed him to maintain himself, not advance his station in life. When the shoemaker died, his business went with him—unless he had a son to inherit and carry on the enterprise. As for shoe quality and cost, the medieval shopper could generally count on getting a good pair of shoes at a fair price because the cobblers' guild strictly controlled quality and price.

Weaving was another big medieval trade. In fact, in the fourteenth century, weaving was the leading industry in the German town of Augsburg. Little wonder, then, that an enterprising young man named Hans Fugger became a weaver when he settled there in 1357. But young Hans had ambitions that stretched far beyond the limits of the weaving trade and the handicraft guild system. And they were grandly realized, for within three short generations a family of simple weavers was transformed into a great German banking dynasty.[1]

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Not content with being a weaver, Hans Fugger began collecting and selling the products of other weavers. Soon he was directly employing the other weavers, paying them for their labor, and selling their products as his own. His sons continued the business and expanded it in new directions, as did his grandsons, especially Jacob Fugger, the foremost capitalist of the Renaissance. Among other things, Jacob Fugger lent large sums of money to the Hapsburg emperors to finance their wars. In return, he obtained monopoly rights on silver and copper ores, which he then traded. When Fugger bought the mines themselves, he acquired all the components necessary to erect an extraordinary financial dynasty and to make himself one of the richest people of all time.

Like latter-day titans of American industry, Fugger employed thousands of workers and paid them wages, controlled all his products from raw material to final market, set his own quality standards, and charged whatever the traffic would bear. In one brief century, what was once a handicraft inseparable from the craftsperson had become a company that existed outside any family members. What had once motivated Hans Fugger—namely, maintenance of his station in life—had given way to gain for gain's sake, the so-called profit motive. Under Jacob Fugger, the company amassed profits—a novel concept—that well exceeded the needs of the Fugger family. And the profits were measured not in goods or land but in money.

Capitalism has undergone changes since then. The kind of capitalism that emerged in the Fuggers' time is often termed **mercantile capitalism**, which is capitalism that is based on mutual dependence between state and commercial interests. Central to mercantile capitalism is the belief that the economic health of a nation is determined by the bullion (precious metals, gold, and silver) it possesses and that therefore government should regulate production and trade with the goal of encouraging exports while keeping out imports, thus building up the nation's bullion reserves. A prudent nation should strive to be economically self-sufficient while using sea power, if it can, to control foreign markets and establish colonies for the benefit of the mother country.

During the eighteenth and nineteenth centuries, however, new economic ideas spread. These emphasized the importance of competition and open markets and of freeing trade and production from government oversight. Trade between nations was now seen as mutually beneficial, and national wealth and prosperity were no longer identified with bullion. With the Industrial Revolution, industrialists replaced merchants as the dominant power in a capitalist economy, and the period of **industrial capitalism** emerged, which is associated with large-scale industry. In the United States, the confluence of many factors after the Civil War—including a sound financial base, the technology for mass production, expanding markets for cheaply manufactured goods, and a large and willing labor force—produced industrial expansion. Exploiting these fortuitous conditions was a group of hard-driving, visionary entrepreneurs called "robber barons" by their critics and "captains of industry" by their supporters: Cornelius Vanderbilt, Cyrus McCormick, Andrew Carnegie, John D. Rockefeller, Jay Gould, and others.

As industrialization increased, so did the size and power of business. The private fortunes of a few individuals could no longer underwrite the accelerated growth of business activity. The large sums of capital necessary could be raised only through a corporate form of business, in which risk and potential profit were distributed among numerous investors. The success—indeed, survival—of a business enterprise came to depend on its having the financial wherewithal to reduce prices while expanding production and either eliminating or absorbing competition. As various industries strove to strengthen their financing and shore up their assets, what is called **financial capitalism** emerged, characterized by pools, trusts, holding companies, and the interpenetration of banking,

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insurance, and industrial interests. Hand in hand with this development, the trend continued toward larger and larger corporations, controlling more and more of the country's economic capacity.

SUMMARY
Capitalism has gone through several stages: mercantile, industrial, financial, and state welfare. Many believe we are now at a new stage, globalized capitalism.

The economic and political challenges of the Great Depression of the 1930s helped usher in still another phase of capitalism, often called **state welfare capitalism**, in which government plays an active role in the economy, attempting to smooth out the boom-and-bust pattern of the business cycle through its fiscal and monetary policies. In addition, government programs like Social Security and unemployment insurance seek to enhance the welfare of the workforce, and legislation legitimizes the existence of trade unions. Conservative politicians sometimes advocate less government control of business, but in reality the governments of all capitalist countries are deeply involved in the management of their economies.

These days, the increasingly worldwide scale of capitalism leads many contemporary commentators to see **globalized capitalism** as a new stage or level of capitalist development. Capitalism has always involved international trade, but today—thanks to the computer, the Internet, satellites, cell phones, and other technological advances—the economies of most countries are becoming more and more integrated, a process labeled *globalization*. Although the world is still far from constituting a single global economy, investment capital is more mobile than ever, and the currencies, stock exchanges, and economic fortunes of all capitalist countries are bound together in a single financial system. The business operations of a growing number of companies take place on a world stage. Capitalist enterprises are more likely than ever before to utilize foreign components and draw on foreign labor or services, to export products or provide services abroad, and to acquire or start foreign subsidiaries or engage in joint ventures with overseas companies. Many apparently national companies produce one component in one country and another component in a different country, assemble them in a third country, and market them throughout the world.

Although capitalism will continue to evolve, it has four characteristic features.

Although the study of capitalism's evolution is best left to economic historians, it is important to keep in mind capitalism's dynamic nature. There is nothing fixed and immutable about this or any other economic system; it is as susceptible to the forces of change as any other institution. Nevertheless, the capitalism we know today does have some prominent features that were evident in the earliest capitalistic businesses.

KEY FEATURES OF CAPITALISM

Complete coverage of capitalism's central features and defining characteristics has filled many a book. Four features of particular significance—the existence of companies, profit motive, competition, and private property—will be discussed here.

COMPANIES

Chapter 2 mentioned the Firestone case, in which a media misrepresentation was left uncorrected. When asked why Firestone officials had not corrected the error, a Firestone spokesperson said that Firestone's policy was to ask for corrections only when it was beneficial to the company to do so. Expressions like "Firestone's policy" and "beneficial to the company" reflect one key feature of capitalism: the existence of companies or business firms separate from the human beings who work for and within them.

"It's not in the company's interests," "The company thinks that," "From the company's viewpoint," "As far as the company is concerned"—all of us have heard, perhaps even used, expressions like these that treat a business organization like a person or at least

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like a separate and distinct entity. This way of speaking reflects a basic characteristic of capitalism: Capitalism permits the creation of companies or business organizations that exist separately from the people associated with them. We take the existence of companies for granted, but some experts believe that it is not church or state but the company that is "the most important organization in the world."[2]

Today the big companies we're familiar with—General Electric, Microsoft, Verizon, Procter & Gamble—are, in fact, incorporated businesses, or corporations. Chapter 5 discusses the nature of the modern corporation, including its historical evolution and its social responsibilities. Here it's enough to observe that, in the nineteenth century, Chief Justice John Marshall defined a *corporation* as "an artificial being, invisible, intangible, and existing only in the contemplation of law." Although a corporation is not something that can be seen or touched, it does have prescribed rights and legal obligations within the community. Like you or me, a corporation may enter into contracts and may sue or be sued in courts of law. It may even do things that the corporation's members disapprove of. The corporations that loom large on our economic landscape hark back to a feature of capitalism evident as early as the Fugger dynasty: the existence of the company.

PROFIT MOTIVE

A second characteristic of capitalism lies in the motive of the company: to make profit. As dollar-directed and gain-motivated as our society is, most of us take for granted that the human being is by nature an acquisitive creature who, left to his or her own devices, will pursue profit with all the instinctual vigor of a cat chasing a mouse. However, as economist Robert Heilbroner points out, the "profit motive, as we understand it, is a very recent phenomenon. It was foreign to the lower and middle classes of Egyptian, Greek, Roman, and medieval cultures, only scattered throughout the Renaissance times, and largely absent in most Eastern civilizations." The medieval church taught that no Christian ought to be a merchant. "Even to our Pilgrim forefathers," Heilbroner writes, "the idea that gain ought to be a tolerable—even a useful—goal in life would have appeared as nothing short of a doctrine of the devil."[3]

Profit in the form of money is the lifeblood of the capitalist system. Companies and capitalists alike are motivated by a robust appetite for monetary gain. Indeed, the **profit motive** implies and reflects a critical assumption about human nature: that human beings are basically economic creatures, who recognize and are motivated by their own economic interests.

The profit motive is central to capitalism. It assumes that economic self-interest motivates human beings.

COMPETITION

If self-interest and an appetite for profit drive individuals and companies, then what stops them from bleeding society dry? What stops capitalists from ripping off the rest of society?

Adam Smith provided an answer in his famous treatise on political economy, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). Free **competition**, said Smith, is the regulator that keeps a community activated only by self-interest from degenerating into a mob of ruthless profiteers. When traditional restraints are removed from the sale of goods and from wages and when all individuals have equal access to raw materials and markets (the doctrine of **laissez faire**, from the French meaning "to let [people] do [as they choose]"), we are all free to pursue our own interests. In pursuing our own interests, however, we come smack up against others similarly motivated. If any of us allow blind self-interest to dictate our actions—for example, by price gouging or employee exploitation—we will quickly find ourselves

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beaten out by competitors who charge less or pay better wages. Competition thus regulates individual economic activity.

To sample the flavor of Smith's argument, imagine an acquisitive young woman in a faraway place who wants to pile up as much wealth as possible. She looks about her and sees that people need and want strong twilled cotton trousers, so she takes her investment capital and sets up a jeans factory. She charges $45 for a pair of jeans and soon realizes handsome profits. The woman's success is not lost on other business minds, especially manufacturers of formal slacks and dresses, who observe a sharp decline in those markets. Wanting a piece of the jeans action, numerous enterprises start up jeans factories. Many of these start selling jeans for $40 a pair. No longer alone in the market, our hypothetical businesswoman must check her appetite for profit by lowering her price or risk folding. As the number of jeans on the market increases, their supply eventually overtakes demand, and the price of jeans declines further and further. Inefficient manufacturers start dropping like flies. As the competition thins out, the demand for jeans slowly balances with the supply, and the price regulates itself. Ultimately, an equilibrium is reached between supply and demand, and the price of jeans stabilizes, yielding a normal profit to the efficient producer.

Competition makes individual pursuit of self-interest socially beneficial.

In much this way, Adam Smith tried to explain how economic competition steers the individual pursuit of self-interest in a socially beneficial direction. By appealing to their self-interest, society can induce producers to provide it with what it wants—just as manufacturers of formal slacks and dresses were enticed into jeans production. But competition keeps prices for desired goods from escalating; high prices are self-correcting because they call forth an increased supply.

PRIVATE PROPERTY

In its discussion of the libertarian theory of justice, Chapter 3 emphasized that property should not be identified only with physical objects like houses, bicycles, and smartphones because one can own things, such as stock options, that are not physical things at all. Nor should ownership be thought of as a simple relationship between the owner and the thing owned. Rather, property ownership involves a complex bundle of rights and rules governing how, under what circumstances, and in what ways both the owner and others can use, possess, dispose of, and have access to the thing in question.

Private property is central to capitalism. To put it another way, capitalism as a socioeconomic system is a specific form of private property. What matters for capitalism is not private property simply in the sense of personal possessions, because a socialist society can permit people to own cars, television sets, and jogging shoes. Rather, capitalism requires private ownership of the major *means of production* and distribution. The means of production and distribution include factories, warehouses, offices, machines, computer systems, trucking fleets, agricultural land, and whatever else makes up the economic resources of a nation. Under capitalism, private hands control these basic economic assets and productive resources. Thus, the major economic decisions are made by individuals or groups acting on their own in pursuit of profit. These decisions are not directly coordinated with those of other producers, nor are they the result of some overall plan. Any profits (or losses) that result from these decisions about production are those of the owners.

Capitalism requires private ownership of the means of production.

SUMMARY
Four key features of capitalism are the existence of companies, profit motive, competition, and private property.

Capital, as an economic concept, is closely related to private property. Putting it simply, capital is money that is invested for the purpose of making more money. Individuals or corporations purchase various means of production or other related assets and use them to produce goods or provide services, which are then sold. They do this not

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for the purpose of being nice or of helping people out but rather to make money—more money, they hope, than they spent to make the goods or provide the services in the first place. Using money to make money is at the heart of the definition of capitalism.

• • •

TWO ARGUMENTS FOR CAPITALISM

People tend to take for granted the desirability and moral legitimacy of the political and economic system they live in. Americans are no exception. We are raised in a society that encourages individual competition, praises capitalism, promotes the acquisition of material goods, and worships economic wealth. Newspapers, television, movies, and other forms of popular culture celebrate these values, and rarely are we presented with fundamental criticisms of or possible alternatives to our socioeconomic order. It is not surprising, then, that most of us blithely assume, without ever bothering to question, that our capitalist economic system is a morally justifiable one.

Yet as thinking people and moral agents, we need to reflect on the nature and justifiability of our social institutions. The proposition that capitalism is a morally acceptable system is open to debate. Whether we decide that capitalism is morally justified will depend, at least in part, on which general theory of justice turns out to be the soundest. Chapter 3 explored in detail the utilitarian approach, the libertarian alternative, and the theory of John Rawls. Now, against that background, this chapter looks at two basic ways defenders of capitalism have sought to justify their system: (1) the argument that the moral right to property guarantees the legitimacy of capitalism and (2) the utilitarian-based economic argument of Adam Smith. The chapter then considers some criticisms of capitalism.

THE NATURAL RIGHT TO PROPERTY

As Americans, we live in a socioeconomic system that guarantees us certain property rights. Although we are no longer permitted to own other people, we are certainly free to own a variety of other things, from livestock to stock certificates and from our own homes to whole blocks of apartment buildings. A common defense of capitalism is the argument that people have a fundamental, **natural right to property** and that our capitalist system is simply the outcome of this right.

One argument for capitalism is that it reflects people's natural right to property.

In Chapter 3, we saw how Locke attempted to base the right to property in human labor. According to Locke, when individuals mix their labor with the natural world, they are entitled to the results. This idea seems plausible in many cases. For example, if Carl diligently harvests coconuts on the island he shares with Adam, while Adam himself idles away his days, then most of us would agree that Carl has an entitlement to those coconuts that Adam lacks. But property ownership as it actually exists in the real world today is a complex, socially shaped phenomenon. This is especially true in the case of sophisticated forms of corporate and financial property—for example, bonds and stock options.

One could, of course, reject the whole idea of a natural right to property as a fiction, as, for example, utilitarians do. In their view, although various property systems are possible, there is no natural right that things be owned privately, or collectively, or in any particular way whatsoever. The moral task, according to utilitarians, is to determine which property system, which way of organizing production and distribution, has the greatest utility.

Even if one believes that there is a natural right to property at least under some circumstances, one need not believe that this right leads to capitalism or that there is a right to have a system of property rules and regulations exactly like the one we now have in the

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SUMMARY
One basic defense of capitalism rests on a supposed natural moral right to property. Utilitarians deny the existence of such rights; other critics doubt that this right entitles one to have a system of property rules and regulations identical to the one we now have in the United States.

United States. In other words, even if Carl has a natural right to his coconuts, there may still be moral limits on how many coconuts he can rightfully amass and what he can use them for. When he takes his coconuts to the coconut bank and receives more coconuts as interest, his newly acquired coconuts are not the result of any new labor on his part. When we look at capitalistic property—that is, at socioeconomic environments in which people profit from ownership alone—then we have left Locke's world far behind.

A defender of capitalism may reply, "Certainly, there's nothing unfair about Carl's accruing these extra coconuts through his investment; after all, he could have eaten his original coconuts instead." And, indeed, within our system this reasoning seems perfectly correct. It is the way things work in our society. But this fact doesn't prove that Carl has some natural right to use his coconuts to earn more coconuts—that is, that it would be unfair or unjust to set up a different economic system (for example, one in which he had a right to consume coconuts but no right to use them to accrue more coconuts). The argument here is simply that the issue is not an all-or-nothing one. We may have a fundamental right to property, without that right being unlimited or guaranteeing capitalism as we know it.

ADAM SMITH'S CONCEPT OF THE INVISIBLE HAND

A second argument for capitalism is that it is the most efficient and productive economic system. This is basically a utilitarian consideration.

Relying on the idea of a natural right to property is not the only way and probably not the best way to defend capitalism. Another, very important argument defends capitalism in terms of the many economic benefits the system brings, claiming that the free and unrestrained market system that exists under capitalism is more efficient and more productive than any other possible system and is thus to be preferred on moral grounds. Essentially, this is a utilitarian argument, but one doesn't have to be a utilitarian to take it seriously. As mentioned in Chapter 2, almost every normative theory puts some moral weight on the consequences of actions. Thus if capitalism does indeed work better than other ways of organizing economic life, then this outcome will be a relevant moral fact—one that will be important, for instance, for Rawlsians.

This section sketches Adam Smith's economic case for capitalism, as presented in *The Wealth of Nations*. Smith argues that when people are left to pursue their own interests, they will, without intending it, produce the greatest good for all. Each person's individual and private pursuit of wealth results—as if guided (in Smith's famous words) by an **invisible hand**—in the most beneficial overall organization and distribution of economic resources. Although the academic study of economics has developed greatly since Smith's times, his classic arguments remain extraordinarily influential.

Smith took it for granted that human beings are, by nature, acquisitive. Self-interest and personal advantage, specifically in an economic sense, may not be all that motivate people, but they do seem to motivate most people much of the time. At any rate, they are powerful enough forces that any successful economic system must strive to harness them. We are, Smith thought, strongly inclined to act so as to acquire more and more wealth.

In addition, humans have a natural propensity for trading—"to truck, barter, and exchange." Unlike other species, we have an almost constant need for the assistance of others. Yet because people are creatures of self-interest, it is folly for us to expect others to act altruistically toward us. We can secure what we need from others only by offering them something they need from us:

> Whoever offers to another a bargain of any kind, proposes to do this. 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.[4]

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This disposition to trade, said Smith, leads to the division of labor—dividing the labor and production process into areas of specialization, which is the prime means of increasing economic productivity.

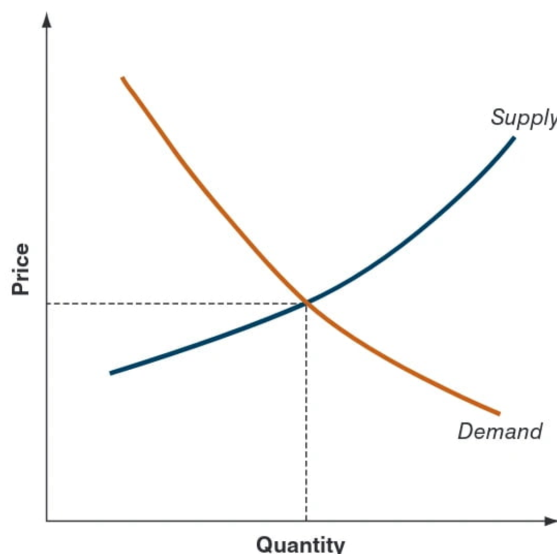
Thus, Smith reasoned that the greatest utility will result from unfettered pursuit of self-interest. Individuals should be allowed unrestricted access to raw materials, markets, and labor. Government interference in private enterprise should be eliminated, free competition encouraged, and economic self-interest made the rule of the day. Because human beings are materialistic, acquisitive creatures, we will, if left free, engage in labor and exchange goods in a way that results in the greatest benefit to society. In our efforts to advance our own economic interests, we inevitably act to promote the economic well-being of society generally:

> Every individual is continually exerting himself to find the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of the society, which he has in view. . . . [But] by directing that industry in such a manner as its produce may be of the greatest value, he [is] . . . led by an invisible hand to promote an end that was no part of his intention. . . . By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it.[5]

SUMMARY
Utilitarian defense of capitalism is associated with the classical economic arguments of Adam Smith. Smith believed that human beings are acquisitive and that they have a natural propensity for trading, and he insisted that when people are left free to pursue their own economic interests, they will, without intending it, produce the greatest good for all.

To explain why pursuit of self-interest necessarily leads to the greatest social benefit, Smith invoked the law of supply and demand, which was alluded to in our discussion of competition. The law of supply and demand tempers the pursuit of self-interest exactly as competition keeps the enterprising capitalist from becoming a ruthless profiteer. The law of supply and demand similarly solves the problems of adequate goods and fair prices.

Some think the law of supply and demand even solves the problem of fair wages, for labor is another commodity up for sale like shoes or jeans. Just as the price of a new product at first is high, like the jeans in our earlier hypothetical example, so, too, are the wages of labor in a new field. But as labor becomes more plentiful, wages decline. Eventually they fall to a point at which inefficient laborers are eliminated and forced to seek other work, just as the inefficient manufacturers of jeans were forced out of that business and into others. And like the price of jeans, the price of labor then stabilizes at a fair level. As for the inefficient laborers, they find work and a living wage elsewhere. In seeking new fields of labor, they help maximize the majority's opportunities to enjoy the necessities, conveniences, and trifles of human life.



A traditional supply–demand curve. The point at which supply and demand meet is called the "equilibrium" and determines the price.

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