Journal of Markets & Morality 2, no. 1(Spring 1999), 125-131
Copyright © 1999 Center for Economic Personalism

Controversy: Does the Free Market Undermine Culture?

D. Eric Schansberg
Associate Professor of Economics
Indiana University at New Albany

Introduction

Economics can be defined in a number of ways. The standard textbook definition is that economics is the study of the allocation of society's scarce resources. In conversation, economists often focus on the "economic way of thinking"—a rigorous analysis of the costs and benefits of personal decisions and public policies. And as a member of the social sciences, economics is also a study of human behavior, particularly in the context of markets. As such, the discipline of economics studies how actions vary in response to changes in prices, laws, and other factors. The concept of "markets" can range from the standard inputs and outputs of production (e.g., labor and the proverbial widget) to a wide array of other areas (e.g., political market transactions, dating and marriage, the market for vital organs, and decisions concerning sin and virtue).

All that said, economic analysis is often ignored or even deplored in today's culture. Some notable examples will follow below. But what is a better option? A more limited analysis can be an improvement only if analysis itself presents more problems than it helps to solve. And surely, the costs of limited analysis can be large. Unfortunately, good intentions and wishful thinking are not sufficient for determining either optimal personal decisions or public policy. Good analysis is, in fact, a prerequisite if we are to do better than throwing darts blindfolded. As Pascal argued, "working hard to think clearly is the beginning of moral conduct."

Do Markets Function?

Consider the current debate about increasing the minimum wage. Some advocates have argued that there were no negative consequences from the last increase—at least in terms of lost jobs—for unskilled workers. (Actually, there is a spirited debate about this in academic circles, but I will allow the point for our purposes here.)[1] Given this state of affairs, they delight in pointing to the predictions of a multitude of economists that the higher minimum wage would cause an increase in unemployment. These predictions were related to the law of demand—the idea that, all other things being equal, as the price of anything increases, quantity demanded will decrease. Perceiving the law to be refuted in this context, some advocates of a higher minimum wage dismiss its efficacy altogether.

However, completely ignoring the law of demand is useful only if it has been, in fact, refuted. For a number of reasons, that is far from the case. First, were "all other things equal?" In particular, given strong economic growth, it could be that unemployment for the unskilled has been reduced—but not so much as it would have been in the absence of the higher minimum wage. Second, was the higher minimum wage an effective restraint on the labor market? In other words, if market wages were typically above the new minimum, we would expect there to be no adverse (or positive) effects from increasing the minimum. Likewise, if Congress passed a law mandating that McDonald's sell Big Macs for at least $.25, and then increased that minimum to $.50, we would not expect it to change McDonald's behavior in the least. Third, perhaps firms reduced other forms of compensation as the wage increased—perhaps ending free uniforms or subsidized meals at fast-food restaurants—on net, making those workers worse off.

The bottom line is that we cannot conclude that the law of demand is inoperative in the market for labor—even if unemployment does not rise after any particular increase in the minimum wage. Regardless of the merits of the minimum wage as an ethical and practical means to help the poor and unskilled, to ignore economic analysis and to argue for a significantly higher minimum wage on the basis of the assumption that there will be no negative consequences is surely foolhardy. There is simply no assurance that the array of effects next time will be as innocuous.

Should We Even Talk About Markets Functioning?

The attempt to dismiss economic analysis is related to a second argument—namely, that invoking economics in certain contexts is inappropriate, or even immoral. For instance, some claim that it is inappropriate to talk about the market for vital organs in economic terms. But whether or not we use economic terminology and analysis, markets will indeed function in this setting.

The only question is how the scarce supplies will be rationed in this context. Will the available resources be rationed by prices or through non-price considerations?

If prices are allowed to operate in a typical manner, buyers (likely through health insurance) and sellers will respond in the standard ways—a higher price eliciting more sellers and fewer buyers. Granted, the demand for vital organs is relatively inelastic (that is why they are vital!). But the supply of vital organs is more elastic; people will likely respond to higher prices by selling organs—whether in life or in death. If prices are allowed to operate, the market will continuously move toward equilibrium, balancing changes in demand and supply conditions. If prices are not allowed to operate, non-price considerations will necessarily take over. For example, since trade in vital organs is prohibited in the United States, the available supply is rationed by doctor fiat, black-market activity, waiting in line, death, and so on.

The market for adoptive babies is similar, operating largely (but not completely) through non-price mechanisms. That said, apparently, there are many different markets for babies, depending particularly on their health, ethnicity, and age. Given that the same price or fee does not allow equilibrium to be approached in each of these markets, the length of the waiting period and the level of black-market activity vary with the type of baby. Moreover, some adoption arrangements are based upon price rationing—implicitly charging higher prices through higher adoption agency and lawyer fees for babies who are relatively scarce. The bottom line is that markets will function. It is merely a question of how they will be allowed to function.

One may protest the language of economists, and, to assist that argument for the moment, I purposefully chose language that was harsh and impersonal. That can be (and perhaps should be) altered. But aside from stylistic considerations, the substance of the analysis is valid. One can wish that markets did not operate this way or that markets did not operate in these contexts, but the fact of the matter is that they do operate whether by price or non-price rationing.

Moreover, lack of rigorous analysis often leads to simplistic moralizing about markets. For instance, is it more morally sound to have thousands of people die each year waiting for vital organs or to allow organs to be sold? Is it better to have different prices for adoptions or to have some children wait longer (or forever) for a good home? The economist will insist on a more complicated analysis, but an analysis that is ultimately more grounded in reality, and thus, compassion.

A similar lack of rigor leads to overly simplistic conclusions about other issues. For instance, people will assert the morality of drug prohibition over drug legalization as a policy recommendation. A part of this advocacy stems from an exaggeration of the connection between legality and morality. And a portion of this advocacy stems from an unsophisticated understanding of the costs and benefits of prohibition. The public typically focuses on reduced drug use and addiction but fails to see the more subtle costs—to name a few, increased inner-city gang violence, a tremendous labor supply temptation for inner-city youth, and an unnecessarily crowded and expensive judicial system that allows violent offenders to have reduced sentences in order to incarcerate drug offenders. When one recognizes the costs—and that those costs are imposed on innocents in an attempt to protect other people from themselves—the morality of the outcomes of prohibition is, at best, dubious.

The Morality of Considering Costs in Certain Contexts

Economists often talk about the costs of different regulations, for example, in the realms of pollution abatement, safety, and public health. This typically leads to complaints that one should not discuss such things in dollar terms: "How can you put a value on human life?" But again, what are our options here—not discussing the costs at all?

For example, in discussing a government regulation that costs one billion dollars and saves the lives of 20 people, an economist might say that there was a cost of $50,000 per life saved. This often leads to angry denunciations of supposedly heartless economic analysis. Instead, such an analysis is, in fact, compassionate since it allows us to compare regulations rationally and choose the one that does the most good for society. If another government regulation costs the same but saves 40 people, is not that the preferable option? Without the analysis of costs along with the benefits, we cannot purposefully reach that conclusion.

The arguments get more subtle as the number of lives saved decreases and if the opportunity costs of the money spent are relegated to the private sector. For instance, is the use of pesticides, on net, bad for people? The public, with the help of certain advocacy groups, tends to focus on the relatively obvious problems with pesticides. But without pesticide use, the price of fruits and vegetables would increase, thus lowering the amount consumed and decreasing the health of the average American. Do the benefits outweigh the costs? Surely, it depends on the particular situation. But the point here is that economists are too quickly shouted down and not allowed to emphasize these important points.

The applications are legion. Does an airline regulation that forces infants to have their own seats on an aircraft increase or decrease safety on net?

Presumably it increases safety by a little bit for those children on the plane—although having a seat during a plane crash is probably not closely related to survival! But the higher price of air travel for such families encourages parents to drive their cars instead, certainly a more deadly form of transportation. Does this regulation save lives, overall? The economist asks the tough, but correct, questions.

Again, what are the options—to focus on the benefits only? I can understand why politicians and special-interest groups prefer this level of analysis since it becomes more likely that their proposals will pass into law. But more objective folk surely would prefer a more comprehensive analysis. While it is strange, in a sense, to talk about costs in the context of saving lives, it is an important discussion to promote.

Ignorance About Economic Versus Political Market Activity

This leads us to a reason why economic analysis is so often forsaken. In the realm of politics, economists tend to be what George Stigler called "pourers of cold water" with respect to proposals for government activism. Typically, the benefits of political market activities are relatively obvious and the costs of such activities are relatively subtle. Proponents of government activism enjoy this information asymmetry. But economists bring more sophisticated and objective analytical tools to the table and thus tend to see and expose the relatively subtle costs. As people are educated about these costs, government activism tends to look less attractive. After all of the relevant factors have been considered, advocates are less likely to see their proposals embraced by the populace.

In fact, people are generally unclear about the differences between transactions in economic markets and political markets. Economic markets feature mutually beneficial trade between two parties. For instance, a customer might buy a shirt from a storeowner for $20. Political markets feature mutually beneficial trade between two parties at the expense of a third party. For instance, an interest group might send votes and money to a politician in exchange for a favor (direct or indirect redistribution of wealth), while the general public bears the costs through higher taxes or prices.

The mechanisms of the two market transactions are fundamentally different. First, political markets are largely coercive, since money is forcibly taken from the general public. Economic markets are typically voluntary in that the customer willingly gives his money to the storeowner. This characterization is a bit exaggerated for both markets. To note, the degree of coerciveness of a political market is a function of the type of government under which one lives. Clearly, a democracy or a republic features relatively less coercive income redistribution in contrast to a totalitarian dictatorship. Likewise, local government activity is less coercive than federal government activity, since it is easier to move to the next county than to another country. But even in somewhat more voluntary situations, coercion is the method used. If you do not agree, then fail to pay your income taxes, or try to grow and sell peanuts, or braid hair for money without a license. Interestingly, economic markets are most famous for the relatively rare and significant exceptions to the purely voluntary example noted above. Instances of trades that are less-than-fully voluntary involve significant degrees of fraud, misleading advertising, or monopoly power. (Note that this monopoly power must be "natural" rather than the far-more-frequent government-sponsored monopoly power to fit this point.) While significant and more exciting, such problems are relatively rare.

Moreover, the outcomes of the two market transactions are fundamentally different. Political markets merely move wealth around, transferring money from one party to another. Economic markets create wealth since both parties benefit from the trade. Likewise, economic activity is typically a positive-sum game. In contrast, political activity is usually a negative-sum game—a zero-sum income transfer from the general public to the interest group, in addition to the inefficiency associated with forcing or encouraging resources to move to lower-valued uses. (There are important exceptions to government activism as only negative-sum. In areas where markets struggle, for example, with externalities and public goods, government activity can improve efficiency and make positive-sum contributions to society.)

Ironically, in much-criticized economic markets, self-interest gives producers an incentive to please their customers. In the selfish pursuit of greater income, producers inadvertently benefit others. The widget manufacturer may strive to make a better and less expensive product because of his deep-seated love of humanity, but more likely, his primary goal is to earn a better living. But in political markets, self-interested agents have an incentive to develop even more sophisticated ways to take money from the general public.

Other Confusions

The confusion between political and economic market activity is also related to a common mischaracterization of our country's economic system—not free-market capitalism but a combination of free markets with a strong dose of mercantilism and socialism in the mix. Furthermore, this leads to confusion about the cause and effect of circumstances that people find disturbing. In a word, people blame capitalists or markets for an outcome that is really perpetuated by the government. For instance, the problem with the market for cable television is not the absence of effective regulation of cable operators, but the existence of (very) effective regulations established by local government to allow those suppliers to have exclusive rights to provide that service in a given area.

Moreover, eschewing economic analysis and failing to understand the distinction between political and economic markets lead to some bizarre and harmful policy conclusions (unless one's goal is to help some at the expense of others). For example, people deplore a so-called private monopoly (e.g., Microsoft), while applauding a public monopoly whose power is greatest over the inner-city poor—the government's elementary and secondary schools. People denigrate racial discrimination while encouraging trade restrictions on people from other countries. People embrace blockades, sanctions, and boycotts to punish others, while simultaneously advocating trade restrictions to be imposed on themselves voluntarily.

Instead of relying largely on rhetoric and emotion, we should avidly embrace the substance, if not the style, of economic analysis to make informed decisions. The questions asked by economists are often awkward, politically incorrect, and otherwise difficult, but they are important and even crucial if our goal is to form public policies that will help society.

Notes

[1] For a detailed analysis of the empirical effects involved in raising the minimum wage, see Marvin Kosters, *The Effects of the Minimum Wage on Employment* (Washington, D.C.: AEI Press, 1996).