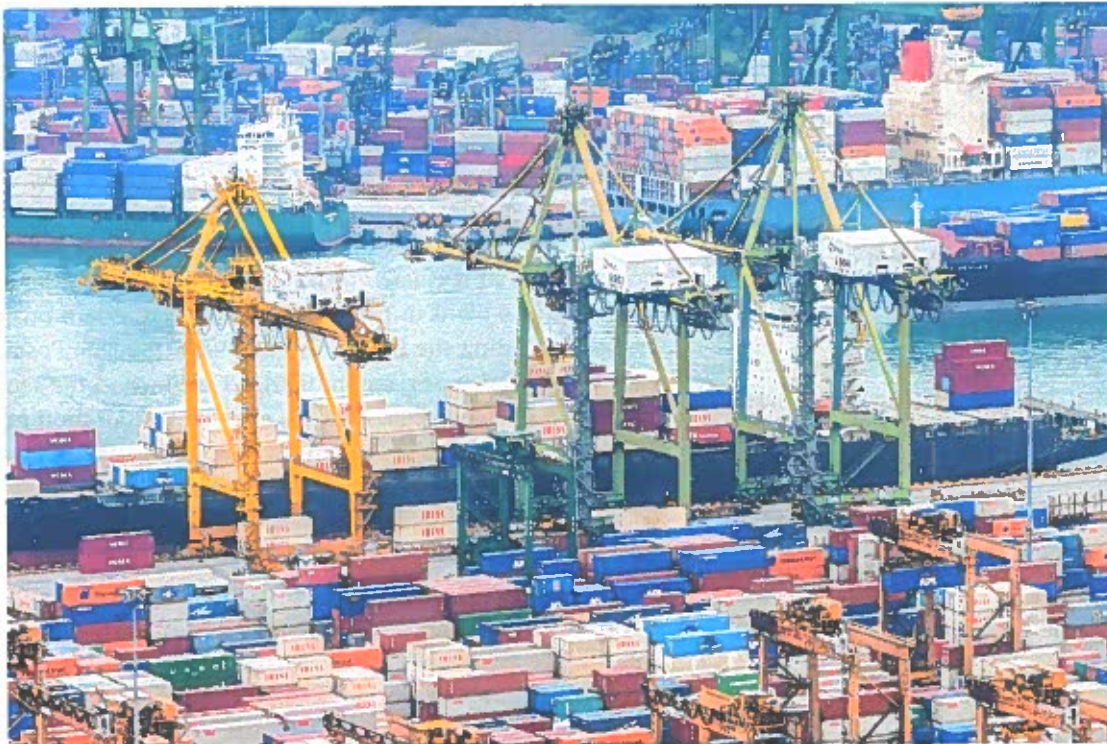


## Chapter 3

# The Business System: Government, Markets, and International Trade



As the world's busiest hub for containerized cargo, the Port of Singapore is at the center international trade. Singapore's government has embraced globalization and supports free trade.

### Learning Objectives

- 3.1** Explain the impact of globalization on the business system
- 3.2** Analyze John Locke's theory of natural rights as it relates to free markets
- 3.3** Assess key arguments associated with Adam Smith's utilitarian view of free markets
- 3.4** Analyze comparative advantage as a foundation for free trade among nations
- 3.5** Interpret Marxist views on the impact on workers of free trade and free markets
- 3.6** Explain the mixed economy and redefinitions of property that affect the business system

## 3.1: Globalization and the Business System

**OBJECTIVE:** Explain the relation between business and globalization

During the past 25 years, **globalization** has surged forward to a degree that is unprecedented in our world's history.<sup>1</sup> Globalization has connected nations so that goods, services, capital, and knowledge now flow freely among them. These flows are carried by ever faster and cheaper transportation and communication systems. They are facilitated by free trade agreements between national governments and supported by international institutions such as the World Trade Organization (WTO), a group of countries that agree to abide by rules establishing free and open markets among themselves. As governments have opened their nations' borders to free trade with other nations, businesses as well as governments have had to face numerous challenges. In every country, individual companies and entire industries have been wiped out as globalization has forced them to compete with companies in other parts of the world. Workers have found themselves jobless when companies have relocated factories to other nations with cheaper wages. Companies have been accused of manipulating the institutions that regulate trade between nations. Governments have been criticized for allowing companies to abandon their workers and move their operations to other countries.

Controversies over globalization and free trade are but the latest episodes in a great and centuries-long ethical debate over a single question: Should governments allow businesses to trade freely among themselves without interference, or do governments have the right and the duty to impose restrictions on business activities in order to protect their citizens? One side argues that when government steps out of the market arena and allows businesses to engage in unrestrained free markets and free trade, unethical behaviors are inevitable, including unfair competition, global pollution, unfair labor practices, sweatshops, discrimination, and disregard for the well-being of the poor. The other side argues that government restrictions on business are bad because they violate property rights and the right to freedom, lead to unfairness, and leave us all worse off. This chapter examines these ethical and moral arguments for and against free markets and free trade systems.

### 3.1.1: Economic Systems

Arguments about free markets and free trade are arguments about economic systems. An *economic system* is the system a society (or group of societies) uses to provide the

goods and services it needs to survive and flourish.<sup>2</sup> This system must accomplish two basic economic tasks.

- The first task is producing goods and services, which requires determining what will be produced, how it will be produced, and who will produce it.
- The second task is distributing these goods and services among the society's members, which requires determining who will get what and how much each will get.

To accomplish these two tasks, economic systems rely on three kinds of social devices: traditions, commands, and markets.

**EXAMINING THE BALANCE** Economies today contain elements of traditions, commands, and markets.<sup>3</sup> The United States, for example, is highly market-oriented, yet both tradition and government are influential. For example, more women work in some job categories (dental hygienists), while more men work in others (roofers), so traditional gender roles still may determine who does those jobs. Moreover, the U.S. government not only issues commands that regulate business, labor, and international trade but also owns or has owned several important businesses, including the Export-Import Bank, the U.S. Postal Service, the Federal Prison Industries, Ginnie Mae, the Tennessee Valley Authority, Amtrak, and the Corporation for Public Broadcasting. In 2010, the U.S. government acquired full or partial ownership of dozens of failing businesses, including car companies (General Motors), banks (Citi-group), and insurance companies (AIG).

It would be undesirable to run an economy completely on the basis of traditions, or commands, or markets. If an economy were to be a pure market system, with no economic interventions by government, there would be no constraints on the property one could own or what one could do with it. Slavery would be entirely legal, as would prostitution and all drugs, including hard drugs. Today, the governments of even the most market-oriented economies decree that some entities (e.g., people) may not be owned, some things (e.g., polluting) may not be done with one's property, some exchanges (e.g., child labor) are illegal, and some exchanges (e.g., taxation) are imposed. Such limitations on markets are the impositions of a command system: government concern for public welfare leads it to issue commands concerning which goods may or may not be produced or exchanged. Similarly, even under the almost all-encompassing command system of the former Soviet Union's harsh Stalinist regime during the twentieth century, local markets—many of them so-called black markets—existed, where workers could trade their wages for the goods they wanted. These local markets were interventions of a market system into a command system.

## Traditions, Commands, and Markets

Each of the three social devices provides a way to organize people's activities, motivate people, and determine who owns or controls society's productive resources.<sup>4, 5, 6</sup>

Interactive

### Tradition

So-called primitive societies used economic systems based primarily on tradition. *Tradition-based societies* are small and rely on communal roles and customs to carry out the two tasks of producing and distributing goods. Individuals are motivated by the community's expressions of approval or disapproval, and the community's productive resources—such as its herds—are often owned in common. A small nomadic tribe, for example, whose members survive by hunting and herding, may hold its herd, its most valuable property, in common. The small society may rely on the traditional roles of husband, wife, mother, father, son, and daughter to decide both who does what and who gets what. Societies that are almost completely tradition-based exist today among Bushmen, the Inuit, Kalahari hunters, and Bedouin tribes.

### Commands

### Markets

**DEBATING THE BALANCE** Since the eighteenth century, debates have raged over whether economies should be based more on commands or on markets.<sup>7</sup> Should we have more government commands in the form of more economic regulations and more government control of business enterprises, or should government stand back and trust the economy more to the workings of the market and the decisions of private owners of companies? Sometimes these debates have been expressed in terms of whether economic activities should be more or less “free of government intrusions,” and then the discussion is framed in terms of **free markets** (free, that is, of government limits) and **free trade**.<sup>8</sup> Sometimes the debate is about *laissez-faire* policies, which, literally, is the French phrase for policies that “let us act” free of government controls.

In this chapter, we will examine the arguments on both sides of these debates, which are, in the end, about the

proper role of governments and of markets, both nationally and internationally.

In analyzing these arguments on free markets and free trade, on government commands and markets, we in effect analyze what sociologists refer to as *ideologies*.<sup>9</sup> An *ideology* is a system of normative beliefs shared by members of some social group. A group's ideology expresses its answers to questions about the following:

- *Human nature*: Are human beings motivated solely by economic incentives?
- *Basic purpose of our social institutions*: What is the purpose of government? Of business? Of property?
- *How societies actually function*: Are markets really free? Does big business control government?
- *Values society should try to protect*: freedom, productivity, and equality.

## Debate over Free Markets and Free Trade

Today, these debates continue on two levels. We should not confuse the two different levels of these debates, although the two levels are related.

Interactive

### Level 1: Debate over Free Markets

#### Should a nation's own internal economy be organized as a free market economy?

The debate at the first level asks whether a nation's government should regulate business exchanges between its citizens or, instead, allow its citizens to freely exchange goods with one another.

### Level 2: Debate over Free Trade

The ideologies that we here in the United States hold today incorporate ideas drawn from John Locke, Adam Smith, David Ricardo, and other influential thinkers whose normative views we will examine and evaluate in this chapter. We discuss these ideas not only because of the significant influence they have had on our ideologies, but because many people today argue that these ideologies must be adjusted if they are to meet the contemporary needs of business and society.<sup>10</sup> It would be a valuable exercise for the reader, while reading this chapter, to identify the ideology he or she holds and to examine and critique its elements.

We will examine two important arguments for free markets.

- The first argument originated with John Locke and is based on a theory of **moral rights**.
- The second argument was first clearly proposed by Adam Smith and is based on **utilitarian** principles.

Then, we turn from free market arguments to focus on international free trade arguments. We will discuss the ideas of David Ricardo, whose life overlapped that of Adam Smith and who, like Smith, based his views about free trade on utilitarian principles. Finally, we will discuss the important but opposing arguments of Karl Marx, who held that without government controls, free market systems defy **justice** and promote injustice, both nationally and internationally.

### 3.1.2: Market Theory and Market Practice

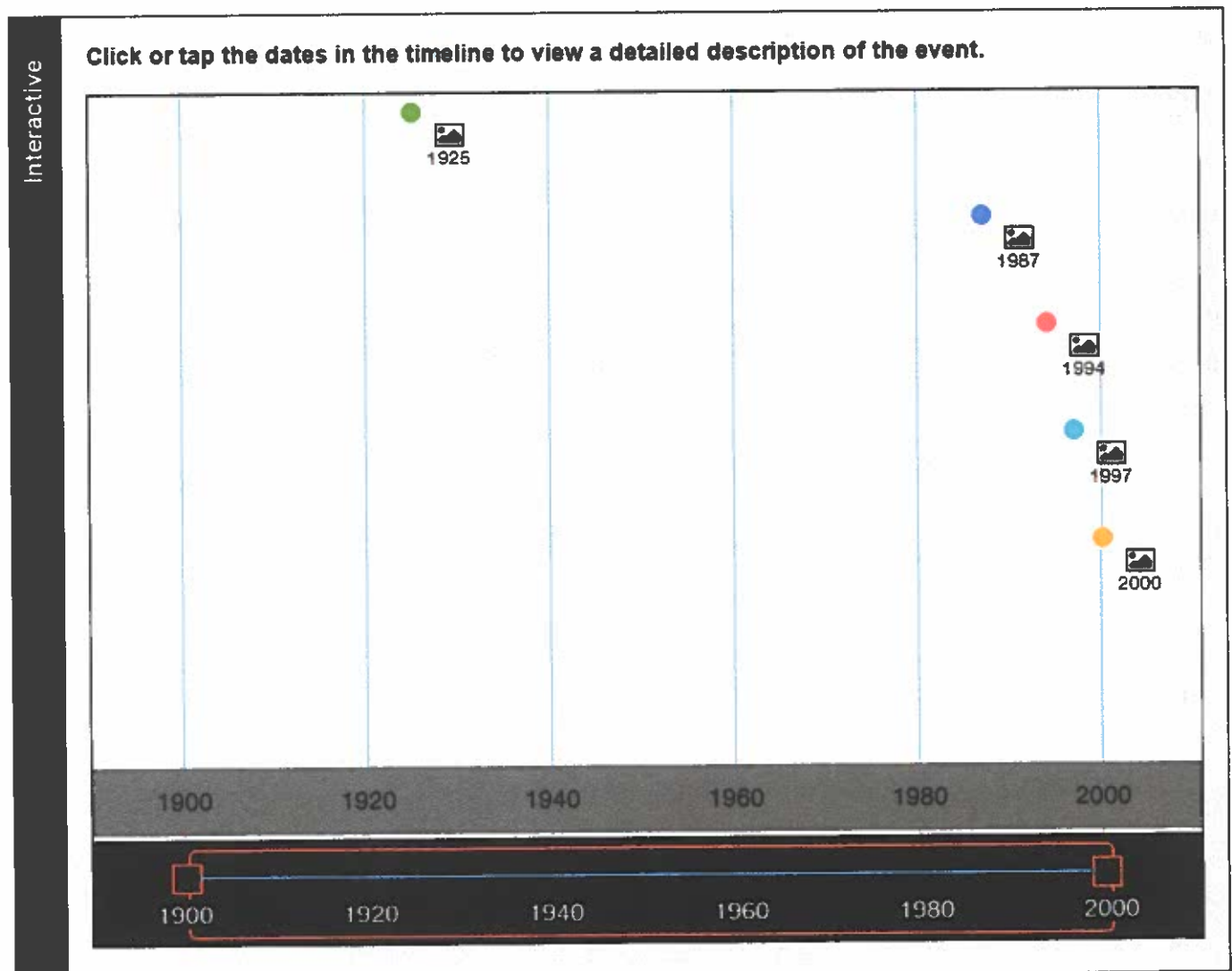
Throughout the chapter, we will illustrate many of the ethical issues connected to markets by looking at how two companies, Swingline (a manufacturer of staplers and related products) and Abbott Labs (a pharmaceutical company), each in different ways took advantage of the market opportunities that globalization provided. We start out with

detailed background information on both companies and describe an ethical situation that relates to each company. We will check in to see how market theory can be applied, using these real-world examples.

**SWINGLINE** Jack Linsky, a Ukrainian immigrant, invented the modern, easy-to-use stapler known as the Swingline stapler. In 1925 he built a stapler factory in New York where he hired immigrants from everywhere. Linsky's workers liked him and with their hard work the company prospered until 1987 when he sold it for \$210 million. But globalization and WTO agreements in 1995 began allowing foreign companies to freely import and sell their copycat staplers in the U.S. By 1997 the company was struggling to compete against these companies whose labor costs were much lower than its own. In 2000 the company fired all of its workers at its New York plant, closed the factory and moved its operations to Nogales, Mexico.

The North American Free Trade Agreement (NAFTA) between the United States, Mexico, and Canada allowed Swingline, to produce its staplers using Mexico's cheap labor and then import the products back into the United States, paying only limited import tariffs.<sup>13</sup> Cheap labor was plentiful in Nogales. Thousands of Mexican farmers and farm workers had been migrating to Nogales and other border towns. Their displacement was also related to NAFTA, which allowed U.S. farmers to sell their corn in Mexico. Since the U.S. government gives its corn farmers \$5 to \$10 billion a year in subsidies, U.S. corn growers could sell their corn in Mexico for less than Mexican farmers could.<sup>14</sup> Between 1994 and 2004, 1.5 million Mexican corn farmers and farm workers lost their main source of income and migrated to border cities, desperate for work. The resulting surplus of workers, the government's low minimum wage laws, and its low health and safety workplace standards all helped to keep labor costs down, which proved to be an irresistible attraction for U.S. companies.

### Globalization Shifts Labor: Swingline<sup>11, 12</sup>



However, as early as 2003, jobs in Mexico had begun leaving the country and heading for China.<sup>15</sup> China's workers were paid even less than Mexican workers, and they often worked in factories whose health and safety standards were even lower than those of Mexico. In 2010, the Swingline factory again fired all its workers, closed its Nogales factory, and contracted to have a Chinese factory make its staplers.

The Swingline story raises a number of ethical questions:

- Is it ethical for a company to abandon workers who have given decades of their lives to make it succeed?
- What ethical obligations, if any, does a company have to the workers left behind when it moves to another country?
- What ethical obligations do companies have toward their foreign workers?

- Should government allow companies to move their operations to other countries, or should it try to prevent or slow their exit?
- As companies continuously search for cheaper labor, will this produce a "race to the bottom" that will unjustly reduce workers' standards of living throughout the world?

**ABBOTT LABORATORIES** Global free trade has been criticized not only for the impact it has had on workers, but because of the impact it has had on those who live in poor nations. Many critics of free trade have argued that the international agreements and institutions that make free trade possible benefit global businesses but harm the world's poor and powerless.

### Globalization Affects Poor Nations: Abbott Laboratories

To understand these criticisms, consider how Abbott Laboratories responded when Thailand's government announced a new policy designed to provide its poorest people with a lifesaving drug.<sup>16, 17, 18, 19, 20</sup>

#### 1990–1995

In the early 1990s, U.S. drug companies began lobbying hard to get the U.S. government to pressure all countries to make patent laws part of the rules for the new WTO that was then being formed.

Pushed by U.S. drug companies, many of which made lavish donations to politicians, officials of the U.S. government insisted that WTO rules should require all member nations to adopt strict patent and copyright laws like those of the United States. Poor nations strongly objected to this proposition.

Until 1994, U.S. patent laws gave a new drug 17 years of protection inside the United States only.

However, when the WTO was finalized in 1995, its rules included an article entitled Trade-Related Aspects of Intellectual Property Rights (TRIPS), which required all WTO member nations to adopt patent and copyright laws modeled on U.S. laws.

Since it is difficult for a country to sell its goods to WTO member nations unless it too belongs to the WTO, most nations joined the WTO in spite of their objections to TRIPS.

Abbott Laboratories argued that if Thailand started making a generic version of Kaletra, it would be taking Abbott's property, since the company had discovered, developed, and tested the drug using several hundred million dollars of its own money and now held the patent. Moreover, Abbott claimed, under its interpretation of TRIPS, Thailand's government had no right to ignore Abbott's patent simply because it did not want to pay for the drug. Reluctance to pay, the company said, did not constitute an "emergency."<sup>21</sup> The head of Doctors Without Borders in Thailand said of Abbott's position: "For me, it's just evil. It's appalling. It reflects so badly on the multinational companies."<sup>22</sup>

The conflict between Thailand and Abbott Laboratories raises many of the ethical and moral questions that surround globalization and free trade:

- Has global free trade unjustly benefitted multinational companies at the expense of poor nations?
- Is it ethical for multinational companies—such as the large drug companies—to influence the rules that govern international trade and bend them to serve their own corporate interests?
- Should governments intervene when companies seem to be engaging in unethical behavior? Is it ethical for governments to intervene in business affairs?
- Are relatively new forms of property—such as patents on drug formulas—ethically legitimate?
- Is it ethical for the governments of poor nations to take a company's patented drug property without the consent of the company?

## 3.2: Free Markets and Rights: John Locke

**OBJECTIVE:** Analyze John Locke's theory of natural rights as it relates to free markets

One of the most popular cases for allowing government to play only a very limited role in markets derives from the idea that human beings have certain **natural rights** that only a free market system can protect. The two natural rights that free markets are supposed to protect are the right to freedom and the right to private property. Free markets are supposed to preserve the right to freedom insofar as they enable each individual to voluntarily exchange goods with others free from the coercive power of government. They are supposed to preserve the right to private property insofar as each individual is free to decide what will be done with what he or she owns without interference from government.

John Locke (1632–1704), a British political philosopher, is generally credited with developing the idea that

human beings have a natural right to liberty and a natural right to private property.<sup>23</sup> Locke argued that if there were no governments, human beings would find themselves in a *state of nature*. In this state of nature, each individual would be the political equal of all others and would be perfectly free of any constraints other than the *law of nature*—that is, the moral principles that God gave to humanity and that each individual can discover by the use of God-given reason. As he puts it, in a state of nature, everyone would be in

*a state of perfect freedom* to order their actions and dispose of their possessions and persons as they think fit, within the bounds of the law of nature, without asking leave, or depending upon the will of any other man. A *state also of equality*, wherein all the power and jurisdiction is reciprocal, no one having more than another . . . without subordination or subjection [to another]. . . . But . . . the *state of nature* has a law of nature to govern it, which obliges everyone: and reason, which is that law, teaches all mankind, who will but consult it, that being all *equal and independent*, no one ought to harm another in his life, health, liberty, or possessions.<sup>24</sup>

According to Locke, the law of nature teaches that each has a right to liberty and that, consequently, "no one can be put out of this [natural] estate and subjected to the political power of another without his own consent."<sup>25</sup> The law of nature also informs us that all people have rights of ownership over their bodies, their labor, and the products of their labor, and that these ownership rights are natural—that is, they are not invented or created by government nor are they the result of a government grant:

Every man has a property in his own person: This nobody has a right to but himself. The labor of his body, and the work of his hands, we may say, are properly his. Whatsoever then he removes out of the state that nature has provided and left it in, he has mixed his labor with, and joined to it something that is his own, and thereby makes it his property . . . [For] this labor being the unquestionable property of the laborer, no man but he can have a right to what that [labor] is once joined to, at least where there is enough, and as good, left in common for others.<sup>26</sup>

The state of nature, however, is a perilous state in which individuals are in constant danger of being harmed by others, "for all being kings as much as he, every man his equal, and the greater part no strict observers of equity and justice, the enjoyment of the property he has in this state is very unsafe, very insecure."<sup>27</sup> Consequently, individuals inevitably organize themselves into a political body and create a government whose primary purpose is to provide the protection of their natural rights that is lacking in the state of nature. Because the citizen consents to government "only with an intention . . . to preserve himself, his liberty and property . . . the power of the society or legislature constituted by them can never be supposed to extend farther"

than what is needed to preserve these rights.<sup>28</sup> Government cannot interfere with any citizen's natural right to liberty and natural right to property except insofar as such interference is needed to protect one person's liberty or property from being invaded by others.

### Quick Review 3.1

#### John Locke's State of Nature

- All persons are free and equal.
- Each person owns his body and labor, and whatever he mixes his own labor into.
- People's enjoyment of life, liberty, and property are unsafe and insecure.
- People agree to form a government to protect and preserve their right to life, liberty, and property.

### 3.2.1: Interpreting John Locke

Although Locke never explicitly used his theory of natural rights to argue for free markets, several authors have employed his theory for this purpose.<sup>29</sup> Friedrich A. Hayek, Murray Rothbard, Gottfried Dietze, Eric Mack, and many others have claimed that each person has the right to liberty and property that Locke credited to every human being and that, consequently, government must leave individuals free to exchange their labor and their property as they voluntarily choose.<sup>30</sup> Only a free private enterprise exchange economy, in which government stays out of the market and in which government protects the property rights of private individuals, allows for such voluntary exchanges. The existence of the Lockean rights to liberty and property, then, implies that societies should incorporate private property institutions and free markets.

Locke's views on the right to private property have had a significant influence on American institutions of property, an influence that continues to be felt in today's digital society. Most important, throughout most of its early history, U.S. law has held to the theory that individuals have an almost absolute right to do whatever they want with their property and that government has only a limited right to interfere with or confiscate an individual's private property even for the good of society. The Fifth Amendment to the U.S. Constitution states, "No person shall be . . . deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation." This amendment (which incorporates Locke's ideas on life, liberty, and property) ultimately derives from Locke's view that private property rights are established by nature (when an individual "mixes" labor into a thing) and so are prior to government. Government does not grant or create private property rights. Instead, it must respect and protect the property rights that are naturally generated through labor and trade.

Different views on property all assume that private property is a bundle of rights. To say that X is my private property is to say that I have a right to use it, consume it, sell it, give it away, loan it, rent it, keep anything of value it produces, change it, destroy it, and, most important exclude others from doing any of these things without my consent.

## Ethical Application

### Abbott Labs and Locke

Let's consider the actions of Abbott Laboratories in light of Locke's views. Recall that Abbott withheld several lifesaving drugs from Thailand's people when the government of Thailand announced its intention to manufacture a drug that Abbott had patented. Abbott claimed that Thailand was stealing the company's intellectual property.<sup>31</sup> Regardless of what any government or other ruling body might say, Abbott insisted it had created the formula for the drug and invested the money needed to develop it, and so it was Abbott's property and no one else had a right to use it without Abbott's authorization. Abbott's position was based on the Lockean view that private property is created by one's labor and not by government. The right to property, like the right to liberty, is prior to, or more basic than, government's authority and, as Locke insisted, government is created to protect these fundamental rights. The head of a pharmaceutical association that represented Abbott and other multinational drug companies said: "After the company does 10 years of research, and then suddenly the Thai government would like to impose a compulsory license, taking away their property, their assets—this is not right."<sup>32</sup>

Thailand's government, on the other hand, issued a report in which it stated that it had "fully complied with [all] the national and international legal frameworks," including TRIPS.<sup>33</sup> It pointed out that the WTO had explicitly declared that to protect its citizens' health, a country could issue a compulsory license and manufacture a drug without the authorization of the company that held the patent. Consequently, Thailand's government determined that it was not wrong to manufacture the drug even though Abbott held the patent, since the legal framework that created the patent and turned the drug formula into a form of property explicitly allowed them to use the formula. The view of Thailand's government, then, was that governments and their laws create property rights, a view that is decidedly *not* Lockean.<sup>34</sup> Also unlike Locke, Thailand's government held that property rights are not absolute. Thailand said in its report that its decision was based on its "commitment to put the right to life above trade interests." Property rights, then, are limited by the right to life, because human life is more important than the international rules that protect trade interests by protecting property rights.

The views of both Abbott Laboratories and Thailand's government were shaped by their ideologies. In other words, they were shaped by their beliefs about which rights are most basic, about the purpose of government, and about the nature of private property.

## Views on Property Rights

It is only relatively recently, in the late nineteenth and twentieth centuries, that the Lockean view began to give way to the more socialist view that government may limit an individual's private property rights for the good of society. Even today in the United States, there is a strong presumption that government does not create property rights, but it must respect and enforce the property rights that individuals create through their own efforts. The U.S. law explicitly recognizes, for example, that if a person produces a literary text, the text is his or her property even without a government-issued copyright.

Interactive

### Different Definitions of Property

It is important to see that this Lockean view of property is not universal. In some countries, such as Japan, resources are not seen as things over which individuals have an absolute private property right. Instead, in Japan, as in many other Asian societies, resources are seen as functioning primarily to serve the needs of society as a whole, and so the property rights of individuals should give way to the needs of society when there is a conflict between the two.

### Property as a Bundle of Rights

## 3.2.2: Criticisms of Lockean Rights

Criticisms of the Lockean defense of the right to liberty, both within and outside of markets, have focused on four of its major weaknesses:

1. The assumption that individuals have the "natural rights" Locke claimed they have
2. The assumption that negative rights take precedence over positive rights
3. A failure to acknowledge that adherence to Lockean rights can lead to injustice
4. The conflict between Locke's individualistic assumptions and the demands of caring

**INJUSTICE AND INEQUALITY** Another major criticism of the Lockean defense of free markets is based on the idea that free markets create unjust inequalities.<sup>35</sup> In a free market economy, a person's productive power is proportioned to the amount of labor or property already possessed. Those individuals who have accumulated a great deal of wealth and who have access to education and training will be able to accumulate even more wealth by purchasing more productive assets. Individuals who own no property, who are unable to work, or who are unskilled (such as the handicapped, infirm, poor, aged) will be unable to buy any goods at all without help from the government. As a result, without government intervention, the gap between the

## Natural Rights and the Conflict between Negative and Positive Rights

Let's examine the first two assumptions: that "natural rights" exist and that negative rights override positive rights.<sup>36, 37, 38, 39</sup>

### The Assumption That Natural Rights Exist

#### The Assumption That Negative Rights Take Precedence over Positive Rights

Even if human beings have a natural right to liberty and to property, it does not follow that these rights must override all other rights. The rights to liberty and to property are negative rights. **Negative rights** can conflict with people's **positive rights**. For example, one person's negative right to liberty may conflict with someone else's positive right to food, medical care, housing, or clean air. Why must we believe that in such cases the negative right has greater priority than the positive right? Critics argue that we have no reason to believe that the rights to liberty and property are overriding. Consequently, we also have no reason to be persuaded by the argument that free markets must be preserved because they protect this right.

richest and poorest widens until large disparities of wealth emerge. Unless government intervenes to adjust the distribution of property that results from free markets, large groups of citizens will remain poor while others grow ever richer. View the distribution of income and wealth among American households in the visual below.

To support their point, critics cite the high poverty levels and large inequalities evident in nations such as the United States that rely heavily on free markets. Consider the following U.S. data:

- The top 1 percent of the population in 2007 held almost half of America's total financial wealth, owned more than one-third of the nation's total net worth, received one-fifth of the country's income, and lived in households with an average net worth of \$18,529,000.<sup>40</sup>
- The richest 5 percent of U.S. households in 2008 made on average \$322,343 or 27 times the average of the poorest 20 percent.<sup>41</sup>
- In 2013, 45.3 million Americans, or 14.5 percent of the population, were living in poverty.<sup>42</sup> In the same year, the richest 20 percent of U.S. households had an average income of \$185,206, while the poorest 20 percent had an average income of \$11,984.<sup>43</sup>
- Some 17.5 million U.S. households—about 49.1 million people—suffered from hunger during 2013 because they did not have enough food to meet the basic needs of all household members.<sup>44</sup>
- About 42 million people had no health insurance in 2013.<sup>45</sup>
- Also in 2013, about 600,000 people were homeless each night, about one-quarter of them children.<sup>46</sup>

**Table 3.1** Distribution of Income and Wealth among American Households, 2013

Critics point to the highly unequal distribution of income and wealth found in the United States.<sup>47</sup> Notice the sharp differences between the top 20 percent and the bottom 40 percent. In Table 3.1, the top 20 percent includes the top 1 percent, and the minus sign preceding certain numbers indicates debt.

Group	Percentage of Total U.S. Income (2013)	Percentage of Total U.S. Financial Wealth (2012)	Percentage of Total U.S. Net Worth (2013)	Average Net Worth (2013)	Percentage of Total U.S. Stock (2012)
Top 1%	19.8	42.7	36.7	\$18,623,900	38.3
Top 20%	61.8	93.0	88.9	\$2,260,300	91.1
Second 20%	17.8	6.8	9.3	\$236,400	6.4
Third 20%	11.1	1.3	2.7	\$68,100	1.9
Bottom 40%	9.4	-1.0	-0.9	-\$10,800	0.6

- Economic inequality has also increased worldwide, driven in part by the forces of globalization. Free trade agreements and globalization have enabled companies to move their operations from one country to another. As they move they leave workers jobless and the result, many claim, is that the working poor of the world keep getting poorer thereby increasing inequality.

Figure 3.1 to 3.3 show the high poverty levels and large inequalities evident in nations such as the United States that rely heavily on free markets.

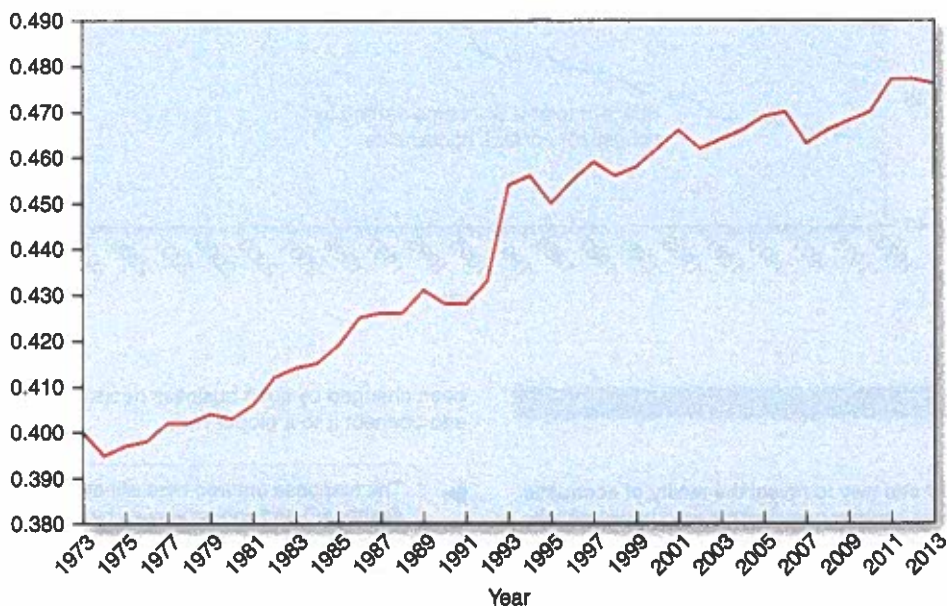
## Ethical Application

### Expanding Inequality

Recall the case of Swingline, the company that manufactures staplers and related products. When the company left its workers behind in New York and moved to Mexico, the economic standing of the abandoned workers declined. When the company then left Mexico and moved to China because of China's cheaper wage policies, the living standards of its abandoned workers once again went down.

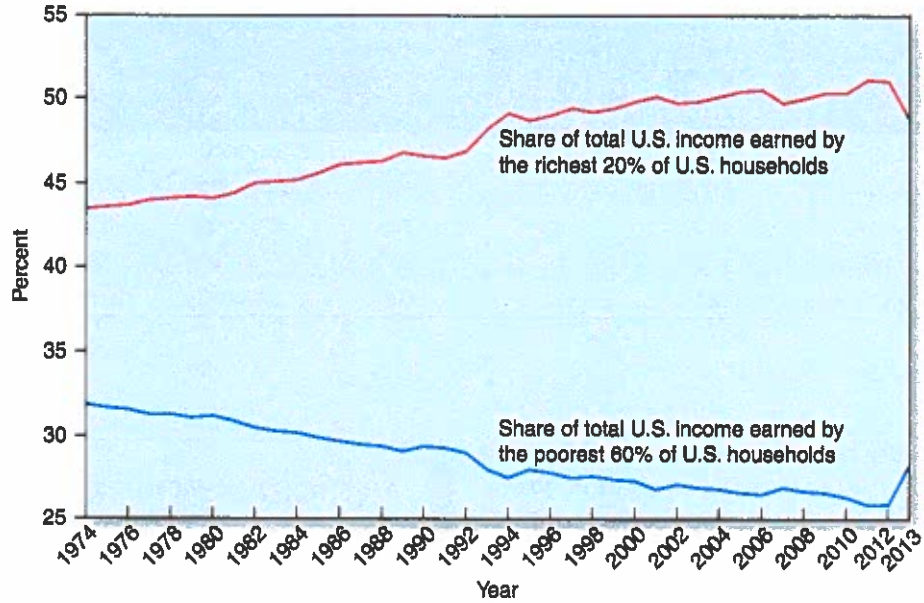
**Figure 3.1** Rising U.S. inequality since 1973

Figure 3.1 depicts the movement of the Gini index, which is a simple standard measure that shows how U.S. economic inequality has been rising steadily since 1973.



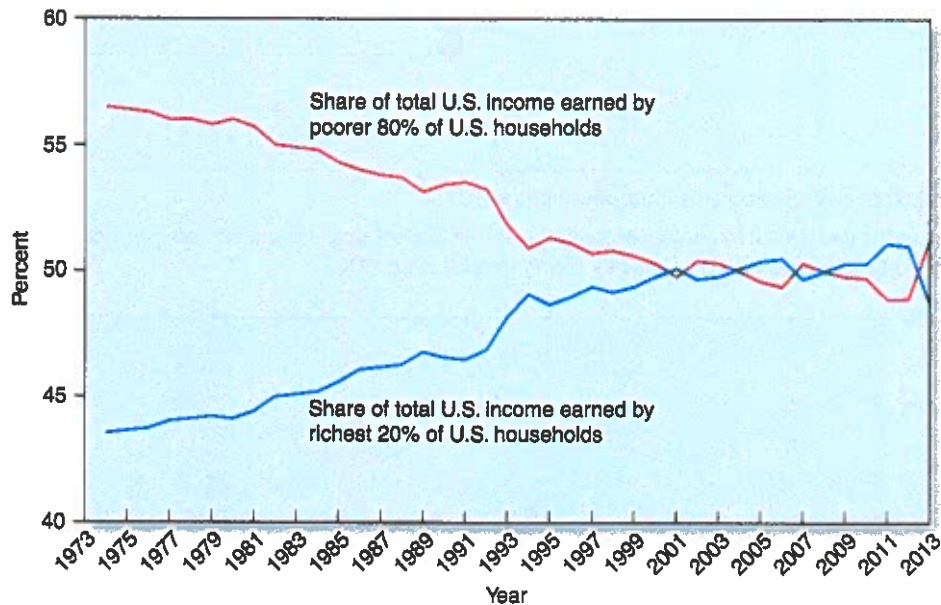
**Figure 3.2** Increasing household inequality, 1974–2013

Figure 3.2 is an overview of the widening gap in household income between wealthy and low-income families. With an overall look at shares of total U.S. income across time, it is clear that the gap between wealthy and low-income households is widening.



**Figure 3.3** Income shares of U.S. households, 1974–2013

Figure 3.3 shows how the richest 20 percent of U.S. households now take in about as much income as all the rest combined.



**WRITING PROMPT**

**Numbers and People**

Graphs and statistics are one way to reveal the reality of economic inequality, and the news is another way. People who have lost jobs and livelihoods can also tell you powerful personal stories. Have you, your family, or friends been affected by business decisions that have created inequality? How has your town or neighborhood

been changed by such business decisions? Write a personal story and connect it to a global view.



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**CONFLICT BETWEEN INDIVIDUAL AND COMMUNITY** Finally, Locke's critics have argued that his argument assumes that human beings are atomistic individuals with personal rights to liberty and property that flow from their individual nature independently of their relations to the larger community. Because these rights are assumed to be prior to and independent of the community, the community can make no claims on the property or freedom of the individual. However, critics claim that these individualistic assumptions are completely false: they ignore the key role of caring relationships in human societies and the demands of caring that arise from these relationships. Locke's critics point out that human beings are born dependent on the care of others; as they grow, they remain dependent on the care of others to acquire what they need to become able adults. When they become adults, human beings still depend on the caring cooperation of others in their communities for virtually everything they do or produce. Even an individual's liberty depends on others. The degree of liberty a person has depends on what the person can do: the less a person can do, the less she is free to do. However, a person's abilities depend on what the person learns from those who care for her, as well as on what others care to help her to do or allow her to do.

Similarly, the property that a person produces through labor depends ultimately on the skills acquired from those who cared for him or her and on the cooperative work of others in the community, including employees. Even one's identity—the sense of who one is as a member of the various communities and groups to which one belongs—depends on one's relationships with others in the community. In short, the individualistic assumptions built into Locke's view of human beings ignore the concrete caring relationships from which a person's identity and the possibility of individual rights arise. People are not atomistic individuals with rights that are independent of others; instead, they are persons embedded in caring relationships that make those rights possible and that make the person who and what he or she is. Moreover, critics continue, people are morally required to sustain these relationships and to care for others as others have cared for them. The community can legitimately make claims on the property of individuals and can restrict the freedom of individuals precisely because the community and the caring it has provided are the ultimate source of that property and freedom.

### Quick Review 3.2

#### Weaknesses of Locke's Views on Rights

- Locke does not demonstrate that individuals have natural rights to life, liberty, and property.

- Locke's natural rights are negative rights, and he does not show that these override conflicting positive rights.
- Locke's rights imply that markets should be free, but free markets can be unjust and can lead to inequalities.
- Locke wrongly assumes that human beings are atomistic individuals.

## 3.3: Free Markets and Utility: Adam Smith

**OBJECTIVE:** Assess key arguments associated with Adam Smith's utilitarian view of free markets

The second major support for free markets derives from the utilitarian argument that free markets and private property will produce greater benefits than any amount of government interference could. In a system with free markets and private property, buyers purchase what they want at the lowest prices they can find. Therefore, it will benefit private businesses to produce and sell what consumers want and to do this at the lowest possible prices. To keep their prices down, private businesses will try to cut back on the costly resources they consume. Thus, the free market, coupled with private property, ensures that the economy is producing what consumers want, that prices are at the lowest levels possible, and that resources are efficiently used. The economic utility of society's members is thereby maximized.

Adam Smith (1723–1790), called the father of modern economics, is the originator of this utilitarian argument for the free market.<sup>48</sup> In his major work, *The Wealth of Nations*, Smith wrote that when private individuals are left free to seek their own interests in free markets, they will inevitably be led to further the public welfare by an **invisible hand**:

By directing [his] industry in such a manner as its produce may be of the greatest value, [the individual] intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end that was no part of his intention. . . . By pursuing his own interest he frequently promotes that of society more effectively than when he really intends to promote it.<sup>49</sup>

### 3.3.1: The Invisible Hand of Market Competition

Smith's invisible hand is market competition. Every producer seeks to make a living by using private resources

to produce and sell those goods that the producer perceives people want to buy. In a competitive market, a multiplicity of such private businesses must all compete with one another for the same buyers. To attract customers, therefore, each seller is forced not only to supply what consumers want but also to drop the price of goods as close as possible to “what it really costs the person who brings it to market.”<sup>50</sup> To increase his or her profits, each producer will pare costs, thereby reducing the resources consumed. The competition produced by a multiplicity of self-interested private sellers serves to lower prices, conserve resources, and make producers respond to consumer desires. Motivated only by self-interest, private businesses are led to serve society. As

Smith stated the matter in a famous passage in *The Wealth of Nations*:

It is not from the benevolence of the butcher, the baker, and the brewer that we expect our dinner, but from their regard for their own self-interest. We address ourselves not to their humanity, but to their self-love, and never talk to them of our own necessities, but of their advantages.<sup>51</sup>

### 3.3.2: Government Plays No Role

The best policy of a government that hopes to advance the public welfare, Smith claimed, is to do nothing: to let each individual pursue his self-interest in “natural liberty” so that he is free to buy and sell whatever he or she wishes.<sup>52</sup> Any interventions

#### Adam Smith’s Market Mechanism

Smith argued that a system of competitive markets allocates resources efficiently among the various industries of a society.<sup>53</sup> He presented a classic supply and demand model.

Interactive

#### Demand

The process starts with consumer demand.

- When consumer demand of a certain commodity is high enough that the supply is not enough to meet it, buyers bid the price of the commodity upward until it rises above what Smith called the *natural price* (i.e., the price that just covers the costs of producing the commodity, including the going rate of profit obtainable in other markets).
- Producers of that commodity then reap profits higher than those available to producers of other commodities.
- Higher profits induce producers of those other products to switch their resources into the production of the more profitable commodity.

#### Supply

#### Utility