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Private Markets and Social Control

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Historically, the basic rationale for the competitive private market system has stated that if individuals are free to pursue their own economic interests, a system of organized cooperation will emerge that serves important personal and social needs. In particular, it has been claimed that the system will be effective in providing:
1) improved material welfare; 2) individual economic and political freedom; and 3) a broad social justice that rewards the individual's effort in accordance with society's evaluation of the services he has provided.

It is perhaps surprising that such a system would come into being, and amazing that it works so well; however, it falls substantially short of reaching technical, moral, or other value forms of perfection. In fact, the claim of social benefits flowing from our own economic system is coming under increasingly broad and severe attack. Critics easily identify serious perversions of the goals which private enterprise is supposed to serve: 1) the encouragement of an individualistic mass market-oriented hedonism at the expense of social needs; 2) the obvious problems of discriminatory restriction and alienation of many human beings, often through other social and political institutions that the economic system allegedly dominates, and 3) a failure of the merit-reward system as an effective or moral basis for income distribution, particularly as it applies to upper and lower income strata.

The continuing failure of society to deal adequately with its problems has led to criticism that goes beyond the imperfections of a fundamentally sound social organization. Individual economic incentive and private markets, the basics of our economic organization, are condemned as inherently destructive of desirable social goals. It may be that such criticism is naive with respect to the basic history of economic organization and the prospects for meaningful alternatives. It also may be that the "solutions" offered are frequently more authoritarian than the critics allege the present system to be. We are still left to ponder the vital, long-standing, but changeable deficiencies and injustices that our system either tolerates or actively perpetuates.

A growth in the "corporate state" has been frequently attacked as causing a distortion of market functions through resource direction by gigantic corporate and
government bureaucracies. These institutions are alleged to either serve the interests of the rich and powerful, or become ends in themselves. They tend to shape human needs rather than serve them, and respond sluggishly and ineffectively to changes in social goals.

Although such descriptions may be gross caricatures of our economic and political system, they do represent fundamental problems in social organization. My purpose is to translate the caricature into a more meaningful analysis—an analysis in terms of important differences between conditions found in our modern corporate economy and conditions presumed to hold in theoretical demonstrations of the attainment of social goals through a system of competitive private markets.

I will concentrate on three conditions that are assumed in the theoretical model of a competitive market system, but are seriously violated in our modern industrial economy. Although these conditions are illustrative and their violation can scarcely explain all of society's ills, they seem to be basic and closely related to a wide range of fundamental social problems. These conditions are:

1. Large private centers of power do not exist. No individual or cohesive group is able to avoid or seriously temper the discipline of the market on a continual or long-term basis.

2. All relatively scarce goods are traded in markets. Generally, economic costs must be borne by those who benefit from the use of society's resources.

3. Buyers and sellers have full knowledge of the good being traded. This provides a precise and known delineation of the good in relation to all other goods in the market.

We will examine some of the consequences associated with the violation of these conditions, provide a few illustrations, and suggest some directions for social policy. Neither the problems discussed nor the suggested solutions are novel. The discussion concentrates on the relation of problems and policies to fundamental conditions for a competitive market system.

The perspective followed is the view of private enterprise as a tool or an instrument—not an end or a goal. It remains a singularly powerful tool for allocating society's resources among alternative uses. It still compares favorably with known alternatives in providing a diversity of opportunity that protects individual economic and political freedom.

However, the circumstances where natural market constraints do not adequately channel the system toward community goals tend to increase with the size and complexity of the economy. Traditional approaches to regulation that may have worked tolerably well in a simpler era are now seriously questioned as their failures and negative side effects become increasingly obvious. New directions for social policy are now being suggested which are likely to be particularly efficient because of their decreased dependence on government bureaucracy and their substantial reliance on decentralized and distortion-free incentives. In contrast with many current policies they tend to complement and strengthen the long-run viability of private markets as an effective social tool.

**CONDITION 1: NO PRIVATE POWER CENTERS**

The absence of private centers of concentrated economic power is presumed in a competitive market system. In our giant corporations and conglomerate enterprises,
however, there is a serious and increasing failure to meet this condition. The
picture of corporate power presented depends on the statistical measure used.
In manufacturing, the most heavily concentrated area, aggregate concentration has
increased markedly. A larger proportion of total manufacturing assets were held
by the top 100 corporations in 1968 (49.3%) than were held by the top 200 in
1947 (47.2%). In terms of concentration within particular industries, little change
has occurred in the last twenty years. The average of sales percentages controlled
by the largest three or four firms in each industry has been stable, indicating
substantial growth in absolute size.

Questions may be raised about the adequacy of these statistics as measures of
private power, but the important point is that, in an era of substantial economic
growth, little has been done with the opportunity to reduce concentration via
constraints on corporate size. The formidable level of concentration is now recognized
by a growing segment of the population, which has a basic understanding of the
subtle as well as blatant abuse inherent in large power aggregations. Discord is the
result, and the market system is condemned for many shortcomings that are
properly the result of the presence of private power centers. The absence of such
centers was always presumed as necessary for the system's effectiveness as a
social institution.

In many industries, substantial size is obviously necessary and beneficial.
Large-scale operations may be required for low unit cost, and a critical mass may be
needed to provide resources for research and development. But the giant corporations
of our society have clearly ballooned to a size and acquired concentrated economic
power far beyond the point where these requirements are met.

In recent years, several economic studies have virtually destroyed the notion
popularized by Madison Avenue that giant corporations are particularly effective
institutions of technological progress and innovation. Giant firms do not contribute
disproportionately to technological progress, and are often found in the position
of slowing down the rate of progress or diverting innovation when it threatens their
vested interests. There are apparently many factors in dominant market position
and corporate bureaucracy that inhibit the potential of large corporations as engines
of progress. After a careful review of the literature relating innovation to industrial
centrations, Frederic Scherer concludes:

We emerge again with a threshold concept of the most favorable
industrial climate for rapid technological change. A little bit of monopoly
power, in the form of structural concentration, is conducive to invention and
innovation, particularly when advances in the relevant knowledge base
occur slowly. But very high concentration has a favorable effect only in rare
cases, and more often it is apt to retard progress by restricting the number
of independent sources of initiative and by dampening firms' incentive
to gain market position through accelerated research and development. Likewise, it is vital that barriers to new entry be kept at modest levels, and that established industry members be exposed continually to the threat of entry by technically audacious newcomers.5

Even in the infrequent cases where giantism is associated with rapid technological progress, it is not clear that the progress is worth the social-political cost or that alternative means of achieving the progress are unavailable.

The defenders of corporate power usually argue that the discipline imposed by rivals and customers will achieve the essential results claimed for a more competitive market system. It is true that varying degrees of market constraint exist, and in some dimensions they are quite strong. But we should note that, while the terms rivalry and competition are virtual synonyms in ordinary usage, their meanings are quite distinct in economics. Competition, as it has been used by the classical formulators and defenders of the "competitive market system," implies the absence of rivalry. When the number of sellers and buyers in a market is large, and no individual or small group has dominant power, then the market imposes its impersonal discipline on all. Producers and traders tend to react to current and expected prices and have little consciousness of each other's behavior, goals, or market shares. For example, the term rival cannot be applied to the individual farmer, or trader in basic commodities on organized markets.

In sharp contrast to the "ideal" of competition, the relation of the giant corporation to its suppliers, dealers, customers, and smaller rivals is inherently unequal. The notion of corporate behemoths without exploitive power in both market and non-market relations is ludicrous to anyone who takes the view that business should exist primarily for the benefit of society, rather than the reverse.6 Valid documentation of abuse seems to be limited only by the amount of resources devoted to investigation.7

A disturbing long-run problem is the tendency of large centers of power to be associated with and foster the development of opposing centers of power—strong labor unions, pyramiding government bureaucracies, and militant dealer and consumer organizations. As a result, decisions tend to be made through adversary power blocs that are large relative to the individual consumer, voter, laborer, and businessman. Some of the difficulties stemming from the relationships of these large power blocs have become particularly obvious in connection with the political scandals of recent years.

Few things are more unpopular with the business community than social policies that limit or reduce large concentrations of corporate power. One gets the impression from positions taken by corporate leaders that they would accept a large degree of government regulation (however reluctantly) rather than face dissolution. Perhaps this primacy of loyalty to a particular enterprise is appropriate, but it should not be confused with dedication to the survival of a competitive market system as the backbone of our economic organization. When there is a choice between reducing private power and regulating it, the requirement for a market-oriented economy is clear—reduce the power. Balance the power of business, labor, and consumers at a relatively modest level. In the other direction lies an increasing degree of economic resource administration through a combination of private and government powers.

Although our anti-trust laws have been credited with preventing the degree of collusion and cartelization that is observed in Europe, they have clearly been
ineffective in preventing less blatant forms of combination through financial control and trade associations, or the growth of power within individual corporate firms. An alternative policy for reducing large aggregates of corporate and financial power is the use of a progressive value-added tax as a replacement for the corporate income tax.

Value-added—essentially the payments to labor and capital made by a firm over a period of time—is one of the best available measures of firm size in terms of current operations. A value-added tax that becomes progressive after a certain level is reached will penalize the large firm in comparison with its smaller rivals. If economies of scale or other efficiencies are sufficiently large to offset the tax rate, then a firm will tend to retain its assets and pay a tax bill that represents the judgment of society as to the disadvantages of large size. Otherwise, the firm will seek some method of divestiture in order to reduce the competitive penalty that the tax imposes.

The advantage of the tax is that it substitutes for a cumbersome and ineffective judicial process a system that could provide a powerful incentive to reduce excess firm size. It also allows the business community to make the crucial decisions as to the most appropriate division or divestiture, as opposed to the more arbitrary decisions of a court.

Many problems as to appropriate rates and exemptions would have to be resolved before the political battle to implement such a policy could begin. The most frequently voiced objection is that growth is the reward for efficiency and a progressive tax would destroy important incentives. But, unlimited growth in firm size is obviously not the only way in which rewards for efficiency can be realized. A progressive value-added tax would encourage realization of reward through profitable spinoff of successful divisions or subsidiaries. The firm would usually prefer the security of size and diversity, but given the social desirability of limiting firm size the progressive value-added tax has much to recommend it when compared to judicial procedure.

CONDITION 2: ALL GOODS TRADED IN MARKETS

A second condition of the competitive market system that is violated with increasingly serious consequences is the requirement that all goods be traded in markets. The effects of this failure are revealed in "spillover" effects, which relate to persons not directly involved in market transactions. Although one of the best current examples of a spillover effect is the pollution problem, the concept is relevant to a wide variety of social problems ranging from defense policy to income distribution.

Society has responded to the economic and political consequences of spillover effects in many areas. For example, the state heavily subsidizes education, in part because society derives enormous benefits above and beyond the benefit to the individual educated. These benefits are "goods" that would not pass through the market if education were left strictly to free enterprise. Individuals would consider only private benefits when deciding how much education to buy. Society as a whole would achieve substantially less than the desirable amount of education. Since the free market is not able to establish a value for society's gains, the case is made for some sort of subsidy to pay for society's benefits and encourage a larger output from the "education industry."

Pollution is, of course, a negative spillover. When levels of population and industrial density are relatively low, air and water resources may absorb society's
Effluent fairly easily. In fact, air and water were used for years in economics as classic examples of "free goods"—goods that were valuable to society, but were in such abundance that no charge was necessary to allocate their use. No more! We have clearly exceeded the assimilative capacity of these resources in many areas in large part because we have treated them as free goods. They are now properly called "common property resources" of the community. Use of these resources cannot be subjected to a competitive market because of their ubiquitous nature; thus, use of the resource by one clearly has negative effects on others for which there is no convenient compensation mechanism.

The business community has absorbed a considerable amount of inappropriate criticism on the pollution issue. Business has used the common property resources within an established social framework on the same basis as everyone else. Costs and prices for privately produced goods were generally lower than they otherwise would have been, but at the expense of environmental deterioration. The charge of high profits from polluting the environment can only stem from a failure to understand how a market system works. Excess profits from the free use of society's resources would tend to be eliminated by an expansion of output and lower prices within the affected industries.

Nevertheless, the day of reckoning has come. The social framework must change, common property resources must be husbanded, and business is in for painful adjustment just like everyone else. The question is how to change the social framework. There is a growing interest in systems of charges (in the form of special taxes) according to use of air and waterways that are based on economic theory and empirical study.

There are two primary advantages to this system. First, the price of a product will better reflect its true resource cost since charges for effluents will be included. This provides for a more effective allocation of resources and also tends to discourage the use of goods with high pollution characteristics relative to other goods. Second, the system would mandate the business community to do what it does best—respond to an incentive. Present a manufacturing firm with a per unit cost and it will immediately seek ways to reduce it; the response will include both the effective use of current technology and a search for new technology. We can anticipate generally reduced effluent and imaginative recycling under this type of program.

Even under an inevitably imperfect system of charges the business community could provide a flexibility in adaptation and an intensity of innovation that could not be matched under the guidance of a regulatory agency. Once a charge system is imposed, the incentive of the firm is switched from hiring lawyers to represent its case before the regulatory agency to hiring engineers in order to minimize the pollution cost of output. The firm must now treat environmental resources in the same way it treats capital and labor resources: that is it must continually try to reduce the environmental content of a unit of output. The long run impact is that a given degree of environmental control could be achieved at a smaller cost to the business community, and thus to society, than would be possible under current programs.

Conservation and ecological groups were initially opposed to the concept of charges for effluents since it seems to emphasize use of the environment rather than its preservation. It appeared that the state would be recklessly selling its
common property resources, and that pollution taxes would become essentially the price for a license to pollute. These views are rapidly changing as the effectiveness and outstanding potential of quasi price-system charges are demonstrated.10

There are many problems associated with establishing an appropriate set of "pollution prices" and overcoming transitional difficulties, but the great promise of this technique is that it constrains business practices by making use of business incentive. It is a piece of the social framework that is both potentially effective and unusually compatible with the free enterprise system.

Business opposition to effluent taxes seems to stem from the immediate impact on cost, and a realization that these charges would not be subject to the delays and manipulation that the administered standards approach has permitted.11 There is also the all too often demonstrated potential for "capture" of the agency by those it is supposed to regulate. In its preference for a bureaucratic over a price-system oriented approach, the business community has provided an excellent example of the conflict between their own short-run interests and the long-run interests of a viable market-oriented economy.

Other examples of policies that make heavy use of individual incentives as effective means for meeting spillover effects can be cited. It has been suggested that giving students vouchers that are spendable at private institutions would result in a more efficient, equitable, and diversified education system that we have with public schools. The market test would encourage efficiency; the statewide or nationwide means of financing the voucher system would provide a more equitable floor than the current property tax base for school financing; and a wider spectrum of institutions would develop to handle the diversity of educational needs that has long been recognized.

Poverty can be related to spillover effects in many important ways. On the one hand, the reduction of poverty would reduce such negative spillovers as crime and social dissension that are associated with low income. On the other hand, poverty itself is importantly the result of negative spillovers that are visited on certain groups by the rest of society. Various forms of discrimination provide an obvious example of the influence of spillovers on income distribution. Less obvious is the disproportionate impact of technological change on incomes in the lower strata. The relatively well off and well educated adapt to technological change fairly readily. But the skills of the poor tend to be narrowly circumscribed, and technological obsolescence of these meager skills tends to drop them to the bottom rung of the income ladder. A phenomenon that has important positive effects for society as a whole visits disproportionate negative efforts on low income groups.

An important conclusion is that the case for income redistribution does not have to rest entirely on ethical grounds. A strong case can be made on technical and economic grounds in connection with certain spillover effects.

The negative income tax, or family allowance, has been widely discussed as an efficient means for the reduction of poverty.12 The details cannot be dealt with here, but essentially the plan starts every family with a basic income floor and then taxes away the subsidy as earned income rises. The basic advantages lie in its simplicity; in the generation of positive family and work incentives when compared to current welfare programs; and in the basic compatibility with other programs such as job retraining and day care.

The negative income tax has only one test for poverty—low income. The distribution of funds becomes relatively efficient and the proportion of tax dollars
going to the recipient, as opposed to the welfare bureaucracy, increases. Since the subsidy is only gradually taxed away there is always an advantage to the recipient of increasing his earned income. There is no precipitous cut-off point. There are no man-in-the-house rules or other regulations that provide adverse incentives and burdensome enforcement problems.

None of the above suggestions for new policy approaches is utopian. They all have problems of implementation and operation, and disadvantages as well as advantages when compared to current policies. What I want to emphasize is that the general public and professional alike need to realize the need to handle the growing spillover problems of a complex society more effectively than we have in the past. An important tool that is available to us is the incentives that already exist in the private system. If we can effectively use them we not only enhance the achievement of our social goals, but we also minimize the inefficiencies that public often imposes on the private sector.

**Condition 3: Full Knowledge of Product**

A third condition required for effective operation of a competitive market system is that buyers and sellers have full knowledge of the product or service being traded. As products become more varied and sophisticated, failure to fulfill this condition becomes more obvious, particularly in markets for consumer goods. To the extent that consumer knowledge is inadequate, there is a tendency for the enterprise to serve consumer interest less and its own interest more.

As a means of communicating objective product knowledge, advertising, particularly in the national media, is of limited value and subject to much justifiable criticism. It may often be viewed as an attempt to instill the idea that detailed product knowledge is unnecessary or even to convey misinformation. The FTC “watchdog”, the need to uphold a “brand name reputation”, and businessmen’s alleged respect for “sharp-eyed housewives” do not seem to have substantially affected the nature of mass advertising. Business gain via product misinformation may not always be a successful strategy, but it is easy to cite examples where it is used profitably on either a temporary or a sustained basis by the most respectable business enterprises.

The apparent profitability of consumer ignorance is further suggested by the uniformly vigorous opposition of the business community to virtually all information disclosure laws. An excellent example was its distress over the Truth in Lending Act, which in essence required only that a customer understand the simple rate of interest that he is asked to pay on the unpaid balance of his debt. If the business community is concerned about its loss of credibility to the public, it would do well to ponder its image as it opposes a modest educative attempt to enable the poor and the ignorant (those most affected by usurious time purchase contracts) to protect themselves from excessive expenditures when they purchase durable goods.

Consumer education should have a high priority among society’s goals. In teaching citizens to care for themselves, we reduce the necessity for someone else to care for them. Product information disclosure, including such items as grade labeling and unit pricing, is also important. The education approach to consumer protection involves not only knowledge, but an effective and convenient means for translating the knowledge into meaningful product and price comparisons in a complex market environment.
Finally, legal responsibility on the part of business for products and advertising may become an important tool for the consumer. It tends to spread the benefits of expertise on the part of a few to the mass of consumers.

There are and will continue to be problems of establishing appropriate guidelines in all these areas of consumer protection. Regulation of advertising has a long history of failure, whether imposed within the industry or by the Federal government. Information disclosure, consumer education, and legal responsibility for products and advertising are likely to be more effective. With these forms of control the degree of centralized regulation and monitoring of economic decisions is relatively small. Also, there is a substantial involvement of individual producer and consumer incentive that will enhance the chances for long run success in this difficult area of social policy.

MARKET ORIENTED SOCIAL POLICY

The question of an appropriate social framework for meeting community goals is a vital one. In relation to the free enterprise system it is important as a determinant of the extent to which the business enterprise serves society’s needs in its pursuit of profit. The claim that the enterprise system automatically serves the best interests of its customers and society and, therefore, should be left free of constraints other than those inherent in the market place (laissez faire) cannot be taken seriously.

It is equally true that, in adding nonmarket constraints to the social framework, we can do worse than laissez faire. Policies must be carefully considered in terms of their interface with the economic system and with other elements of the social framework. The negative effects of failure to do this are obvious in many areas of social policy: e.g., pollution control, urban renewal, family assistance, and various forms of industry regulation.

My purpose has been to interpret some of the major problems faced by the modern business system in terms of the system’s failure to meet certain conditions presumed to hold in a competitive market economy. This approach suggests a search for policies that are surrogates for the constraints that were never adequate or have failed to survive naturally within the system. A proper surrogate should be compatible with the enterprise system, insofar as possible, in order to enhance the system’s long-run social-political viability and preserve the drive for efficiency that flows from private incentive. The most successful policies are likely to be those that have a strong element of private incentive in their operation and enforcement. Sustained concern for our fellow man is, unfortunately, a commodity that is in short supply. We should not squander it in areas where more sustainable—if less laudable—motivations will achieve the same or superior results.

It is my belief in society’s ability to erect a framework that uses individual incentive to meet society’s goals that leads me to take a dim view of “corporate responsibility” and “public members” on boards of directors. This is not a question of the corporate leader’s morality; the view is based on concern for an effective organization of society’s institutions. It is the appropriate role of businessmen (as well as workmen and consumers) to pursue their economic goals in the market place. It is the citizen’s responsibility through the political process to establish a social framework that makes this pursuit compatible with community goals. To shift social responsibility to the business community is to both reduce the effectiveness of the enterprise and ensure a selective and haphazard pursuit of community
goals. Also, the additional status conferred on corporations as quasi-political organizations has implications that are disturbing to anyone who values a pluralistic society. If we expect businessmen to behave like statesmen, we will ultimately be faced with their claim to the powers of statesmen!

A serious counterargument to the view that society should depend heavily on self-interest in its economic organization claims that such emphasis interferes with the development of desirable social motivations and the achievement of society's highest aspirations. The issue is an important one and needs wider recognition and discussion than it receives.

Unquestionably, the efficiency that stems from individual economic incentive is of value when viewed in isolation. Nearly all of society's goals require the use of economic resources for their achievement. Unless one of our goals is make-work (perhaps on the grounds that work builds moral character but output destroys it), efficiency will simply enable us to achieve more of our goals with given resources and technology. Even if our primary goal is more leisure, the vital role of efficiency should be obvious. The negative aspect is, of course, that individual incentive—or, more broadly, the private enterprise system—inevitably influences society's goals. It may do so in ways that are judged to be undesirable and thereby diminish its own value as a social instrument.

Many abuses and questionable goals are directly or indirectly related to the failure of market conditions and inadequate policy concepts emphasized in this paper: the self-serving and manipulative tendencies of market power; the failure to give proper consideration to a wide variety of spillover effects (e.g., in pollution, health, and income redistribution); and the exploitation of consumer myopia and ignorance. The basic problem remains: can we build a social framework that is compatible with both a system of markets and the achievement of our social aspirations? The radical contention is that we cannot—social goals will continue to be lost in a structure that generates the power mechanism and the will to concentrate our efforts on the creation and satisfaction of a narrow spectrum of private wants.

The suggestion that strengthening effective market mechanisms and reducing market power are central to preserving the viability of free enterprise is usually labeled as naive in the context of the twentieth century industrial world. It does seem out-of-touch with trends. But what are the alternatives? The world of private and public socialism that Galbraith suggests is already upon us. A more traditional form of central planning? Marcuse's world of "repressive tolerance"? I find these a dismal choice of oligarchies.

The broad-based and serious questioning of our institutions is likely to continue as levels of public education and awareness are increased. The promise of a good society, based on a Calvinist morality or National Association of Manufacturer's rationalization in relation to our present set of institutions, will wither under the intense questioning of existing and coming generations. The question is can we, or should we, save the concept of free markets from the drift of twentieth century capitalism and the reactions to capitalism's excesses?
FOOTNOTES


2 The connection between private enterprise and political freedom is strongly argued by such writers as Milton Friedman and Frederich Hayek. In my view the ability of the initial anti-Vietnam war protestors to sustain themselves, and sometimes prosper, within our economic system lends substantial support to this argument. See Milton Friedman, Capitalism and Freedom (Chicago: University of Chicago Press, 1962) and Frederich Hayek, The Road to Serfdom (Chicago: University of Chicago Press, 1944).


5 Ibid., pp. 377-78.

6 For an excellent short discussion of the corporation's actual and potential impact on the control of power by pluralism see H. Scott Gordon, Social Institutions, Change, and Progress (Vancouver: The University of British Columbia, 1971), Chapter 4.


13 National advertising in all media account for less than one-third of advertising revenue. It is, however, the advertising to which the individual has by far the greatest exposure, and is also the type of advertising most subject to abuse. Newspaper classified advertising accounts for nearly as much revenue as network television, but there is little controversy over its social value. Criticism centers on the advertising that has the greater impact; the proportion of the advertising dollar absorbed by this advertising is not relevant. For a good discussion of the social values and problems of advertising see F.M. Scherer, op. cit., Chapter 14.
