# CHAPTER 4:
# THE CAPITALIST MARKET: HOW IT ACTUALLY WORKS

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In the last chapter we examined the central virtues of capitalism as seen by its defenders and the basic way capitalism is supposed to work. Six points were especially salient:

- Capitalist markets are an expression of the value of individual freedom, organized around voluntary exchange between people; no one is forced by anyone to engage in any particular exchange.
- Free markets are an extremely effective mechanism for coordinating complex economic systems.
- Markets accomplish this remarkable result through supply, demand and the price mechanism
- Free markets result in allocative efficiency: after all the trading is done, the allocation of things is "pareto optimal" – no one can be made better off without someone being made worse off.
- Capitalist Markets create incentives for risk-taking and innovation and thus capitalism is an engine of economic growth.
- State regulations of capitalist firms and markets interferes with the free market and undermines these virtues.

This is how capitalism is supposed to work. Now let's look at some of the problems and dilemmas of markets and capitalism. We will begin by examining the moral argument for capitalism and freedom and then turn to a range of problems with the pragmatic defense of free markets. The chapter will conclude with a discussion of how intensely competitive capitalist markets can undermine a range of social values outside of the economy itself.

## I. The moral argument: How well do capitalist markets advance the value of human freedom?

Individual freedom is a terribly important value, and it is a tremendous historical achievement that individual freedom has become a core value of our culture. Historically this value emerged and was strengthened, if unevenly, by the spread of market relations, and a good case can be made that capitalist development has further promoted this value. Nevertheless, capitalist markets really only affirm a very limited notion of freedom, and in certain important respects constitute an obstacle to the fuller realization of this value.

To understand this we must look more closely at the idea of individual freedom. There are two sides to the idea of freedom, sometimes referred to as "negative freedom" and "positive freedom". Capitalism and markets have an ambiguous relationship to both of these faces of freedom.

*Negative freedom* means freedom *from* coercion. Individuals have negative freedom when no one directly commands them to do things against their will. Individuals have autonomy to direct their own actions unless they voluntarily agree to follow the orders of someone else. A "contract" embodies this ideal of freedom: two people voluntarily agree to some kind of exchange. So long as the contract is free of force or fraud, it is an expression of negative freedom. By historical standards, capitalist markets have done a pretty good job at reducing involuntary coercion in economic life. Compare a free market economy to slavery or feudalism: in both of these sorts of economic systems the direct application of force is a central, pervasive feature of allocating people to tasks. In a capitalist market economy the allocation of people to activities is the result of the self-directed choices of persons: no one is told "you must work for this employer" or "you must buy this product." In Milton Friedman's famous words, within a capitalist market people are "free to choose."[1]

*Positive Freedom* refers to the actual *capacity* of people to do things. This is freedom *to* rather than freedom *from.* A person has greater positive freedom if he or she can do more things, has greater capacity act in the world. Negative freedom identifies freedom solely with the *act of choice*, whereas positive freedom identifies it with the *range of choices* a person is actually able to make. Capitalism has also certainly played a pivotal role in expanding the range of choices available to many people. One needs only to compare the vast array of consumer products available today with 100 years ago to see this. And further, economic growth has improved the standards of living of a significant proportion of the population so that they have access to at least a part of the expanded range of alternatives.

With respect to both the negative and positive face of freedom, therefore, capitalism and markets can be seen as having made a real contribution. And yet, in other crucial ways, capitalism also generates and enforces considerable restrictions on both negative freedom and positive freedom for many people. Two issues are especially salient here. First, the power relations within capitalist firms constitute pervasive restrictions on individual autonomy and self-direction. At the core of the institution of private property is the power of owners to decide how their property is to be used. In the context of capitalist firms this is the basis for conferring authority on owners to direct the actions of their employees. An essential part of the employment contract is the agreement of employees to follow orders, to do what they are told. In most capitalist workplaces this means that for most workers, individual freedom and self-direction are quite curtailed.

One response to this by defenders of capitalism is that if workers don't like what they are told to do, they are free to quit. They are thus not really being dominated since they continually voluntarily submit to the authority of their boss; they are not slaves, after all. The real freedom of individuals to quit their jobs, however, provides only an illusory escape from such domination since without ownership of means of production or access to basic necessities of life, workers must seek work in capitalist firms or state organizations, and in all of these they must surrender autonomy. It may be true that the agreement to work for a particular employer is "voluntary" in that no one commands this,

[1] The expression comes from Milton and Rose Friedman in their passionate defense of capitalism, *Free to Choose* ( ).

but the decision to work for some employer is not. Capitalism, therefore, violates the value of negative freedom by making it very difficult for most people to avoid being directly dominated by others in work.[2]

The second way in which capitalism undermines the ideal of individual freedom and autonomy centers on the massive inequalities of wealth and income which capitalism generates. These inequalities mean that some people have enormously greater capacity to act on their life plans than others, to be in a position to actually make the choices which matter to them. Large inequalities of wealth and income mean some people have much greater positive freedom than others. Of course, one can cite many wonderful rages-to-riches stories to refute this: there are people who start out with extremely limited resources and correspondingly limited options who nevertheless acquire the material conditions for expansive positive freedom. Can one say that capitalism denies people positive freedom when such opportunities exist? This is rather like observing that some people escape from prison -- and undoubtedly these are the prisoners who are the cleverest and most committed to escaping -- and then concluding that the people who do not escape are therefore not really in prison. Free markets inherently generate very large disparities in resources available to people. If everyone started out in the same position with the same assets and these differences were just the result of effort and choice, then perhaps it wouldn't really contradict positive freedom. In fact, most people who accumulate great wealth started with considerable wealth and other advantages. They have greater freedom, not just more stuff, than someone born poor.

Capitalism and free markets, therefore, have contradictory effects on the value of individual freedom, whether understood in the negative or positive sense. American capitalism does relatively little to counteract these freedom-reducing processes. Employers face very weak legal restrictions on their authority over their employees, and most workers have very limited autonomy and self-direction within work. Relatively despotic forms of power over individuals within workplaces are thus common. The processes of income and wealth redistribution organized by the state are also very weak, and thus little is done to secure the positive freedom of the poor and disadvantaged. American capitalism may be defended on the moral grounds of individual freedom and liberty, but it supports only a thin understanding of this important value.

## II. Problems *internal* to markets: inefficiency and market "failures"

Defenders of free markets and capitalism as a social order do not primarily defend these institutions because they embody the moral principle of maximizing individual freedom, but rather because these institutions are also supposed to promote the general welfare. Many people may concede that markets may be unfair in some ways, that real freedom is limited for many people within capitalism, but still believe that maximally free markets based on private property are the surest route to efficiency and improvements in the general welfare.

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[2] For a good discussion of the sense in which the employment contract, in spite of its apparently voluntary character, still reflects a form of unfreedom, see g.A. Cohen, "[proletarian unfreedom article…]. For a discussion of the problematic relationship of managerial authority to individual freedom, see……

It is certainly the case that markets are often pretty efficient and that private ownership of firms can often "deliver the goods". But this is a seriously incomplete picture. There are many circumstances in which markets fail and important instances where they do a terrible job. Our ultimate conclusion will be that if one wants to realize to the greatest extent possible the values of efficiency, then the ideal should not be the free market of unregulated capitalism, but democratically accountable markets. In the case of Contemporary American Society this would require a dramatic revitalization of democracy and strengthening of the "affirmative state".

In order to get to this conclusion we need to understand more systematically the problems and dilemmas of capitalist markets, and this will require more discussion of some basic ideas and concepts in economics and economic sociology. This will be the task of the rest of this chapter. This will be followed in Chapters 5-8 with a more empirical discussion of market inefficiency in several important domains of economic activity.

We will examine five problems in the functioning of capitalist markets that can generate significant economic and social inefficiency:

1. Information failures
2. Concentrations of economic power
3. Negative externalities
4. Short time horizons
5. Public goods

### 1. Markets and information

At the center of the idea that markets generate efficient allocations of resources is the problem of information. This is a simple point, embodied in jokes about used car salesmen describing vehicles as having been driven by little old ladies only on Sundays and aphorisms such as "buyers beware." Basically the problem is that sellers on a market have strong interests in hiding certain kinds of information from buyers in contexts in which it is costly, if not impossible, for buyers to get the necessary information to make an optimal choice. Because of this severe information problem we have laws that regulate false advertising, and we require firms to provide certain kinds of information to consumers *which they would not provide if there was a perfectly free market*. Food labeling is a good example. Laws that require nutrition information on food violate the free market. Food processors would not provide this information unless forced to do so. It costs the seller something to calculate nutritional content, assemble the data, and put this on a label. Individual consumers are unlikely to have strong preferences about this information until after it is provided. And furthermore, even if there were some consumers who wanted the information, it would initially be quite costly for producers to provide this information – there are considerable economies of scale in providing the information if it is done on a wide scale rather than on a limited scale – and thus the price difference between products with and without product information would be prohibitive. As a practical matter, this information will be widely provided only when there regulations which require this. Such regulations violate the principles of the free market.

Laws that prevent firms from false advertising violate the logic of the market as well. In a perfectly free market, firms could make whatever claims they liked about their products. If consumers felt that it was valuable for them to know the truth, then there would be a market for better information about products, and consumers could buy that information if they wanted to. If a consumer felt that the distortions of information harmed them and amounted to fraud, then they could sue the sellers in court and the threat of suits would act as a deterrent for excessive falsehood. In any case firms would not want to distort information too much or they would lose customers. Reputation matters for firms, and thus the market itself would impose constraints on distorted information.

It is possible, therefore, to imagine a free market with no government regulations on information. In such a truly free market economy, the quality of information would depend upon the preferences of consumers for good information and their ability to pay for it, the value of reputation to sellers, and the effectiveness of threats posed by private law suits for fraud. This is an imaginable world – and indeed was more or less the way American capitalism functioned in the 19$^{th}$ century – but the average quality of information consumers would get in the market would be much lower in such a world than in one with good state enforced regulations on information. And if the average quality of information is lower, than the allocation of resources generated by such a market would be less efficient.

A special case of product information concerns product safety. Suppose that there were no regulations for safety standards for automobiles. Carmakers would then be free to make cars with different standards of safety. If consumers valued safety, then they would be free to pay a premium for cars designed to be safe. If some consumers were risk-takers and preferred a cheaper car, then they could buy a less safe car. A libertarian might argue that this would be a better market since it would give consumers more power, more ability to choose freely the risk/safety/cost mix that they prefer. However, one of the major problems with this scenario concerns the problem of information, since carmakers would have large incentives to hide safety problems and characterize their cars as being safer than they really are and it would be difficult for consumers to weigh the technical information to make informed decisions, and extremely difficult for them to effectively to use the courts to remedy the resulting harms.

This problem is not just hypothetical. The notorious cases of the Pinto automobile and its exploding gas tanks in the 1970s and the road instability of certain SUVs in the 1990s clearly show the problem of information failures in the "market" for automobile safety even in a world in which safety regulations exist.[3] The Ford motor company realized by the late 1960s that there was a design flaw in the Pinto which, in certain accidents, caused the gas tank to explode. Ford engineers designed a retrofit which would eliminate the problem at a cost of roughly $11/car. The issue, then, was whether or not it was worth it for the company to recall all Pintos and make the change. The company did the math: the safety improvement would cost $11/car and would save roughly 180 lives per year. The cost of the retrofit would be about $137 million (12.5 million vehicles x

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[3] The following account of the Pinto case comes from Mark Dowie, "Pinto Madness", *Mother Jones,* September/October, 1977.

$11/vehicle). How much was a life "worth"? Ford calculated this on the basis of the likely court costs for passenger deaths and they came up with a figure of roughly $200,000 per death. They did the math and decided that it wasn't worth making the safety change. And further, by fighting the court cases, insisting that these fiery deaths were due to driver error, and resisting legislative regulation, they could further minimize the costs of the safety problem.

The same basic story was repeated in the 1990s when certain sport utility vehicles were found to be unstable on curves and had a tendency to roll over. The manufacturers denied this was a problem, blamed drivers, and fought court cases. This occurred in a context where there was considerable machinery of safety regulation in place. Imagine how serious the safety problems would become in the absence of such safety regulations and requirements for information reporting.

### 2. Concentrated economic power

Another premise of the defense of the virtues of free market is that individuals and firms do not really accumulate large amounts of power in the market: everyone enters into exchanges as individual, voluntary actors, making choices freely. They may have different purchasing power, and this means that they may have different sets of choices, but no one has the kind of power in which they can impose their will on others.

What is power? There are many answers to this question, but one simple one it that power is the ability to get your way even against the objections or resistance of others. This is the ability to impose your will on others. If you announce in the newspaper that you have a stereo to sell for $100, everyone who reads the ad is completely free to say no to your offer. You have no power over anyone. This is one of the virtues of market exchanges and is why many people believe that markets are the enemy of power and domination; they are the realm of free, autonomous, voluntary action.

The problem is that free markets tend to lead to concentrations of wealth in the form of personal fortunes and, even more significantly, the large mega-corporation. It is an inherent feature of market dynamics that winners in competition will tend to become larger and larger, and when they become very large they exert real power inside of the market (as well as in the political arena)**.** Microsoft, Wal-Mart, Exxon, Boeing, and many other corporations do not just make things and sell them on a market; they shape the market through their exercise of power. The large corporation is not just like the corner grocery store, but bigger; it has the ability to make strategic choices that massively affect the lives of people and communities, the choices they face and the kinds of lives they can lead. Microsoft is notorious in this regard: it is so big that it can force people to buy products that they don't want by bundling them with their windows operating system, and they can force computer companies to install their entire suite of programs rather than individual components. Wal-Mart forces suppliers to squeeze their workers wages to ruthlessly cut costs. Wal-Mart is so big in many markets that suppliers simply cannot refuse to comply with its demands. Wal-Mart is not just a "price taker" that responds to the prices of products in an impersonal market; it is a "price maker", using power to shape prices in the market. General Motors, when it was one of the largest corporations in the world, used its power to purchase urban electric rail systems and convert them to buses thus, as we will see in Chapter 6, expanding the potential market for automobiles.

Many many other examples could be given. In all these ways, concentrations of economic power undermine the efficiency-generating dynamics of markets.

The power of the large corporation is enhanced by the increasingly global character of capitalist production and markets. Large corporations have the ability to locate their facilities anywhere in the world. This means that when they face regulations they do not like or employees that demand higher wages than they want to pay, multinational corporations have the option of moving their production elsewhere. Small local firms do not have this ability and are thus weaker in their dealings with other local actors. Because large firms have the power to use threats to get their way they have competitive advantage over small firms. This again reduces the efficiency properties of markets.

**3. Negative externalities**

Negative externalities are all the side-effects of an activity that have negative effects on others. Positive externalities are side-effects that benefit others. Playing a loud boombox in a park generates negative externalities on bystanders who prefer quiet; planting flowers in one's front yard crates positive externalities for passers-by who enjoy their beauty. Negative and positive externalities, therefore, are an inherent feature of social activity.

The problem of negative externalities is one of the most pervasive sources of inefficiency in capitalist markets. If these were just random perturbations, noise in the system, then perhaps one might think that negative and positive externalities would more or less balance each other out: the unchosen harms on people caused by negative externalities would be neutralized (in the aggregate at least) by the unchosen benefits of positive externalities. The problem is that in capitalism negative externalities are not random deviations from a "perfect market." Rather, there are strong incentives on firms to engage in practices which generate them. Let us see why this is the case.

Capitalist firms do not simply produce goods and services for the market; they attempt to do so in a way that maximizes profits. Profits are basically the difference between price at which things are sold and the costs *paid by the firm* of their production. Therefore a central part of maximizing profits is maximizing the difference between such costs and selling price, and one way to do his is to lower costs. But note: what matters here are only the costs actually experienced by the firm, not the total costs of production. In many contexts, an effective way of reducing such costs faced by the firm is, in one way or another, to displace costs onto others. One way of doing this is to increase negative externalities.

The classical example of this is pollution. We will discuss this in more detail in the next chapter, but the basic point is simple enough: it is cheaper for a factory to dump pollutants into a river or the air than to dispose of them in a nonpolluting manner. But polluting the environment imposes costs on other people – for example communities downstream from a source of water pollution have to spend resources to clean the water, and air pollution increases medical bills and the frequency with which homeowners have to repaint their houses. If a firm was either forced to install technologies that would prevent the pollution or pay for all of these displaced costs, then their costs of production would increase significantly. An individual firm, therefore, would be at a competitive disadvantage if it did so out of the moral principle that it was wrong to displace costs on other people. Displacing such costs on others is therefore perfectly rational behavior for a capitalist firm engaged in profit maximizing competition.

Another important type of negative externality centers on the investment decisions of corporations. Consider a firm that decides to move production to Mexico because it will have a higher rate of profit there than in the United States. Many firms that have moved production away from the U.S. did so not because the plants in the US were losing money – they were making a profit -- but because they could make higher profits elsewhere. This is a perfectly rational economic decision on the part of the corporation given what counts as a "cost" in their calculations. However, there are many significant social costs of this decision which do not appear as "costs" to the corporation and which, if the firm had to cover these, would change the profit maximizing strategy, For example, when a large factory moves abroad this often triggers a decline in home values in the abandoned community. This can have a devastating economic impact on these homeowners even if they themselves were not employees of the firm in question. These costs to homeowners are not included in the investment decisions of the firm owners. *If they were, plant closing would not be profitable*. To see this, suppose that the plant in question were owned by all of the people in the affected community rather than by an outside corporation. In this case the impact of moving the factory on home values would not be a negative externality, but a negative "internality" – it would be experienced as a cost to the people making the decision. Even if the direct production costs were lower in Mexico, in this situation it would not be viewed as a way of increasing profits.

This, then, is the important lesson about negative externalities: in making investment decisions the owners of firms look at the costs and benefits of alternative choices, but only certain costs are counted. Some costs are displaced onto other people, so they do not appear in the bottom line of the firm. This means that the ordinary price mechanism of a competitive market cannot lead to optimal allocations even in the restricted sense of allocative efficiency. Efficient allocations in a market only happen when prices are closely linked to the *true total costs* of producing things. But if firms can displace significant costs on others, then prices no longer reflect true costs, and allocations based on those prices are no longer efficient. Negative externalities pervasively muck up this process.

### 4. Short time horizons

The idea of "time horizons" refers to the length of time into the future that figures in decisions people make in the present. A particularly important issue in this regard is the extent to which the interests and welfare of future generations are taken into consideration in investment and consumption decisions made today. Highly competitive, free markets have the effect of shortening the time horizons of most investors. Capitalist firms compete for investments. Investors look to firms that give the highest rates of return in the relatively short term. Even investors with relatively long time horizons are concerned about the likely rates of return over a relatively short period – a decade or so perhaps – not fifty or a hundred years. This means that investment projects that would take many decades to generate a return are very unlikely to be undertaken. The result is that investments generated through competitive markets cannot give significant weight to the welfare of future generations since this will generally not be the short-run profit-maximizing business strategy.

The problem of energy conservation is a good example. The price of oil in the world at any given time broadly reflects the costs of extracting oil and the market demand for its products. The fact that in the future the costs of extracting oil will become much more expensive due to depletion of the resource and thus it will be much more expensive to produce a given level of supply is not reflected in current market prices. The prices individuals face in the market when they make individual consumption choices around gasoline consumption thus do not reflect the costs to future generations. As a result, unless an individual is very self-conscious about these issues, individual consumption choices will only reflect immediate personal needs. The market itself cannot solve this problem. It is only through public deliberation and collective political choices that the longer term future can significantly affect present decisions and economic allocations, both in terms of broad patterns of investment and of consumption.

### 5. The problem of public goods.

What is a “public good”? Without going into technical details, as a first approximation a public good is something which provides benefits to people even if they did not voluntarily contribute to producing it. Or, to put it slightly differently, a public good is something which, if produced, is difficult to exclude people from consuming. The classic example is national defense. Suppose national defense was paid for by voluntary contributions rather than taxes. The national defense that was provided by this means would benefit those people who did not contribute, not just those who did. Public sanitation and public health, public broadcasting, clean air, education, and many other things have this character. Some of these may also provide private benefits to particular individuals: education does provide specific benefits to those who receive it, but it also contributes to higher overall economic productivity which benefits the society as a whole. And here is the problem: in general, the level of public goods provided through unconstrained free capitalist markets will be far below the socially optimal level.

A few examples will make this clear. Suppose that education was only provided by the market. Private firms offered educational services and parents would buy these services for their children’s education. There would be no subsidies and no public provision. In such a world, a large proportion of poor people would fail to get even minimal education. Or consider public health and sanitation. Suppose that sewers, water treatment and human waste disposal were provided only by the market; there was no public provision of these services. This would be a disadvantage even to those who could afford those services, since poor sanitation would be a breeding ground for diseases that would affect everyone. Markets are good at producing things in which most of the benefits are captured by those who directly pay for the good or service, but not public goods whose value is diffuse to a wide variety of people. Markets will underproduce public goods, and this is inefficient.

The problem of public goods is a specific example of a more general problem studied by sociologists, political scientists and economists referred to as the problem of “collective action” and “free riding”. We will encounter collective action problems many times in this book, so it is worth spending a little time explaining just what this means and how it relates to public goods.

The problem collective action and public goods is often explained through the analysis of a paradox called "the prisoners dilemma." Here is the story: There are two prisoners accused of jointly committing a crime. They are held in separate cells. They only care about their own welfare: they are pure selfish individualists. Each of them is told the following: If you confess and rat on the other person and that person remains silent, you will go free and the other person will get 10 years in prison. If you remain silent, and the other person rats on you, you will get ten years and that person will go free. If you both are silent you each get 2 years in jail; if you both rat on each other, you each get five years. These options are illustrated in the following table, called a "pay-off matrix":

**Pay-offs from Prisoners Dilemma**

| | | **Prisoner X** | |
|---|---|---|---|
| | | *Silent* | *Confesses* |
| **Prisoner Y** | *Silent* | Both get 2 years<br>**A** | X gets 0 years<br>Y gets 10 Years<br>**B** |
| | *Confesses* | X gets 10 years<br>Y gets 0 Years<br>**C** | Both get 5 years<br>**D** |

What should a prisoner do as a rational, selfish person? The rational thing is to confess. Here is how each prisoner reasons: "if the other guy is silent, I get zero years if I confess and five if I stay silent; if the other guy confesses I get five years if I confess and ten years if I remain silent. Regardless of what the other prisoner does, I am better off confessing. So I confess." The other prisoner reasons (correctly) the same way, and confesses, so both end up with five years in prison even though, if both prisoners had remained silent they each would have received only two years in prison. This is called a "collective action failure" because the two people fail to collectively coordinate their actions in a way which would have been mutually beneficial.

The under-provision of public goods has this kind of character. A good example of this is the problem of depletion of fishing stocks in a lake or other body of water. This is an instance of what is called "the tragedy of the commons". A healthy stock of fish in a body of water is a public good: everyone who fishes benefits from this. Suppose there is a lake in which roughly 10,000 fish can be caught a year and still have the fish stock reproduced year after year. Suppose there are 1000 fishermen fishing in the lake. If everyone catches 10 fish a year, the fish stock will remain stable from year to year and all the fisherman will be able to continue to catch fish, so there is a sign posted at the Lake which says: "fishing limit per fisherman, 10 fish per year". You are one of those fishermen, and you know that if you catch 20 fish this will not have a significant effect on the fish stock. You figure, whether 10,000 fish are caught a year or 10,010 are caught a year won't matter. After all, the 10,000 figure is just an estimate. So you ignore the sign and catch twenty. You want to be a "free-rider" on everyone else's restraint. Every other fisherman behaves the same way, so in all 20,000 fish are taken, and the following two years there are so few fish in the lake that each fisherman can only catch 2 fish a year. Now suppose you are an honest, moral person (but no one else is) so you decide to obey the sign. You catch 10 fish the first year and 2 the second and third. Everyone else has caught 20 the first year and 2 thereafter. You feel like a sucker (maybe a virtuous sucker, but a sucker nonetheless): over the three year period you only got 14 fish and everyone else got 24.

The amount of fish caught over the three year period under different combinations of choices is illustrated in a pay-off matrix like the prisoners dilemma:

| **Numbers of fish you catch over three years with different patterns of fishing** | | | |
|---|---|---|---|
| | | What *YOU* do | |
| | | Obey the fishing limit | Ignore the fishing limit |
| What *Everyone else* does | Obeys the fishing limit | 30 | 60 |
| | Ignores the fishing limit | 14 | 24 |

This is precisely what has happened in the great fishing banks in the North Atlantic: poorly regulated and policed fishing practices have lead to over-fishing, as each commercial fisher tries to maximize their catch, with the result that the collective resource – the fishing stock – is depleted. **[Add some data on the actual depletion of fishing stocks here]**

Here is another example that may be less familiar: the provision of skills training within capitalist firms. Firms are able to compete more effectively on world markets when they have a highly trained labor force. What is especially important is having workers who have what can be termed "meta-skills" – the skills-to-learn skills quickly. Such workers can quickly adapt to new technologies and flexibly respond to production problems. Such meta-skills are often best developed within the practical settings of real production processes rather than in stand-alone schools. Every firm will be better off if there is lots of training of this general sort. But what happens in a competitive market? The owners and managers of each firm think the following: "It is costly to provide such training. If every other firm provides such training but we don't, then we will save on these training costs and be able to hire workers trained at other firms by offering them a bit more money than can the firms that provided the training. Those firms won't be able to match our wage offers because they have higher costs than we do because they provided the training. We will make higher profits by poaching trained workers from the firms that train them than we can by providing the training ourselves. We will maximize our profits by "free riding" on other firms' efforts at training." If every firm is profit maximizing, then every firm will make the same decision, and no one will provide the training. The result is a labor market with workers lacking adequate meta-skills. This is called the public goods problem of skill formation.

These kinds of collective action problems in which the incentives are very strong to be a free rider are very difficult to solve within competitive, unregulated markets. Since markets themselves do not produce public goods very effectively, in economic systems such as that in the United States in which there is very heavy reliance on markets there tend to be an undersupply of public goods. This is a serious source of inefficiency, whether this is understood in narrow economic terms or broader social terms.

### III. The Free Market and Social Values

So far we have examined ways in which markets generate problems inside of the economy itself – various ways in which free markets fail on pragmatic grounds in terms of different aspects of efficiency. But capitalist free markets also have important consequences for other social institutions and values, for aspects of our lives outside of the economy narrowly understood. And here too, weakly regulated, intensely competitive free markets of the sort that are idealized in the United States can pose serious problems.

Human activities within markets revolve around one specific dimension of human personality, values and social interaction: *the rational pursuit of one's self-interest as a separate person.* This is what economists call "utility maximization." People do act this way, some of the time, in some places, under some circumstances. But humans are also characterized by solidarity, generosity, kindness. Human beings are characterized by the search for meaning and companionship, by caring for the wellbeing of others and not just themselves. Even in such a rampantly individualistic a society as the United States, solidarities and altruism are important. Indeed, sociologists generally argue that without such values, society would collapse: pure economic self-interest by itself cannot provide the glue for social life.

Now, here is the really important point: The specific *mix* of these human characteristics – in particular, how important is greed and competitive individualism relative to other values – is not something given once and for all by "human nature", but is shaped by our social institutions in complex ways. A crucial question for sociology and for politics is thus how our institutions either reinforce or undermine different kinds of values and traits. Or to say it even more simply: the kind of people we get in a society is not given by nature, but by the ways our institutions encourage some traits and discourage others. In our present context, the question thus becomes: *what kinds of people and traits does a highly competitive, individualistic capitalist society foster?*

This turns out to be a very difficult question to answer in any definitive way. The relationship between values and personality traits on the one hand and economic institutions on the other is a kind of chicken-and-the-egg problem: do competitive free markets foster self-interested individualism or does self-interested individualism foster competitive free markets? The causal relation almost certainly runs in both directions: competitive markets may foster certain kinds of values and personality traits, but those traits and values, in turn, shape economic institutions. What we have, then, is a kind of system of mutual reinforcement.

We will not attempt here to sort out all of the complexity of this difficult, but interesting, problem. What we will do is say something about the way markets act to weaken certain kinds of values and traits and reinforce others. Three issues are particularly important:

1. The erosion of community
2. The commercialization of morally-salient aspects of life
3. The skills of “exit” versus “voice”

**1. The erosion of community**

“Community” is one of those flexible terms in social and political discussions which is used in a wide variety of ways for different purposes. Here we will define the idea of community quite broadly as any social unit within which people are concerned for the well being of other people and feel solidarity and obligations towards others. The value of community, understood in this way, is very close to certain core values in many religious traditions. The moral precept “love thy neighbor” is basically an expression of this idea. A “community” need not be a small geographical locale like a neighborhood, but frequently communities are geographically rooted, since such deep attachments and commitments are often built on direct, face-to-face interactions. One can also talk about the degree of community in a particular social setting, since reciprocity, solidarity, mutual concern and caring can vary in intensity and durability. A strong community is one in which these mutual obligations run very deep; a weak community is one in which they are less demanding and more easily disrupted.

Community is important both as a value in itself and because it helps people solve practical problems of social cooperation. The problems of cooperation and collective action we discussed in the analysis of public goods, for example, are easier to solve when people feel moral obligations to each other and a shared sense of community. The free-riding problem within collective action depends upon people acting strictly on the basis of their own self-interest without regard to any moral commitment to contribute to the public good. In social settings where there is a strong sense of community, free-riding is less likely.

Capitalist markets are corrosive of a sense of community for two main reasons. First, intensely competitive markets reward self-interested individualist behavior and reinforce it as a normative ideal. The market cultivates a sense of individual responsibility, of looking out for #1, but not a sense of moral obligation to the welfare of a broader community. The market also cultivates mistrust: everyone is out to take advantage of you, to make a fast buck, so you need to be wary. Life is a competition of survival of the fittest; nice guys finish last. Buyers beware. Highly competitive markets tend to encourage the pursuit of self-interest as the overriding motivation for action, and in so doing undermine the broad value of community in society.

Second, unfettered market forces are corrosive of community by fostering high levels of inequality. Vast disparities in quality of life undermines social cohesion, breeds resentments from below and contempt from above, and creates a stratified social order in which people no longer feel that “we’re all in the same boat together.” Not only does the cultural content of market competition undermine community by encouraging single-minded individualistic competitiveness, it undermines community by generating poverty in the midst of plenty.

This does not imply that the value of community cannot survive in a strongly inegalitarian market-oriented society like the United States. There are, after all, other forces at work besides the market, and some of these help to preserve a sense of moral community. But it does mean that values of community become a more fragile and less effective.

2. **The Commercialization of morally-salient aspects of life**

Markets may be an economically efficient way of organizing the production and distribution of many things, yet most people feel that there are certain aspects of human activity which should not be organized by markets even if it would be “efficient” in a technical economic sense to do so. Virtually everyone, except for a few extreme libertarians, believes that it would be a wrong to create a capitalist market for the production and adoption of babies. Even if it were the case that the exchanges on such a market were voluntary, the idea of turning a baby into a commodity with a market price and selling the baby to the highest bidder is seen by most people as a monstrous violation of the moral value of human beings. Most people object to a market in voluntary slaves – that is, a market in which you are allowed to sell yourself voluntarily into slavery. Most people also object to markets in most body parts and organs, whether the organs come from live donors as in the case of things like kidneys and corneas, or from deceased donors, as in the case of hearts. Partially this is because of the belief that such markets would inevitably pray on the vulnerabilities of the poor and lead to many types of abuse, but also it is because of wariness in reducing the human body to the status of a commodity with a market price attached to it. And most people believe it would be wrong to have a free market in votes in elections, in which people could directly purchase votes from citizens, even if this would improve the welfare of both parties to the exchange. So, even in highly commercialized capitalist societies, most people believe that there are moral limits to the domains in which markets should be allowed to organize our activities. Human beings and democratic rights should not be treated like commodities.

American society is one of the most commercialized in the world. While some prohibitions on market transactions remain in force – most notably, markets are prohibited for certain kinds of recreational drugs, for sex and for votes – commercialization has deeply penetrated many spheres of life in ways that threaten values intrinsic to those spheres. A few examples will illustrate this problem.

*Child care*

Children require labor intensive care and nurturance. This care can be provided through a variety of social organizations: the family, state-organized childcare services, various kinds of community-based child care, or for-profit market based child care organized by capitalist firms. The market solution to this problem does not mean that all for-profit child care will be of poor quality and harmful to the well-being of children. What it means is that the quality of the care will be a function of the capacity of parents to pay.

Capitalist firms providing childcare services will be organized around the objective of maximizing profits, and meeting the needs of children will only matter to the extent that this contributes to this goal. In order to maximize profits, firms will have strong incentives to seek low cost labor for the staff of childcare centers, especially for those servicing poor families. The training of caregivers will be low, and the staffing ratios suboptimal in most centers. Parents with lots of resources and a capacity to obtain good information about the quality of providers will be able to purchase good quality childcare, but many families will not.

*The Arts*

Many people regard the arts as a vitally important domain of human activity for exploring problems of life, meaning, beauty, creativity. Of course, artists and performers of all sorts have often been prepared to make considerable personal economic sacrifices in order to participate vigorously in the arts, and much arts activity takes place outside of the discipline of the capitalist market. But still, the arts do need financial resources to thrive: drama needs theaters; symphonies need concert halls; and all performers and artists need to eat. If the main source of such funding is from the capitalist market, then the autonomy and vitality of the arts are threatened. Many theaters face enormous pressures to produce only those plays that will be a "commercial success," rather than plays that are controversial, innovative, or less accessible. Musicians are hampered by the commercial imperatives of "record deals." Writers find it difficult to publish novels when profit-maximizing strategies of publishers become oriented to producing "blockbusters". A fully commericalized market for the arts thus threatens the core values of human artistic activity. This is one of the central reasons why in most countries there is substantial public subsidy of the arts. It is also why the wealthy subsidize through philanthropy the kinds of arts which they consume – opera, art museums, symphonies. They realize that if these organizations had to rely strictly on commercial success through the sale of tickets to the consumers of the performances they would not be able to survive.

*Religion and Spirituality*

Religion and spirituality grapple with some of the deepest issues people confront: death, life, purpose, ultimate meaning. All religions see these issues as transcending the mundane world of economic activity; religion is valued because of its importance in helping people come to terms with these matters. The distinctive value of religion is continually threatened by commercialization. The most notorious example, decried by many religious Christians, is the commercialization of Christmas. But perhaps even more profoundly, the commercialization of churches themselves – turning churches into profit-maximizing sellers of religion – threatens religious values.

*The value of a "human life"*

Every society faces the problem of putting some kind of "value" on human life. In a society in which highly competitive capitalist markets play a pervasive role in determining the value of things, there are situations in which value of human life tends to be assimilated to market principles. After 9/11 when the U.S. government was figuring out how much monetary compensation should be given to the families of those who died in the destruction of the World Trade Center, the basic formula concerned the lost earnings of the people who died. In the Ford Pinto case when the Ford motor company was trying to figure out the costs and benefits of retrofitting the dangerous gas tanks, they calculate the value of a human life in terms of the income lost because of death and the court costs they would face for wrongful death suits. This way of thinking about people flows naturally from the penetration of commercial thinking into everyday life.

### 3. The cultivation of social skills and dispositions: Exit & Voice

Institutions do not just shape our values and preferences, they also significantly shape what might be called our “strategic skills” – our personal capacities to solve problems in particular ways. A useful way of thinking about this is with a contrast developed by the economist Albert Hirschman between “Exit” and “Voice” as two different ways of responding to an organization that does not perform as you would like.[4]

*Exit* means that if you don’t like something, you leave, you quit, you exit. If you don’t like your job, quit and get another one; if you don’t like a university course, drop it and enroll in another one; if you don’t like the country you live in, you migrate to another; if you don’t like a restaurant, go to another; if you don’t like your marriage, get a divorce, etc. This is the way people deal with dissatisfactions in a market.

*Voice*, in contrast, means if you don’t like something, you actively speak up, you try to change a policy, you try to improve a product. If you don’t like your job, you talk to the boss and fellow workers about improving conditions; if you don’t like a course, you negotiate with the professor to change what’s going on; if you don’t like the government, you organize politically to change it; if you are unhappy in an intimate relation, you talk about it and try to work through the problems.

Markets encourage a style of dealing with problems through exit. Voice is difficult. It requires skills of negotiation, communication, coalition building. This is hard. Exit is, by comparison, easy. Markets cultivate skills of exit, not of voice. Shopping is the market model for getting what you want rather than community participation and deliberation. This has very broad ramifications in the society at large. Consider marriage as a social institution. Finding a spouse is understood by many people as a “marriage market” in which people shop for a partner. Is it any surprise that divorce is a common solution to marital dissatisfactions: if you don’t like a marriage, exit and shop for another spouse. (This is a great irony for social conservatives who believe both in the sanctity of marriage and in the unregulated competitive free market: their attack on the state regulation of the market intensifies the sense of individualistic competition and exit strategies, which reinforces the idea of marriage as a competitive market.) Consider politics: most people participate in politics as passive shoppers among political candidates, not as active participants in democratic deliberation. The political marketplace is entertaining, the media turn political conflict into a horse race competition, and democracy is reduced to a specialized form of consumption.

Of course, exit is an important way for people to deal with dissatisfactions, and is an important value linked to negative freedom. The issue here is not that exit as such is

[4] Albert O. Hirschman, *Exit, Voice and Loyalty….*

undesirable, but that the principles of the market tend to increase the weight of exit in social problem-solving, and the habits of the market tend to develop shopping skills and dispositions rather than the deliberation skills of voice. A healthy, democratic society with vibrant communities requires citizens to develop real capacities for active participation and engagement, and these are precisely the skills that are not reinforced by the market.

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This chapter has explored in a general a variety of ways in which capitalist markets, left to their own devices, undermine certain core values they are thought to promote, especially freedom and efficiency. In the next four chapters we will further explore these issues by a more detailed examination of a number of specific problems: the environment, transportation, consumerism, and health.