Microeconomics with Ethics

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Chapter 26

Course Recap:
Designing the Best Economic System

This final chapter is designed to bring together several important elements of the course and use them to provide a guide, first, for understanding the workings of a modern economy, and second, to provide an understanding of the differences of opinion that exist about how to best organize an economy. The economics discipline prides itself as being the most scientific of the social sciences and this creates an inclination not to discuss what is best because to do so ventures into normative debates that involve matters of opinion rather than fact. However, I think this approach does a disservice to students. Students are often inspired to learn about economics because they are interested in understanding the current debates about economic policy. While lessons about how an economy works surely contributes to that understanding, the economics approach can actually provide a much richer understanding when we venture into normative territory.

This textbook has done that by including the role of ethics in the functioning of an economic system. And as this book has shown, ethics isn't introduced as an add-on after discussing the mechanical workings of the economy. Rather, ethics is shown to be an integral behavioral feature whose absence would make it unlikely for economic systems to achieve economically efficient outcomes. It will also be suggested in this chapter why the inability of economists to discuss the role of ethics has contributed to some of the disagreements about economic choices.

A second feature of this textbook that will be highlighted in this final chapter is the role of economic modeling as a way of understanding the economic system. Many economists present models as a depiction of how the world works. Students demonstrate a preference for this approach when they say, "just tell me the answer and I will memorize it for the exam." The problem is that this creates a false impression that economic models are true representations of the economy and as such can be used to predict economic outcomes. (Yes, they can to a degree, but not perfectly.) Instead, this text has emphasized that economic models do not provide a perfect representation of the real world, but, that does not make them useless. Instead, they can be used to provide insight into the conditions necessary to produce particular outcomes, such as the realization of economically efficient outcomes.

In recognizing the imperfections in economic models, we can also provide an explanation for differences of opinion about how to organize the economic system. Different models provide different lenses through which to see aspects of the economy. Each model has strengths as well as weaknesses. As such, observers can and do disagree about which models are stronger or weaker and these disagreements often result in different policy approaches. In this chapter, we will review some of the key findings in the economic models presented in this course by showing

how they can be used to support different policy positions.

This textbook does not intend, nor does it claim, that there is one best way to organize an economy. Instead, it suggests that there are valid reasons for many of the popular beliefs or opinions about how an economy works best. The textbook also provides reasons why in every belief system one might consider, there are inherent flaws or weaknesses in the arguments. This is why fundamentally there is no one right path and why there are enduring differences of opinions.

26.1 The Goal of Economics

Learning Objectives

1. Review different ways to conceive of the goal of economics.
2. Review the important role of economic efficiency in promoting the goal of economics.
3. Review the distinction between positive and normative economic evaluations.

There are many different ways to define what economics is and what the goal of the discipline is. Some definitions emphasize the marginal nature of decisions made by market participants when they weigh the costs and benefits of their economic actions. Some definitions highlight the necessity of empirical observations of the economic system and the need to use these in making economic decisions. Still others focus on the recognition that economic agents must always make decisions in the presence of scarcity and that implies the need to consider trade-offs. Each of these definitions is appropriate because they each emphasize an important element considered in every economics course.

However, in this course the purpose of economics was defined in terms of the ultimate economic goal, rather than in terms of the practices of the participants in the economic system. And what is that ultimate goal? Stated simply, the promotion of human happiness via the consumption of goods and services that are produced and distributed via the economic system. How best to organize the economic system to improve people's lives is ultimately what most who study economics would like to learn. How best to organize the economic system is the question that motivates continual discussion and ultimately results in the struggle we experience in every polity or political system.

The economics discipline, and by that I mean the collection of ideas that has been constructed, discussed, debated, and ultimately written down by numerous thinkers in human history, and which form the core lessons in a modern economics textbook, has reached some noteworthy conclusions about how to achieve the maximum amount of human happiness in an economic system. Stated most succinctly, the economics answer is to promote economic efficiency.

Economic efficiency satisfies the economic goal because an economically efficient outcome is one where limited resources have been used in a way that achieves a very high level of human happiness. If an economic outcome is efficient, there is no way to adjust the outcome via trade to make *everyone* happier. In economics jargon, the outcome is pareto optimal. Of course, it would always be possible to make adjustments which make some people happier, but only by simultaneously making others less happy. When an outcome is economically efficient, goods and services are also being produced in the least costly way and therefore the most effective way in light of the scarcity of resources that prevails.

Critics of economics often argue that economic efficiency isn't everything. This criticism is certainly valid but it needs to be qualified. Economics studies the system in which human happiness is derived from the production, distribution and consumption of goods and services. But this is not the only way humans derive happiness. Humans also derive happiness from their families and friends, from the community connections that they establish, from the empathy and support that they provide to each other. Humans derive happiness from their status, from their sense of dignity and from a fulfillment of a life purpose that they define for themselves. For the most part, these elements are absent from economic models and to the extent that is true, promotion of economic efficiency doesn't capture everything that is important for human happiness.

Critics of economics also contend that economic efficiency isn't everything because it misses the critical element of the final distribution of happiness within the economic system. For example, it is possible for an economic system to maximize economic efficiency in a way that leaves the distribution of happiness wildly unequal among members of society. In other words, an outcome with some members obtaining large amounts of happiness and others obtaining very little, can be perfectly consistent with maximum economic efficiency. This critique is also valid and worthy of further discussion and debate and has been a primary concern in the economics discipline in the debate over equity versus economic efficiency. This too is a valid criticism suggestive that economic efficiency should not be the sole criterion used to measure a successful economic system.

However, although there are valid criticisms of economic efficiency, it does not mean that economic efficiency is therefore unimportant or not worthy of consideration. The consumption of goods and services in the form of food, clothing, shelter and care for one's health are an extremely important source of human happiness. Indeed, if basic human material needs are not first satisfied, spiritual needs and desires are unattainable. Thus, these criticisms do not invalidate the importance of identifying the best methods to achieve economic efficiency. Instead, they imply that merely achieving this goal is not enough.

In the past, many economists have argued that the task of economists is to first identify how to achieve economic efficiency and once this is satisfied one can turn attention to normative issues such as the appropriate distribution of income and wealth. This approach has the advantage of narrowing the research focus and making the problems somewhat more tractable. However, the approach may be problematic when a sole focus on efficiency causes researchers to ignore possible efficiency-equity tradeoffs. These are situations in which equity might be enhanced only by sacrificing some degree of economic efficiency. While there is a literature that focuses on equity-efficiency tradeoffs, the economics discipline has mostly avoided this discussion via reference to the positive-normative distinction and its preference to avoid normative issues.

One of the first things discussed in economics courses is that there are some questions that are of a positive nature, meaning questions of how the system functions, and there are other questions of a normative nature, namely questions about how the system *should* function. Positive economics is about *what is*, normative economics is about what *should be*. Economists have long been proud of the fact that the discipline is primarily positive in its approach and have used this distinction to laud the more strictly scientific nature of the discipline. Normative questions are pushed aside with the argument that these are matters of opinion, not of scientific fact. Normative questions may be interesting and important, it is said, but their discussion is for philosophers and policymakers, not for economists to contemplate. With this rationale, economists have long relegated ethics, and normative issues more generally, to the sidelines and have not considered it worthy of serious discussion. Furthermore, they have often branded those

who would discuss these issues as heterodox economists.

Key Takeaways

1. This book's identified goal of economics is the promotion of human happiness via the consumption of goods and services that are produced and distributed via the economic system.
2. The achievement of economically efficient (a.k.a. pareto optimal) outcomes is the primary economic method to promote human happiness.
3. While economic efficiency is not the only criterion important in the achievement of human happiness, it ranks as one of the most important.
4. The economics discipline during the past few generations has displayed a preference for purely positive rather than normative economic evaluations.
5. The defined goal of economics in this textbook reintroduces normative issues as an important feature of the course.

26.2 The Political / Economic Spectrum

Learning Objectives

1. Learn two simplified classifications for popular political/economic opinions; right-leaning and left-leaning.
2. Learn the primary distinction between these two broad classification as the degree of government intervention in the economy.
3. Learn the basic economic rationale behind the ideas on each side of this spectrum.

Once the economic goal is defined, namely the achievement of economic efficiency, the next issue is how to best obtain such an outcome. Of course, there are numerous opinions across many different dimensions on this issue, so to make better sense of it, we shall apply an economic modelling technique, namely simplification. Let's imagine two broad popular approaches to economic policymaking and label them right-leaning and left-leaning ideologies. We will focus attention on just one criterion, namely the degree of government intervention in the economy. Suppose the right-leaning approach to economic policy is one prescribing limited involvement by the government in economic decisions, while the left-leaning approach prescribes a much greater role for government. This characterization is mostly aligned with the American right (pre-Trump) and the American left. Although promoting economic efficiency may not be the stated goal of either of these approaches, we can nevertheless evaluate these positions from using this economic perspective and discuss strengths and weaknesses on this basis. In doing so, we will be providing the economic rationale for the popular opinions on the right and the left.

Right-Leaning Ideology

On the right are those who believe in the workings of a free market system and are more inclined to accept economic efficiency as a stated goal. Terms used to refer to this group of opinions are right-wing, conservative, Republican (in the US), neoliberal, free market, and laissez-faire. This group can draw support for their opinion from Adam Smith's description of the invisible hand and Ricardo's notion of comparative advantage. In these models, described in Chapters 3, 4 and

5, individuals who pursue their self-interest and seek profit will be led, as if by an invisible hand, to produce the goods in which they have a comparative advantage (thereby promoting production efficiency), and will trade their goods in markets generating mutually beneficial outcomes for everyone involved (thereby promoting consumption efficiency). In this story, as in the economic model of perfect competition presented in Chapters 12 and 13, there is no need for government to step in to facilitate these decisions and outcomes. With no government, individuals have maximum freedom to satisfy their own demands, whatever they may be, and firms will arise to satisfy those demands because doing so will fulfill their own self-interest. In this stylized view of the world, government intervention does little more than to interfere with individual freedom to live in a manner one most desires.

However, right-leaning individuals do typically accept government in a least several roles. First, the government should establish a criminal justice system that will keep internal law and order, including a police force to protect against violence and theft, and establish a judicial system that will enforce contracts and maintain a system of property rights. Government's second role is to establish a military that will protect its citizens from foreign invaders. This limited interference by government into an economy is often referred to as a minimal government, or a minimal state.

One prominent advocate for these free market ideas was the philosopher and author Ayn Rand. Her ideas are worth mentioning because many thinkers on the American right have drawn inspiration from her writings including former Federal Reserve Chair Alan Greenspan, US Supreme Court Justice Clarence Thomas, US Senators Ron and Rand Paul, and entrepreneurs Mark Cuban and Peter Thiel. These ideas epitomize a tradition that focuses on the pursuit of self-interest above all else and has acquired its most recent label, neoliberalism.

Rand's philosophical ideas were expressed in two famous novels, Atlas Shrugged and the Fountainhead, as well as being the inspiration for what was called the Objectivist movement. Rand was an outspoken critic of communism and collectivism, having fled the Soviet Union for a life in the West. The protagonists in her novels were fiercely independent and self-reliant, extremely ambitious and unwilling to yield to the demands of others who would ask them to compromise their values. These ideas translated to an economic system in which government stayed out of the way of the personal ambitions of entrepreneurs who were characterized as the "makers" in society. In contrast, for Rand, government was characterized as a "taker," stealing the hard-earned income from creators in order to redistribute it to others who were undeserving. She believed that there was no moral necessity for altruism and that altruism was incompatible with freedom, capitalism and individual rights.

Left-Leaning Ideology

On the left on the political spectrum are those who believe that government intervention is a necessity, especially to promote fairness and social justice in the workings of the economic system. In the extreme form, this side tends towards pure socialism in which free markets are abandoned in favor of government ownership of the means of production and in some instances, supports centrally planned decisions as to what will be produced, in what way and how it will be distributed. Today most on the left are far less extreme than this, believing in private ownership and free markets except that governments should administer a set of rules, regulations, taxes and subsidies that will assure more equitable outcomes for all. Terms used to refer to this group of opinions are left-wing, progressive, Democratic (in the US), socialist, and social-democratic.

This group can draw economic support for their opinion from the theory of market imperfections covered in Chapters 22 – 25. In these models, deviations from standard neoclassical assumptions are introduced and it is shown how government intervention into economic decisions, via tax, subsidy and regulatory policies, can improve market efficiency in the economy because it corrects for the particular market imperfection that is introduced.

Although, this impact on economic efficiency may not be the intention of those on the left, who may believe instead that government support for policies that promote more equal outcomes are the primary goal regardless of the impact on economic efficiency, this textbook demonstrates how government intervention can often achieve both goals simultaneously. For example, one of the reasons for the widening of income inequality in recent years may well be the increased concentration in production in many industries. Monopoly power is in the narrow interests of businesses and they have found many creative ways to increase it, even though it is demonstrably bad for economic efficiency and the equality of incomes (See Chapters 10 and 16). In this case, governments have intervened with competition policies designed to prevent excessive concentration from occurring. Of course, one can argue about the effectiveness of these policies and whether they are being properly designed and implemented, but regardless, the use of these policies by government can promote the left-leaning goals of equality as well as economic efficiency simultaneously. This is just one of many examples that can show consistency between greater equality and economic efficiency. A more substantial discussion of this issue follows later.

One way to state the goal for the economic and political system is to follow the suggestion of political scientist and author Francis Fukuyama, who in his book The Origins of Political Order: From Prehuman Times to the French Revolution, coined the idea of "Getting to Denmark." The term is meant as short-hand for the societal goal of how to create a "stable, peaceful, prosperous, inclusive and honest society." The country he suggests that most epitomizes this goal in today's world is Denmark, a thriving and peaceful social democratic country that has high taxes and a prominent role for government in ensuring greater equality among its citizens.

Key Takeaways

1. A right-leaning economic opinion favors very little government intervention in the economy whereas a left-leaning economic opinion favors more substantial government intervention to control economic outcomes.
2. Right-leaning ideologies can draw support from economic models of pure exchange and comparative advantage and from models of perfect competition.
3. Left-leaning ideologies can draw support from economic models highlighting the presence and correction of market imperfections.
4. Ayn Rand's writings, which are highly antagonistic towards government, have been extremely popular among many right-leaning individuals.
5. Francis Fukuyama's notion of "getting to Denmark" epitomizes the goal of many left-leaning individuals.

26.3 The Invisible Hand Controversy

Learning Objectives

1. Listen to two Nobel prize winning economists discuss their views on Adam Smith's concept of the invisible hand.
2. Learn why they may be more in agreement about the invisible hand than it would seem.
3. Learn why the knowing the definitions of concepts are critically important in understanding individual points of view.
4. Learn how the key difference in opinion between these two economists is the acceptable role of government in organizing an economy,

Milton Friedman and Joseph Stiglitz's ideas have been featured periodically in this course in part because they have both contributed substantially to our understanding of economic systems (they are both Nobel prize winners) and also because their points of views lie on opposite sides of the economic spectrum.

Milton Friedman was one of the many University of Chicago economists who were vocal free market supporters typical of the neoliberal approach to economic policymaking on the right side of the political spectrum. He is famous for having said that the only social objective of business is to increase its profit and promote shareholder value. He was also strongly against most types of government intervention, although he did support a limited role in particular circumstances in line with acceptance of a minimal state.

Joseph Stiglitz contributed substantially to our economic understanding of the role of market imperfections and imperfect information and is prominent in his support of government intervention to correct for situations when the market gets things wrong. His views are typical of those on the left-side of the political spectrum and he could be properly labeled a progressive economist.

Early in the course, in Chapter 1, I introduced these two economists using videos highlighting their views about a popular idea in economics, Adam Smith's concept of the invisible hand. Their statements appear to strikingly contradict each other with Friedman arguing that the invisible hand is more relevant today than ever before, while Stiglitz states that the invisible hand seems invisible because it's not even there. I suspect that most listeners of these two videos would quickly conclude that one of these economists must be right and the other wrong and our task as students of economics is to determine the truth. However, armed with the lessons from this course, I intend to demonstrate that both of these economists are correct in their statements and further that these two individuals are likely to be closer to agreement than disagreement about both this economic concept and many others as well.

Milton Friedman on the Invisible Hand

Joseph Stiglitz on the Invisible Hand

The key reason there is less disagreement here than it seems is because the two economists are applying different definitions for the term invisible hand. Friedman defines invisible hand as market coordination without any central planning when he refers to Smith's "conception of how it was that without any central body planning it, millions of people could coordinate their activities in the way that was mutually beneficial to all of them." In contrast, Stiglitz defines the invisible hand as the idea that the pursuit of self-interest always leads to more efficient market outcomes.

Friedman's definition is more traditional. It is the concept explained in some detail in the famous "I Pencil" story, referenced in Chapter 1, which highlights how the inputs to produce a simple wooden pencil are assembled together in production without the need for any central body planning or coordination. What is it that motivates firms to produce the cedar wood, the rubber, the tin and the graphite needed to construct a pencil? Only the individual desire of each of these firms to profit by selling a product at a price slightly higher than the cost of producing it. These were the lessons presented in Chapters 3 and 5 of this textbook, namely, that the pursuit of profit could lead individuals and firms to produce the goods in which they have a comparative advantage and trade with others in markets to the mutual benefit of everyone.

I have little doubt that Stiglitz accepts that this process occurs and is a critically important reason for the high productivity in modern economies today. If he were forced to accept this definition of the invisible hand, I'd hazard to say that he would have to concur. However, what he would undoubtedly insist on adding, is that this outcome is not guaranteed and that it does not always occur.

Stiglitz's definition of the invisible hand is an extension of this very idea. There are some on the right - some stalwart supporters of free markets - who do believe that unfettered self-interest would automatically lead to the most efficient outcomes. Stiglitz states that this idea was taught in many graduate schools in the country, and here he is thinking mostly of the University of Chicago. However, in some ways this is an exaggeration. Although many research agendas were intent on showing that pursuit of self-interest would result in efficient outcomes, not everyone on the right believed this would always hold. For example, although Friedman certainly believed that free markets would work better than government intervention in most cases, he also recognized that government would be needed in certain circumstances. Those circumstances refer to whether the conditions of perfect competition prevail or whether there are market imperfections present.

And this gets to a finer point made by Friedman in the video. In it he clearly stated that the "application of principles has to take account of circumstances." In saying this, he is cautioning that if the assumptions in a model are changed, then the conclusions will likely change as well. Friedman was well-aware of the presence of the market imperfections that Stiglitz would later study. Friedman knew, for example, that firms producing negative externalities would tend to over produce and generate economically inefficient outcomes. He knew that government could be used to correct for these externality effects. Under these "different circumstances," the application of principles will change.

The reason then that both Friedman and Stiglitz can be viewed as correct in their statements, is because Friedman is thinking of examples, of which there are many, where the presence of market imperfections are minimal and where free and fair competition in markets generates equilibrium prices which are used by self-interested profit seeking firms to allocate resources to the production of goods and services that are desired by consumers. The production of the simple pencil is a perfect illustration of this and there are many more. This is why he claims that we have even more reason to believe in the invisible hand today than in the time of Adam Smith.

In contrast, Stiglitz is thinking of examples, of which there are many, (see Chapters 22-25 in particular) in which market imperfections are present and therefore in the absence of some sort of intervention, such as government, the market outcome will be economically inefficient. This is the reason government provides for a criminal justice system to maintain order internally, a national defense system to protect against external hostilities, and various rules and regulations, like environmental policies to promote more efficiency economic outcomes.

That these two economists are applying a different definition of a commonly used term in economics is an important lesson to take from this course. Concepts that are widely analyzed and discussed invariably take on different meanings to different observers. Sometimes this happens because the same word is used in different contexts. For example, in this course, we used the term welfare to mean the surplus value obtained by individuals in trade, but in a public economics course, welfare may be defined as the payments made by the government to support low-income households. Same word, different meanings.

Words used to describe complex concepts are even more likely to have multiple meanings and interpretations. The invisible hand is a subtle concept that is difficult to understand and this is one reason different people may conceive of it differently. Some complex concepts mentioned in this course, such as capitalism and socialism, have innumerable meanings and interpretations among authors and observers. This is why the famous French author and philosopher Voltaire once said, "If you want to converse with me, define your terms." Voltaire was well aware of the misunderstandings and disagreements that can arise because of the use of conflicting definitions. This is also why the economic discipline is so insistent on laying out the set of assumptions in a model before analyzing and deriving implications and conclusions. It is a practice that has grown up in the age of reason and rationality and is something we must all strive to remember, especially when trying to make sense of differences of opinion.

In summary, Friedman and Stiglitz do disagree, but their disagreements have more to do with the extent of appropriate government intervention in the economy and less to do with the fundamentals of the economic system such as the invisible hand. With respect to economic concepts, I suspect they are more in agreement than disagreement once we correct for the definitions of terms. With respect to government, they have significant differences of opinion about the role of government in an economic system. Next, we will highlight some of the additional reasons for these differences.

Key Takeaways

1. Friedman, who accepts the notion of the invisible hand, and Stiglitz, who rejects it, disagree primarily because they are applying a different definition of the invisible hand.
2. Stiglitz likely accepts that much free market activity occurs because profit seeking firms supply products to the market without central government coordination.
3. Friedman likely accepts that under the circumstances of market imperfections, government can intervene to improve the economic outcome.
4. Nevertheless, Stiglitz surely believes much more than Friedman of the necessity for and the extent of government intervention to secure more favorable economic outcomes.

26.4 The Role of Government Controversy

Learning Objectives

1. Learn what economic theories can be used to justify both right-leaning and left-leaning opinions.

This course has had a lot to say about the role of government in the economy and by reviewing these lessons we can learn a lot about what motivates the opinions of thinkers who are right-

leaning like Milton Friedman and thinkers who are left-leaning like Joseph Stiglitz. The differences of opinion depend importantly on which assumptions about the economic system are believed to be true, or in other words, which conditions prevail.

For example, the case for little to no government can be made using the economic model known as perfect competition (see especially Chapters 12 and 13). Under perfect competition, there are many consumers with varied demands seeking to maximize their own individual utility and many firms producing many varieties of goods and services seeking to maximize their profit. These buyers and sellers come together in markets where they exchange in a mutually voluntary way that in turn generates surplus value, meaning higher utility and profit, on both sides of the exchange. Mutually voluntary trades are mutually beneficial.

Suppose a government steps in to this sort of economy and implements a policy such as a tax or subsidy, or a control on the pricing of a good such as a price ceiling or price floor. These policies were analyzed under the assumptions of perfect competition in Chapters 17 – 20. There it was shown that although government intervention will have positive impacts for some in the economy, it will cause even greater losses to others and result in a reduction in market efficiency. In other words, under perfect competition, government intervention does more harm than good. This also means that the best government policy, in terms of market efficiency, is no government at all.

This economic model, also sometimes referred to as the neoclassical model, was developed piecemeal from the late 19th century into the middle of the 20th century. It has become the mainstay of economic thinking, and remains so today. As shown in Chapters 12-14, perfect competition is the underlying assumption of the standard supply and demand model in economics.

To the extent that we believe that the assumptions of perfect competition prevail in an economy, it follows that government intervention makes economic outcomes worse, and therefore, *laissez-faire*, meaning keeping the government out of economic decision making, makes sense. There are indeed many instances when there is substantial competition in markets, (think the markets for food and clothing, or, for common wooden pencils) and for which the pursuit of self-interest by market participants results in a greater good for communities. And this means there is some theoretical support for those who believe that governments make economic outcomes worse.

However, upon deeper inspection, this theoretical support is limited because no clear-thinking individual should believe that the real world encompasses all of the assumptions of perfect competition. Indeed, throughout this course we considered many instances in which we relaxed the assumptions of perfect competition and evaluated how the market outcomes would change. For example, the first market outcome shown in Chapter 10 was that of a monopoly firm suppling a large number of consumers. One firm in a market is not perfect competition. We then compared that outcome with the case of two firms competing against each other in a duopoly market in Chapter 11. Finally, we compared these two outcomes to that of a perfectly competitive market with many firms competing in Chapter 14. The result, stated in reverse, is that a reduction in the number of firms competing, and thus a movement towards duopoly and monopoly, causes a reduction in market efficiency. Monopoly markets are less efficient than competitive markets. Later it was suggested in Chapter 16 how government antitrust legislation is used to discourage monopolization and stimulate greater competition in markets. If done right, this government policy can improve economic efficiency by eliminating the effects of the market imperfection.

Later, in Chapters 22 – 25, it was shown that there are numerous realistic market imperfections, whose presence can be shown to cause reductions in economic efficiency, when compared to the perfect world of perfect competition. These included negative externality effects such as pollution, positive externalities such as research and development, public goods like national defense and roads and bridges, and common resources such as ocean fisheries, among many others including informational imperfections. Again, the presence of these market imperfections result in reductions in economic efficiency in the absence of government intervention. What can be done instead is government intervention to tax, or otherwise regulate polluters; to subsidize the positive external effects; to provide for the necessary public goods; and to protect the common resources.

To the extent that we believe in the presence of market imperfections in an economy, then it follows that government intervention can improve economic efficiency and make economic outcomes better. This means that there is a theoretical justification for government, using the commonly used measuring stick in economics, namely economic efficiency.

In summary, to the extent that perfect competition prevails in an economy, the case for government is weak to non-existent. Market observers on the right on the political spectrum, like Milton Friedman, can use these models to support their opinions that less government is better for the economy. However, realistically, although there may be some rare cases in which perfect competition very nearly prevails, it is virtually certain that there are numerous market imperfections present in real world economies. It is hard to deny the presence of public goods, common resources, oligopoly markets, and externality effects. Under these circumstances then, there is theoretical support for the opinions of left-leaning market observers, such as Joseph Stiglitz, who favor much more government intervention to influence market outcomes.

If we stop right here, we might quickly decide that left-leaning policies are the clear winner in terms of promoting economic efficiency. It is much more realistic to believe in a world riddled with correctable market imperfections than the highly stylized and "perfect" world of perfect competition. However, there are a few additional issues to be discussed next that will temper this conclusion and assure a result that is quite a bit more ambivalent.

Key Takeaways

1. Right-leaning opinions draw the most support from economic models that assume perfect competition prevails in the economy.
2. Under the assumption of perfect competition, the ideal government roles is *laissez-faire*, meaning that the government should leave to economy alone.
3. Left-leaning opinions draw the most support from economic models that assume the presence of one or more market imperfection.
4. In a model with a market imperfection, government policies can be designed to improve economic efficiency.
5. Based only on these justifications, the left-leaning opinions are clearly stronger than the right-leaning opinions because the presence of market imperfections is virtually undeniable.

26.5 Ethical Economic Principles

Learning Objectives

1. Recall the ethical principles discussed in this course that are necessary to assure economically efficient outcomes.
2. Learn why the absence of ethical behavior in society can be thought of as a market imperfection.
3. Learn the different private and public mechanisms, or interventions, that intend to induce ethical behavior in society.

One of the unique features of this textbook is the inclusion of ethics in the description of the economic system. For the past half century and more, explicit discussion of the importance of ethical behavior in introductory, as well as more advanced, economics courses was minimal at best and in the extreme, considered almost sacrilegious. As mentioned earlier, one key reason for its absence is the desire among economists to present a positive, and therefore scientific, evaluation of the economic system rather than making value judgements about how an economy ought to function. Since ethics involves statements about how humans ought to behave, it would seem to contradict the goal of presenting a purely positive theory.

However, as demonstrated in this course, ethics cannot rightfully be ignored because assumptions about market participants' ethical behavior is already built into the economic models. There are many critics of economics who have emphasized that its key behavioral assumption, namely that consumers seek to maximize utility and firms to maximize profit, is a value statement in itself which implies that ethics is already in the standard neoclassical model. This claim is certainly valid, but the role of ethics is much deeper than this.

What is shown in this course is that when particular ethical rules are followed by market participants, it contributes to the standard efficiency outcomes displayed in economics models. However, if these ethical principles are violated, it is shown that the standard economic outcomes are no longer guaranteed. Put another way and more generally, if market participants behave ethically, then markets can achieve economically efficient outcomes, but if participants behave unethically, then market efficiency is undermined. Put still another way using economic terminology, the absence of ethical behavior, as described below, represents an additional set of market imperfections that can be corrected for using government intervention.

What follows is a list of the ethical principles covered in this course and a brief description of the ways in which each behavioral principle contributes to the achievement of economically efficient outcomes. In addition, we explain briefly how both private and public mechanisms contribute to induce the ethical behavior of participants in society.

a) Do Not Steal

This result was shown first in Chapter 4 in the context of the pure exchange model using an Edgeworth box. The standard model assumes that participants will bring their products to the market and trade mutually voluntarily to acquire surplus value, that is, greater happiness for both. But if a participant were overly eager to maximize their own utility and if they could exercise power, or force, or the threat of such action against another, then they could leave the market with more of everything without having to give up anything of one's own. The possibility of theft was considered as an alternative to trade by Francis Edgeworth himself back in the 19th century, but somehow explicit mention of this was dropped in later iterations of the economic model.

The implication is that theft, the violation of the ethical principle "thou shalt not steal," would not only eliminate the mutual benefits arising from trade, it would also serve to discourage

active future participation in markets. If a merchant cannot trust that the market will consist of other willing traders, or if a merchant cannot transport their product safely to the market, perhaps fearful of encountering bandits along the way, then the merchant will stop participating and retreat back into self-sufficiency.

As shown in Chapter 5, a retreat to self-sufficiency would mean that the economy is not specializing in its comparative advantage goods and is forgoing the productive efficiency effects that are possible via specialization and trade.

If instead, we explicitly incorporate an assumption that market participants will abide by the ethical principle against theft, then we can assure the outcome of mutually beneficial trade and achieve the economic efficiency effect that arises from specialization and trade.

Of course, most economics texts have argued that enforcement of property rights is an important feature in an economic system and this is largely equivalent to an assumption against theft. However, because of the way this is typically presented, readers will usually take this to mean a system of recording and transferring property titles together with contracts establishing the rights of owners of corporate entities, stocks, and other financial assets. While this interpretation is true and is important for the operation of the economic system, hidden in the statement of property rights enforcement is the presumption that others are assumed not to engage in outright theft. In other words, the establishment of property rights by the government represents a method to assure that your property is yours to use or trade as you choose and therefore that others are not allowed to steal it away for their own use.

b) Do Not Lie

It was also demonstrated in Chapter 5 in the model of pure exchange that traders have perfect information about the products they are trading. This assumption is necessary to rule out the possibility that individuals receive a product in trade that was not expected, and to eliminate the possibility that the other party does not live up to their side of the deal to complete the trade. There is another way of describing this situation, though, which also highlights its ethical nature.

If traders do not have perfect information about the trades they are engaging in, or cannot trust the people they are trading with, then it is possible for some traders to deceive others. For example, I might tell you my apples are fresh and sweet, engage in trade, only for you to discover later that the apples were rotten at their core. Alternatively, I might lend you $1000 with the expectation that you will pay me back in 11 monthly $100 installments, only to discover that you have disappeared afterwards and had no intention of repaying the principle or interest. The deceiver in these cases comes out way ahead relative to mutually voluntary trade and so if we stick with the principle of pursuing one's self-interest, then self-interest would be maximized by becoming a deceiver. However, if the market is rife with deceivers, we should expect a similar outcome to a market rife with thieves, namely merchants will stay away and withdraw into self-sufficiency thereby eliminating the potential gains that arise from specialization and trade.

A better way to describe the assumption of perfect information then, is to assume instead that traders will not lie about their products or their intentions. If a person informs us about the qualities of their products for sale, then we trust them to be telling the truth and base our decisions on that information. If a person promises to pay back borrowed monies, then we trust that the repayment will be made. In other words, we assume that traders will be honest and true, or that they will not tell a lie. If so, then we can be assured that the conclusions of the

model, namely the efficiency improvements that come from specialization and trade, will indeed occur.

We could now ask whether it makes sense to assume that market participants in today's real world economies behave honestly. Do they refrain from theft and engage with each other without fraud or deception? The answer varies but it is probably accurate to say that honesty is pervasive but not 100% and there is a fair amount of variation across communities and countries. If we inquire why people behave honestly rather than reverting to their self-serving instincts, there are several answers worth considering.

First, we must look to institutions. There are a number of mechanisms that have arisen whose purpose is to inspire people to behave with honesty and integrity. Most of these institutions achieve ethical outcomes by imposing substantial costs on those who behave unethically. Also, it is useful to differentiate these institutions between private and public mechanisms.

The most important private mechanism to encourage ethical behavior is organized religion. All major religions encourage their followers to be kind to each other, to not murder, rape, or lie, and to engage in honorable and honest behavior. The cost of unethical behavior to believers is disfavor with one's God and potentially eternal damnation for one's soul. Such high costs are surely enough to convince many believers that the cost-benefit calculation tilts in favor of morality. Thus, to the extent that religions induce their followers to behave ethically, market interactions, and the benefits that derive from them, become more likely to occur.

There are also strong community and cultural encouragements to ethical behavior transmitted via numerous media outlets such as literature, movies and music. Many of these arise from artists who seek to transmit their own religious beliefs in their works of art. There are numerous examples one can consider but several examples in of ethics in movies can be found at my Ethics in the Movies webpage.

Other private mechanisms to protect against the impacts of unethical behavior include the hiding of stored goods and the use of locks and safes, the building of fences and walls around farms and cities, the use of dogs to provide sentry and early warning systems around property, and the buildup of defensive weapons, at least as powerful as the ones the thieves have, to raise the costs to those who would rape, pillage and plunder to satisfy their self-interests. Public institutions may become necessary when the costs of providing private protections become too burdensome and economies of scale can be utilized. As discussed in Chapter 22, government can provide public goods that use taxpayer money to fund local law enforcement and police protections, a national defense and security against external threats, and a criminal justice system to prosecute those would violate the law and engage in dishonest behavior.

This means that both public and private institutions exist whose, at least partial, purpose is to discourage unethical behavior with the threat of punishment. As a side-note, these institutions were not separate, historically, when rulers were considered gods themselves and so this separation between private and public interventions is a more modern feature. Nevertheless, despite the presence of numerous institutions designed to prevent unethical behavior, such behavior still persists to varying degrees, perhaps slightly because the economics discipline has avoided discussion of it. However, once ethical behavior is recognized as necessary in promoting economic efficiency, we can conclude that the more a community of people behave ethically, either because they believe it to be morally right or because they are induced to behave this way to avoid punishments, then markets are more likely to grow and extend as are the benefits that arise from specialization and trade.

A second reason why people may choose to behave honestly rather than reverting solely to self-serving instincts may be due to evolution. This idea is merely speculative but it could be that as human society transformed itself from small groups of hunter-gatherers to large stationary agrarian communities during the early stages of the neolithic age, the benefits that accrue to communities of honest cooperators may have been sufficiently high to inspire an aversion to marriages with known thieves and cheats. Over many generations this could lead to the growth in the number of honest cooperators in a community and the steady decline of dishonest thieves. Note also that this trend would be reinforced with the growth of organized religions who still today often promote intra-faith marriages. Perhaps only when the proportion of honest cooperators is sufficiently high then, will a society take off towards exponential economic growth as was seen after the 18th century.[1]

We should also point out that the presence of unethical individuals, who are inclined to commit violence and issue threats in order to steal and deceive others, represents another type of market imperfection because this behavior is not consistent with the assumptions of perfect competition. This is the main reason that there is a possible role for government to intervene in the market, correct for the imperfection, and generate an outcome that is superior to a free market, laissez-faire approach.

Many free market, right-leaning economists such as Milton Friedman recognized and understood this condition. When Friedman argued that the only social responsibility of firms is to increase their profit on behalf of shareholders, he finished the statement with a condition, namely, as long as these businesses “engage in free and fair competition without deception or fraud.” Although he didn’t mention theft explicitly, he clearly emphasized the importance of a system of property rights in his other writings and would surely agree that business pursuit of profit via theft is also excluded. Indeed, because Friedman recognized the role of government to correct for these problems, as well as several others to be discussed below, he was amenable to some government involvement in the economic system, but he also felt that government’s role should be as minimal as possible.

In contrast, Joseph Stiglitz’s comment that no one agrees that the greed of bankers was good and yet many economic departments taught that it was, is also recognizing that unethical behavior represents a market imperfection that can be corrected for by government. However, Stiglitz, as a left-leaning economist, is open to much more government intervention, well beyond the minimal level that Friedman was comfortable with.

c) Engage in open and free competition

This is one principle, derived from economics, that probably has the least support in the philosophical literature. For example, there is no explicit guidance such as this provided by any of the world religions. Written in a negative form, it might say do not prevent, or hinder, others from freely engaging in the trade of products in competition with yours. This principle is about enabling the freedom for businesses to compete in the marketplace.

However, in practice this dictum is rarely followed as demonstrated in Chapter 16. Instead, businesses use a multitude of schemes and techniques to respond to increases in competition within their markets. These range from beneficial responses that do not impede freedoms, like improvements in product quality and process innovations on one end of the spectrum, to

[1] See especially McCloskey, D. N. Bourgeois dignity: Why economics can't explain the modern world, University of Chicago Press, 2010.

diabolical responses, in the form of purposeful dissemination of misinformation about competitors, or, threats of violence to prevent competitor entry (e.g. consider the behavior of mafias) that clearly do impede freedoms.

In between these extremes, there are somewhat innocuous responses such as product differentiation, as well as more overt and damaging impediments such as the protection of trade secrets, intellectual property provisions, professional licensing requirements and non-compete clauses. Also included are techniques to solidify a firm's monopoly position using mergers and acquisitions of competitors and price fixing agreements. In fact, there are so many mechanisms that are used to prevent free entry of new competitors into industries that it is a wonder that highly competitive markets can prevail anywhere.

For many, the prevalence of these types of business behaviors intending to secure greater monopoly profit is their definition of market competition. Under this view, market competition is seen in Darwinian terms and the winners are those who are the fittest of the bunch. A survival of the fittest business mentality matched with an unfettered pursuit of self-interest is surely consistent with many real-world business behaviors in which large oligopolistic firms dominate a market. However, this is not the description of perfect competition as envisioned in economic models or espoused, for example, by the likes of Milton Friedman. Rather, free and fair competition means a market devoid of all of this antagonistic behavior and in which information about best practices flows freely to all who can use it.

Recognizing that different people define competition differently is key to understanding many of the misunderstandings that persist. Many observers who are appalled by Friedman's proclamation that the SOLE purpose of a business should be the maximization of profit, quite likely interpret this to mean that firms can employ any technique they choose, including any legal means of monopolization, to secure benefits for its shareholders. As previously mentioned this was not Friedman's definition. Once again those who agree and those who disagree with Friedman are thinking about the issue in two distinct ways such that both positions can actually be correct simultaneously, much like the invisible hand controversy.

The response to the problem of monopolization varies between the right and the left based largely on one's faith in government to implement effective policies. Joseph Stiglitz, on the left, believes that strong antitrust regulation, as was first implemented in the US in the late 1800s, is a necessary tool to prevent businesses from creating monopolies in certain industries. More recently, he has favored increased enforcement in light of growing US industry concentration.[2]

Although Friedman was not opposed to government policy to correct for market imperfections in general, he thought that antitrust laws were more likely to be counterproductive. He believed that monopolies have great difficulty forming and being maintained and that free market forces of new entrant firms seeking higher profits would be sufficient to prevent undue monopolization. Note that the disagreement between right and left-leaning economists is based less on disagreement over basic principles and more on the effectiveness of government to implement the corrective policies.

d) Share ideas and information about consumption possibilities and production techniques. Teaching is a virtue, not a vice.

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[2] See Philippon, Thomas. "The great reversal: How America Gave up on Free Markets." Harvard University Press, 2019.

This ethical principle derives from the assumption that firms and consumers have perfect information in a perfectly competitive economy. Perfect information for consumers means that consumers know their own preferences and cannot be deceived into trades that are ultimately welfare reducing. This was discussed briefly above in the context of pure exchange. Perfect information in the context of production though, means that each firm knows all possible production techniques and can identify which is lowest in cost.

When we introduced production in perfect competition in Chapter 12, we noted that all firms producing in a perfectly competitive market have the same U-shaped cost functions. This implies that they share the technological knowledge to achieve the lowest cost at every output level they may wish to produce at. If we go one step back though, we might ask how all of these firms came to acquire the best information? The answer must involve transparency and/or sharing of information.

For example, suppose one firm develops a new production technique that will lower the average unit-cost of production. Perfect information means that other firms immediately observe the new production technique (transparency), or, the innovating firm shares the information by teaching the technique to other producers. If you are now thinking that this doesn't seem to happen very much in the real world, you are right.

Instead, the natural inclination for profit seeking firms is to hold on to innovative ideas as a trade secret or to acquire intellectual property rights (IPR) from government, both of which are allowable by law. This will prevent other competitor firms from acquiring the new ideas at least for 20 years in the case of a patent, and indefinitely in the case of a closely held secret. We showed in Chapter 16 that firms have a profit incentive to withhold useful information from others and use a variety of mechanisms including non-disclosure agreements, non-compete agreements, internal controls on access to information and intellectual property protections from government. Profits obtained in this way can also enable a firm to acquire other firms and enhance their longer-term monopoly position.

There is a justification for inhibiting the free flow of ideas with IPR, namely that doing so will stimulate innovation. Businesses will frequently point out that acquiring new ideas is very expensive and thus successful pursuit will only occur if there is a sufficiently large prize at the end, in the form of monopoly profits. IPR has been a part of US law since its inception in 1790 while more recently the extension of these rights internationally has been a prime policy discussion. Thus, one might think that IPR must be widely accepted as a necessary feature of a free market economy. However, there are many critics of IPR too. Indeed, recent empirical studies in economics suggest that the innovation stimulus effect may be much weaker than is commonly suggested.[3] If this is true, then IPR protections might be encouraging innovation only weakly while simultaneously encouraging monopoly profit quite strongly.

Once again, based on definitions applied by many who are left-leaning, firms using their capacities to increase their monopoly profit is the very essence of competitive behavior. However, this is not the definition of competition that is applied in the standard economic model. Instead, protection of IPR to obtain monopoly profits is anti-competitive because it does not conform to the assumptions in the static model of perfect competition. That means that a left-leaning person who says she is against market competition (applying the left-leaning definition) might be in total agreement with the right-leaning person who says he's in favor of

[3] See for example, Boldrin, Michele, and David K. Levine. "The case against patents." Journal of Economic Perspectives 27.1 (2013): 3-22.

market competition (applying the right-leaning definition). Both positions are in agreement that monopoly profit is bad for the economy.

With this issue, we also begin to open a pandora's box of potential problems with government. Proponents of government argue correctly that government policies can be used to correct the negative effects caused by market imperfections. It's true, they can. However, government intervention can also be used to solidify and promote market imperfections to the benefit of certain groups in the economy. In this case, firms use government policies (e.g., IPR) to prevent the flow of perfect information and thereby potentially enhance the market imperfections in the economy. More on this issue follows below.

e) Be benevolent towards one's neighbors

Benevolence is clearly a virtue that is much espoused. It can take many forms including charity to others in need, empathy for the well-being of others, or actions intended to prevent harm to others. Benevolence in the form of charity is not considered much in this textbook, largely because it has not been shown as necessary to generate economic efficiency. Nowhere in the economics models is it shown that charity is necessary to achieve economic efficiency.

This is a valid criticism of economics because the models typically studied do not guarantee that overall market utility will be maximized in a perfectly competitive equilibrium. Instead, the realization of maximum efficiency only means that a pareto optimal outcome is reached and that the mutual benefits from exchange are exhausted. After a pareto optimum is reached, it is conceivable that some may be much wealthier than others, in which case it is also conceivable that a redistribution from richer to poorer could potentially raise total market welfare. The primary reason redistribution could be favorable is the assumption of diminishing marginal utility. When applied to income, it means that a dollar taken away from a richer person would be worth less to him than the next dollar received by a poorer person. This argument can certainly justify charity and is not incompatible with the market outcome as long as charity occurs after the realization of the market equilibrium. In other words, there is nothing in the economic models to suggest that richer individuals should not freely choose to be charitable if they are so inclined. Benevolence in this form is acceptable, even laudable, but not absolutely necessary. There is a lot more one can say on this topic and indeed there is a vast literature, but instead we'll focus on a different application of benevolence.

There is a situation in our models of the economic system where benevolence is important to secure economic efficiency and that is the case of externalities. As with the principles of theft and deception, it is easiest to see the importance of this principle by imagining what would happen if this trait did not exist in people. Consider the case of industrial pollution. Firms that emit dangerous effluents into rivers and oceans or hazardous smoke into the air create negative impacts on others in the local community. In the early stages of industrialization, firms demonstrated very little empathy for the communities they affected because they could make much more profit by ignoring these impacts. If early industry leaders had had feelings of benevolence towards others around them, they may have been induced by community complaints to work towards compromise solutions.

In Chapter 25, we introduced the Coase theorem which argues that externality problems could be resolved via bargaining between the affected parties. While the dual problems of inadequate allocation of property rights and transactions costs make the Coase solution difficult to obtain in practice, we would not even get affected parties to the bargaining table if there was no sense of empathy among the participants. Not only must polluters be willing to give up some profit to

reduce the harm to the local community, but the community must be willing to accept a modest level of pollution in order to achieve the economically efficient solution. A willingness to compromise in the face of a shared struggle is a clear example of benevolent behavior.

Another example arises in the case of common resources as discussed in Chapter 23. Elinor Ostrom's Nobel prize winning research, highlighting the conditions needed for communities to independently resolve 'tragedy of the commons' problems, relies on the fact that community members have a sense of empathy towards each other. If individuals had no sense of benevolence, they would never agree to adjust their behavior to achieve an economically efficient outcome.

We also showed in those Chapters that firms or community members who refuse to be empathetic can be forced to change their behavior using government policies. This would mean we could achieve economically efficient outcomes even for the firms or community members who were not benevolent. However, in this scenario we would still need to assume there is a sense of empathy and benevolence on the part of the government policymakers. If government officials were solely interested in their own self-interest, it is difficult to imagine government programs doing anything more than filling the pockets of the officials themselves.

Finally, if we did not all have a sense of empathy and benevolence, I would not even be able to argue, as I did in Section 26.1 above, that the goal of economics is to improve human happiness. In a world with no empathy, the goal of economics would become to identify the system that is best for myself alone. And if everyone were so inclined, we would surely imagine the world as a horrible dog-eat-dog dystopia in which human lives were, as Thomas Hobbes put it, "solitary, poor, nasty, brutish and short."

Thus, feelings of empathy and benevolence are much more important than one might initially imagine. So much so, that it might make sense to begin an economics course with this as its first foundational assumption, namely that at least some humans are empathetic and benevolent. Although this idea is rarely if ever discussed in a modern economics class, it was not unknown to the founder of modern economics, Adam Smith. Before he published his more famous economics treatise, the Wealth of Nations, he published his less famous treatise, the Theory of Moral Sentiments, in which he explored the very nature and characteristics of human empathy towards others. That means that the first economist, did begin with the assumption of human empathy and benevolence.

f) Be loyal, courageous and respect authority

These two sentiments become necessary in several related economic situations when large groups of people must be organized to fulfill a common purpose. The cases I refer to are the operation of a large firm and the operation of a military.

Consider the military first. In Chapter 22 we introduced the concept of public goods. Free markets have difficulty supplying the optimal level of public goods because they have the features of non-rivalry and non-excludability. For this reason, public provision of these goods, such as a government funded military for national defense, can secure the optimal level of economic efficiency. However, it takes much more than simply spending money to establish an effective military. The beliefs and attitudes of the military personnel themselves matters as well. Most important are sentiments in which the hierarchical organization of decisionmakers is accepted so that directives from superior officers are followed by the personnel below them. Again, consider what would happen if military personnel were instead motivated by self-interest

alone. Military operations would likely become chaotic and disorganized as different individuals choose actions for themselves what they believed to be best. Commands from some would be ignored by others and there could be no leader of such a group.

However, if a military unit is comprised of individuals who accept the nature of the hierarchical order and follow commands from above, then the leaders can inspire coordinated activities that will be more successful in repelling the enemy forces. When a military unit confronts its enemy, individuals must be willing to put themselves into mortal danger to achieve the objectives of its unit. That means the sentiment of courage is extremely important. Without the sentiments of respect for authority and courage, military units will not be as effective in satisfying its goal of national defense.

Loyalty is a term that captures the devotion of an individual to the needs and desires of another and a willingness to be courageous in the face of danger. If someone is loyal to their military unit, they will do whatever is necessary to fulfill its needs including devotion to the authorities. If we ascribe one's loyalty to the country that the military supports, then we refer to this sentiment as patriotism.

In simpler terms, if soldiers are patriotic or loyal, respect the designated authorities, and are courageous in battle, then the military will be much more effective than if individuals did not have these sentiments. In this way, these ethical beliefs contribute to the provision of the public good, national defense.

Loyalty and respect for authority also plays an important role in the operations of businesses and any large organization, even government. Corporations, for example, are not democratic institutions in which all employees have an equal voice. Instead, they are organized as hierarchies and the expectation is that employees will follow the commands of their superiors. Patriotism and courage, on the other hand, play a much smaller, to non-existent, role in most private organizations. Nevertheless, as stated above, if employees are loyal and respect the designated authorities in businesses, then the business will be much more effective than if the employees did not have these sentiments. In this way, these ethical beliefs contribute to the efficient functioning of businesses.

However, it is important to mention that these same ethical principles of loyalty, courage and respect for authority can be appropriated by unethical individuals to achieve inefficient outcomes. The classic examples are the patriotism and courage applied in hostile military actions intended to pillage and plunder one's neighbors, and the individual loyalty devoted to the operation of an unethically oriented business or government organization. These ethical principles should therefore be viewed as conditional on the ethical behavior of the leaders to which one devotes one's loyalties.

Summary on Ethics

In summary, this section has highlighted that ethical behavior in a variety of ways is critically important in facilitating the smooth efficient operation of the economic system. If individuals were truly unfettered self-interest maximizers, then all, or most people, would be liars and thieves, they would be unwilling to share useful information with others, they would be malevolent towards each other or indifferent to the well-being of others, and they would display no loyalty to their friends or families and would not be courageous in the face of adversity and in support of their community. Under these circumstances, market exchange would become virtually impossible to engage in. Specialization in comparative advantage goods would never

occur and people would be forced back into total self-sufficiency. The advancement of new ideas could have no benefit and people would be forced into isolation and fear. The world would be a dreary place indeed.

Now I think that virtually all economists believe that each of these ethical principles are important to some degree. And yet to a young person first learning economics from traditional textbooks, they would not hear very much, if anything, about any of these principles. They would hear that individuals should pursue their self-interest, but they'll be given very little information about how that **self-interest must be constrained by ethics to assure** the **efficient economic outcomes** that are later presented. Thus, to the extent that the economics discipline continues with its promotion of self-interest maximization without discussion of ethical constraints, it's not surprising if outside observers look at economics as irrelevant and even dangerous. A change in the approach, one that is accepting of the broader philosophical underpinnings that were a part of the development of the economics discipline is needed so the discipline can advance. That is what is being offered in this textbook.

Key Takeaways

1. The ethical principles needed to assure economically efficient outcomes are,
    a. Do not Steal
    b. Do not Lie
    c. Engage in open and free competition
    d. Share ideas and information about consumption possibilities and production techniques. Teaching is a virtue, not a vice.
    e. Be benevolent towards one's neighbors
    f. Be loyal, courageous and respect authority
2. Unethical behavior can be considered a type of market imperfection because violation of these ethical principles leads to inefficient market outcomes.
3. Religion is the primary private mechanism, or institution, that facilitates ethical behavior
4. Government institutions are the primary public mechanism, or institution, that facilitates ethical behavior.

26.6 Monopoly Capitalism

Learning Objectives

1. Learn how the political process interferes with the ability of democratic governments to implement efficient economic policies
2. Learn how the potential for government failure represents a valid concern for government intervention in an economy.

The ideological right has long been an opponent of big government and especially against government beyond some minimal level. As discussed above, there is some support for this position if an economy fulfills the strict assumptions of perfect competition. However, this is an extremely weak argument since it is abundantly clear that market imperfections are the norm rather than the exception in all economies around the world. This means that the theoretical support for government interventions designed to correct the inefficiencies caused by market imperfections is quite a bit stronger than the case for limited government.

However, the case for effective government intervention rests on another hidden assumption not often highlighted; namely that government will choose to implement those policies that correct for the market imperfections. This would certainly occur under the assumption of a government that takes policy advice from a group of economists who use the most advanced empirical techniques available to identify the optimal policies. Sometimes economists have referred to this situation as assuming a benevolent dictator. Unfortunately, for economists and others, this scenario does not match reality. Instead, in many countries, democratic governments elect representatives to a legislature, who then make decisions based on inputs from their concerned constituents who will invariably have conflicting interests. Some countries do have dictators, or autocrats, but only rarely would they be considered benevolent. Below we'll focus on the process in democratic societies only.

We can see the inherent problem by noting the welfare effects of government policies shown in Chapters 17-21. In every case in which the government implements a policy change, some market participants benefit while others lose. That means that if the government proposes a tax, or subsidy, or price control, or import tariff, etc., someone will surely be harmed by that policy change and someone else will surely benefit. Therefore, whenever legislators seek inputs about any policy change, presumably some constituents will favor the change and others will oppose it. If democracy works as intended, a legislator will support a policy only if the majority of his or her constituents support it.

In Chapter 21 we introduced **the logic of collective action**, an idea popularized by the economist Mancur Olsen in a 1965 book of the same name. Olsen argued that small groups can more easily succeed in collective action efforts compared to large groups because they can solve the free-rider problem and thereby leverage greater resources to effectuate political change. When this idea is coupled with the nature of the income redistributions that arise from government policy changes, we get one of the strongest cases to be made against the use of government policy in democratic countries.

For example, consider a policy change such as the implementation of a price support on butter, as analyzed in Chapter 21. This policy will benefit domestic butter producers but will harm both domestic consumers of butter and the taxpayers who have to finance the surplus butter purchases. The net effect was shown to be negative, meaning that the total losses to consumers and taxpayers is larger than the benefits that accrue to the butter producers. If market participant voices were heard in proportion to the extent of the losses and gains, legislators would not vote to implement price supports. However, largely because of the logic of collective action, constituent voices are unlikely to be heard in proportion to the economic gains and losses.

In the case of the butter price support, the gains to the butter producers will be concentrated in the hands of a smallish number of butter firms. The concentrated benefit to a small producing group enables that group to lobby effectively in support of the policy. In contrast, the consumer and taxpayer groups are very large in size such that the per-individual losses from the price support will likely be too small to even be noticed. When losses accrue to a very large group it is very difficult to organize politically and so legislators are unlikely to hear much opposition to the policy even though the total negative effects are larger.

This means that a representative democratic political system is more likely to choose the economically inefficient policy because of the collective action problem. The small groups that are politically influential are most often business groups who strive for policies that increase their ability to obtain monopoly profit. Indeed, the top lobbying groups in the US include the

pharmaceutical industry, defense firms, business advocacy groups, technology firms and internet companies. Presumably, these business advocacy expenditures, which amounted to almost $3 billion in 2022, would not be made if they were ineffective in securing policies favoring the companies. In contrast, there is very little lobbying expenditures made on behalf of consumers and taxpayers.

Referring back to Chapter 16, which highlighted the many ways in which firms stave off competition, we learned that there are numerous examples of government policies that do not serve the national interests, but rather the special interests of large corporations. Businesses use government to acquire price supports, price ceilings and floors, import tariffs, intellectual property rights, occupation licensing requirements, energy subsidies, and many more interventions that usually serve the immediate interests of business rather than promoting economic efficiency and a greater good.

Monopoly capitalism is the term often used to describe a market riddled with these kinds of government interventions serving to increase the monopoly power of large dominant firms. Because the main beneficiaries of these policies are often an elite group of business owners with close connections to the ruling class, the system is also referred to as crony capitalism.

Government Imperfections vs Market Imperfections

The problem with monopoly capitalism, or crony capitalism, is that it is a situation in which wealthy special interest groups use lobbying and campaign contributions as a mechanism to control democratic processes. Because this influence gives greater voice to the wealthy few and diminishes the voices of the middle and lower-income groups, we can characterize this as government failure. Democratic government fails when representative government tilts outcomes in favor of an elite and away from the ideal of the "one person – one vote" notion of democratic equality.

Recall that in Chapter 22 we introduced the concept of market imperfections as any deviation away from the standard assumptions of perfect competition. These imperfections can include any phenomenon, like the presence of a monopoly firm, that would prevent the market from obtaining its ideal outcome. We noted that some refer to these situations as market failures and in the subsequent chapters, highlighted numerous such realistic failures. That means we can now characterize these as the two key problems societies have to deal with, namely, how to overcome both market failures and government failures. As an alternative interpretation, we could simply fold-in the government failure of monopoly capitalism into the case of market failure in the standard economic model if we also assume that perfect competition requires a benevolent dictator.

When the benevolent dictator doesn't exist, and it never does in reality, then we can no longer assume that the most efficient policy will be implemented by government. One general principle about market imperfections is that in the presence of one, a government policy can be devised to correct for the market imperfection and thereby raise economic efficiency. However, in the case of a government imperfection, the only government fix would be some mechanism to prevent the effectiveness of the lobbying process and its influence in political campaigns.

There are many examples of legislative attempts to correct for this type of government failure. One such example is the many US campaign financing laws enacted in the late 1900s culminating in the McCain-Feingold Act of 2002. These laws aimed to restrict monied special-interest groups from having undue influence in the political process. However, to solve one

problem, these laws may infringe upon other inviolable rights of citizens, most notably free speech. For example, in 2010, the US Supreme Court ruled on the Citizen's United case and struck down the McCain-Feingold act citing violations of the first amendment rights to free speech. Opinions are wide and varied about this case and I have no intention to argue who is right. Instead, I raise it only as an example of attempts designed to rein in the power of special interest groups in the political process and the problems that arise when such attempts are made.

This issue also turns the table on left-leaning policy advocates who support government intervention to induce favorable outcomes in an economy. While the proposition that government CAN improve economic efficiency with appropriate policies remains true, whether an optimally designed policy will survive the political process intact is more dubious. This democratic legislative process is sometimes referred to as a political meat grinder, because the sausage (legislation) that is produced at the end, doesn't look anything like the inputs (policy proposals) that were put in at the beginning. The broader implication is that well-designed and well-meaning policy proposals that would correct appropriately for market imperfections may emerge from the political decision process instead as a set of policies that further increase the monopoly power of large businesses rather than improving economic efficiency.

The problem of monopoly capitalism is even more likely in authoritarian regimes. In these cases, the autocrat can use government policy to create industry sectors with monopoly profit and allocate control over these sectors to family, friends and other political supporters. These monied special interests may then emerge as the permanent ruling authorities as power transitions over time between members of this elite oligarchic class.

It is worth pointing out that democracy arose largely to take power away from the ruling autocratic elites who generally establish government monopoly controls to secure their own fortunes to the detriment of their impoverished subjects. But while democracy is a step in the direction of greater prosperity for a greater number of people, the logic of collective action demonstrates that democratic institutions alone are insufficient to solve these inherent problems.

Right leaning groups opposed to government intervention rely on this issue as a major pillar supporting their reluctance to turn to government to solve economic problems. However, there is one additional aspect of government that adds an additional pillar of support for the right, namely government administrative inefficiency.

Key Takeaways

1. The logic of collective action merged with the results of economic redistributions that occur from government policies, suggest a strong tendency for democracies to choose policies that favor business interests, over the general national interest synonymous with economic efficiency.
2. Monopoly capitalism, or crony capitalism, refers to a system in which businesses are able to secure significant monopoly privileges via government policy.
3. A strong right-leaning argument in opposition to government control over economic outcomes is the government failures associated with the collective actions problem.
4. Autocratic regimes are more likely to suffer from the problems of monopoly capitalism because monopoly profit can be the source of government power as seem in oligarchies around the world.

26.7 Government Inefficiency

Learning Objectives

1. Learn how the lack of competitive incentives in government can contribute to waste, fraud and abuse of taxpayer money.
2. Learn how government inefficiency can be used as a rationale for less government.

Government agencies operate very differently from private firms in a marketplace. When firms operate in a competitive market, they must consistently maintain their product quality and keep costs to a minimum. If they don't succeed in this endeavor, consumers will switch to purchase products from other firms. This is a difficult process to manage effectively and it means that a firm is in constant jeopardy of extinction. It is why many businesses, more often newer ones, fail every year in competitive environments. It is also one reason firms strive to obtain monopoly privileges.

Government agencies that provide government services, in contrast, rarely face the possibility of extinction. In most cases, government agencies use tax revenues to finance the provision of public goods and services. In years in which tax revenues fall, government can run larger budget deficits and borrow money to maintain agency funding. In addition, most governments plan subsequent year spending by increasing the previous year's budget by some agreed percentage. In this way, agency "revenue" is more consistent year after year than in the private sector.

Which public goods to provide, and at what level and quality, are the decisions public legislators and officials must make. Their objective is not to maximize profit, but instead to provide the optimal level of the public good, if they are adhering to the benevolent dictator assumption made in economics models. However, if government decisions are tilted in the direction of the special interests of lobbying groups, then the objective may be a more complex mixture of public good objectives mixed with private side-benefits to the lobbyists.

Usually, a legislature will approve a fixed amount of money in the annual budget that can be used during the year to provide for the provision of various types of public goods such as national defense, social security, parks and recreation, roads and bridges, etc. When government works well, the money will be spent in the best possible way to achieve to goals of the legislature and the citizens of the country. Historically however, there are numerous instances in which the money is not spent wisely. At one extreme, corruption occurs when the leaders in government appoint their own family members, friends, and political supporters to control various agencies. These political insiders sometimes spend their budgets enriching themselves and their associates rather than providing the designated services. Problems with nepotism in government have been rampant historically in most countries. If citizens complain that services are not being provided, leaders may use this as an excuse to allocate even more money to solve the problems and the cycle of corruption may continue.

Even when officials are not corrupt, government agencies have little incentive to reduce costs like private firms have. In fact, most agency leaders know that the only way to assure a larger budget next year is to spend all of this year's budget allocation. There are few incentives in

government to cut service costs and pass those benefits back to citizens in the form of lower taxes. Thus, waste of taxpayer money is prominent even in well-run government agencies.

In many governments around the world, employees often have implicit job guarantees. Many parents encourage their children to acquire government jobs because, once obtained, employees are almost assured of employment for their entire careers. In most governments, it is often very difficult to fire employees. This guarantee is also a perk that may result in lower pay in exchange for job security. In addition, low pay, relative to the private sector, is often made up for with very generous benefits packages and pension plans which guarantee income payments after retirement. An important consequence of these job guarantees and extra benefits is that it often disincentivizes government workers from working hard.

Of course, it is worth pointing out that problems with government incentives and government waste are not new. As an example, the US Federal government has put into place countless processes to try to overcome these problems including even the establishment of whole agencies like the Government Accountability Office and the Inspectors General Office, to name just two. In every agency, there are branches charged with the task of auditing and investigating waste, fraud and abuse and in the establishment of procedures to improve efficiency. Government reform historically has also involved measures to professionalize the provision of government services. For example, nepotism can be reduced if government agencies have strict job requirements that insist an employee have the educational background and experience needed for that agency's tasks.

Nevertheless, the impression that inefficiencies, waste, fraud and abuse are widespread in all levels of government remain valid although it certainly varies over time and from country to country and state to state. The problem is surely worse in autocratic governments because voters have no power to replace a corrupt government. But as discussed in the previous section, the problem persists even in democracies. Indeed, the journalist Ronald Kessler once remarked that, "incredibly, whenever I have proposed the theory that half of government workers could be cut, current and former federal employees I know have all agreed." It is these sentiments about the wastefulness of government that also inspired US President Ronald Reagan to say, "government isn't the solution to our problems, government IS the problem."

The presence of government inefficiencies, then, represents another reason many right-leaning individuals continue to oppose the expansion of government policies intended to oversee a greater share of the economy and society. Going back to our basic economic principles, while there is theoretical support for the idea that government can intervene with regulatory policies to correct for market imperfections, those interventions are less likely to be successful if there are rampant inefficiencies, with waste fraud and abuse in the administration of these policies.

Key Takeaways

1. The lack of competition, the near guarantees of lifetime employment, and the generous benefit packages and pensions tends to reduce work efficiency in government agencies compared to the private sector.
2. Strong tendencies towards nepotism, either towards family and friends or towards the politically influential, remain a problem in all governments today, despite many attempts to reduce these effects.
3. Concern about government waste, fraud and abuse provide an additional rationale used by right-leaning groups to oppose expansion of government.

26.8 Inequality and Discrimination

Learning Objectives

1. Learn how the ethical principles highlighted in this course relate to the realization of economic inequalities and discriminatory practices.
2. Learn the two fundamental methods to resolve problems related to economic inequality and discrimination.

For many people, a discussion about ethics in economics usually inspires questions about the large inequalities in wealth and income that exist between different groups of people and the discriminatory behavior that often limits the opportunities of some people within the economy. Indeed, many books about ethics in economics begin with a description of these inequities and then works to establish methods to reduce or eliminate the oftentimes glaring disparities that persist in our world.

This text has taken a different approach by focusing on the fundamental ethical principles that enable an economy to generate more efficient economic outcomes. While inequality and discriminatory practices have been a part of some discussions on these issues, these have not been the starting point of the discussion or the central focus. A key reason is because if the ethical principles highlighted above were followed by participants in the economy, then income and wealth would automatically become more equal and discriminatory practices would largely be avoided.

One problem facing many societies throughout history is that some individuals are able to use their power over others to acquire a larger share of the economic output for themselves. Power can be wielded firstly, by superior physical strength and a willingness to use it to acquire what one desires, and secondly by superior influence often because of filial ties or the ability to spend a large amount of money to affect the decisions of others in one's favor.

In the first instance, physical force enables some to steal and/or exploit others who are weaker. For example, a willingness to use physical force against others is at the root of slavery. It is a reason kings, noblemen and plantation owners lived much better lives than the people they ruled over. And it is the reason those on the losing side of these relationships felt a strong sense of injustice. Anyone who rightfully believes they deserve the output of their own labor, will feel exploited when that output is stolen away by invading armies, or by roving bandits to use Mancur Olson's description from Chapter 21. It is precisely this desire to protect one's belongings from theft that inspires the creation of institutions such as internally-oriented police forces and externally-oriented military defenses. Finally, it is the difficulty in providing for these collective efforts using purely private market mechanisms that inspired the discussion of public goods in Chapter 22 and the subsequent discussion of the benefits of loyalty, patriotism and a respect for authority.

Although the advent of democracy has eroded many of the mechanisms of theft via physical force, a more modern display of power arises in the use of high profits by corporations and individuals to lobby for favorable policies within democratic societies as discussed in Chapter 22. An effect of this lobbying is that policies favoring the monopoly privileges of firms often, though not always, results in increased ability of businesses to increase its profit at the expense

of consumers and taxpayers.

Regardless of how power is used in economic relationships though, it invariably leads to widening income and wealth disparities. This is especially true because the more powerful generally begin with greater economic advantages and the exercise of their power, whether physically or monetarily, only exacerbates the differences. As a thought exercise one can conceive of a world in which individuals with power felt a moral or ethical compunction not to use their power to steal or deceive others and refrained from activities that inhibited the free and open competition of products in private markets. Such a world would surely be much more equal in terms of both income and wealth, and differences in economic outcomes would depend more on differences in innate abilities together with some occasional good or bad luck. In other words, if people simply behaved ethically, there would surely be much less income and wealth inequality than there is today.

Furthermore, in the absence of strong religious values inspiring individuals to act ethically of their own accord, institutions have developed and could be strengthened further to induce ethical behavior on the part of most producers and households, which in turn would also contribute to the reduction in inequality.

Non-Discrimination

In the case of discrimination, the fundamental complaint is not discrimination per se, but the discrimination of people for reasons that are unrelated to the activity engaged in. For example, it is acceptable for a business or government agency to discriminate in comparing two individuals for employment on the basis of their skills and experience related to the job. It is not acceptable for employment to be based on a preference for a person of a particular race, gender, religion, ethnicity, sexual preference, age, political party, or one's personal connection to the employer. Individuals will reasonably feel an injustice has occurred when their own appropriate characteristics for a position are overlooked in favor of someone less qualified but who has one of the immaterial, yet favored, characteristics.

One would worry less about this phenomenon, though, the more competitive is an industry. In a competitive market, any firm that hires on the basis of irrelevant criteria, such as race, creed, or gender, will eventually produce less efficiently than firms that hire on the basis of relevant characteristics. Thus, discriminatory firms should make less money, be less successful and fail more frequently than firms that do not discriminate on the basis of inappropriate characteristics. Competition, then, is a force that not only induces market efficiency, it also discourages discrimination.

However, when monopoly power is present in an industry, or more generally, when market imperfections are present, discrimination can persist for very long periods of time and result in lost opportunities and lower income and wealth for many in the disfavored groups. For example, government agencies that have a monopoly in the provision of many government services may put friends and family members into authoritative positions even when those individuals have limited qualifications in their appointed area. The result would be inefficient provision of the agency services that may persist indefinitely because there is no recourse for service users to seek help elsewhere (i.e., no competition). Since government agencies do not earn revenues via sales in the market, but instead are funded out of government revenues appropriated from taxpayers, this type of discrimination and inefficiency can last indefinitely. Similar discriminations can be sustained in private industries that have market power and thus are not subject to the same incentives as businesses in competitive markets. So again, it is the

lack of competition in both government and businesses with monopoly power that enables discriminatory behavior.

Solutions to Inequality and Discrimination

There are two basic ways to solve problems related to the inequities of inequality and discrimination. The most commonly proposed approach is to use government to redistribute income to resolve the problem of inequality and to regulate the behavior of market participants in the case of discrimination. The less commonly proposed approach is to reduce or eliminate the market behaviors that sustain the unequal and discriminatory outcomes.

Progressive taxation, which means to tax wealthier individuals at higher rates than lower income individuals, represents one way to place a greater burden/responsibility to fund government on individuals who can better afford it. It is also a way for government to provide a small redistribution of income from wealthier households towards the less wealthy.

A more effective method to reduce inequality is not merely to reduce the tax burdens of poorer households, but to provide direct subsidies or transfers to poorer households. These transfers are sometimes called welfare payments because they seek to improve the welfare of the neediest families in an economy. In the US. such programs for low-income families include Medicaid, a health insurance program; the Supplemental Nutrition Assistance Program (SNAP), providing food assistance; Housing Choice Vouchers (HCV), that provides rental assistance; and Temporary Assistance for Needy Families (TANF), that puts cash in the hands of poorer families with children. Governments generally offer many other programs such as these at both the federal and the state level.

It is worth noting here that in many instances private non-governmental organizations (NGOs) are established by private citizens to provide assistance to many vulnerable individuals in society. These organizations are generally funded via the charitable contributions of many compassionate and generous people. The most substantial funding often comes from the philanthropic donations of very wealthy individuals. In this way, many services often provided for by government, can be supplemented, or in some cases supplanted, by the activities of private organizations.

With respect to discriminatory behavior, government can step in and require that businesses act in a non-discriminatory manner with respect to hiring and its treatment of customers. For example, in the US Title VII of the Civil Rights Act prohibits discrimination in hiring on the basis of race, color, religion, sex or national origin. The Age Discrimination Act prohibits discrimination because of age. There are many other regulations related to employment enacted at both the federal and state levels as well.

In contrast, another type of market discrimination involves firms setting different prices for the same product to different customers. In the US, the Clayton Act prohibits price discrimination when it substantially reduces competition in an industry. The Robinson-Patman Act of 1936 also prohibits the sale of products of like quality at different prices. However, these laws are rarely enforced and firms have discovered many ways to distinguish the nature of products to avoid the regulations. For example, economy-class airline tickets may be classified as different by virtue of one being refundable and the other being non-refundable, or one including airline points while another doesn't. In this way, virtually every ticket can be classified as a unique product and thus sold legally at a different price.

The effects of price discrimination were illustrated in Chapter 10 as a method firms can use to shift surplus away from consumers into increased profits. As such, it represents one of the many ways firms use to establish advantages over other firms at the expense of consumers in the industry. Even though, to some consumers, price discrimination seems innocuous, as when one enjoys a senior citizen discount, these benefits to some come at the expense of other consumers, non-seniors in this case, who pay higher prices than they would in a system without price discrimination.

While the use of government regulatory and tax policy to correct for inequalities and discriminatory behaviors is one method to achieve greater equity, one other option is to work towards correcting the market imperfections that tend to cause these outcomes and behaviors in the first place. Thus, any corrections that can prevent the formation of monopoly power in private markets and the effects of monopoly provision in government will subsequently have an equalizing effect upon income and wealth distributions and help to prevent instances of discrimination. This may mean more stringent enforcement of antitrust legislation for the private market and strict rules and procedures in government to assure improvements in public efficiency (for example, anti-nepotism regulations and the professionalization of government agencies). If, or when, these actions fall short of achieving an acceptable level of equality and fair treatment of individuals, then government tax and regulatory policy can be considered as a supplement to resolve these persistent inequities.

Key Takeaways

1. Inequality in economic outcomes arises in large part from the application of physical or monetary power over others.
2. Market competition tends to reduce incentives to discriminate against others because discriminatory firms will be less profitable.
3. Discriminatory practices can be sustained indefinitely in government agencies, because competition is not a factor, and in businesses with monopoly power.
4. If economic agents abided by the ethical principles highlighted in this course, they would thereby choose not to use force against others and economic outcomes would become more equal, differing only on the basis of inherent differences in abilities and good or bad luck.
5. If economic agents abided by the ethical principles highlighted in this course, they would naturally be less inclined to discriminate against others in the marketplace.
6. There are two fundamental ways to reduce inequalities and reduce discrimination
    a. Eliminate the unethical practices that sustain these outcomes, most notably via the reduction in monopoly power in businesses.
    b. Redistribute income between rich and poor and regulate behavior to prevent discriminations.

26.7 Conclusion: A Tale of Two Approaches

The economic principles discussed in this textbook offer a meaningful guide to understanding not just the workings of the economic system in the modern world, but also the policy positions that economic observers and policymakers propose across the ideological spectrum. The workings of the system are based on the careful interpretations of simplified economic models

that, at best, offer insights into complex economic relationships but do not provide perfect predictions about economic outcomes. Thus, economic principles alone cannot tell us the best way to organize an economy, but it can give us insights about advantages and disadvantages to be aware of across the ideological spectrum of ideas.

If we broadly characterize the economic ideological spectrum as left-leaning or right-leaning then we can offer generalizations of these two positions.

Right-leaning economic policies in democratic countries generally begin with an acceptance of private ownership of businesses and the mostly-free pursuit of profit by those businesses. Most who lean right do accept that government is needed at some minimal level to provide for a criminal justice system, the enforcement of contracts and the provision of the main public goods such as an internal police force and an external national defense. Government can also be used to provide basic common infrastructure such as roads and bridges and possibly some interventions to correct for externality problems such as pollution. Right-leaning groups tend to prefer private mechanisms to public mechanisms to solve economic problems whenever possible. They exhibit a strong skepticism of the effectiveness of government interventions and tend to believe that governments will overtax and overspend thereby eliminating a degree of personal economic freedom. They also believe that government will operate inefficiently thereby causing a waste of economic resources when compared to private market interventions. To assure the necessary moral or ethical behaviors, the right turns to religious institutions to provide primary guidance, although the right is generally accepting of government laws against violence, theft and deceptions. To solve the problems associated with inequality, the right prefers to rely on non-governmental organizations, such as religious and other charities to provide a safety net for vulnerable individuals and families.

Left-leaning economic policies in democratic countries also generally begin with an acceptance of private ownership of businesses and the mostly-free pursuit of profit by those businesses. Most who lean left accept that government is needed to provide for a criminal justice system with the enforcement of contracts and the provision of the main public goods such as an internal police force and an external national defense, as well as basic common infrastructure such as roads and bridges. However, the left tends to believe that government is necessary to correct for many more market imperfections including interventions to correct for externality problems such as pollution, subsidies to encourage production of selected industries, trade protections to support import-competing sectors, price controls, such as minimum wages, to resolve perceived inequities in market prices, labor unionization to adjust the share of revenues allocated to workers, and protections for individuals in the form of guarantees for health care, child care, retirement care, etc. Left-leaning groups tend to prefer public mechanisms to private mechanisms to solve economic problems whenever possible. They exhibit a strong skepticism of the effectiveness of free markets and tend to believe that monopoly capitalism will become rampant without strict oversight and control by government institutions. To assure the necessary moral or ethical behaviors, the left turns to public institutions to provide regulations prohibiting unethical behaviors. To assure freedoms, the left turns to the establishment of individual rights that will be supported by government guarantees. To solve the problems associated with inequality, the left prefers to rely on government to implement progressive taxes with higher taxes of the wealthy individuals and companies used to support transfers to more vulnerable individuals and families.

Left-leaning ideology is more in line with Francis Fukuyama's suggestion that the world is trying to find a way of getting to Denmark. By this he means creating a "stable, peaceful, prosperous, inclusive and honest society." Denmark is typically classified as a social democracy and its

government is much more involved in the maintenance of the economic and social system than in economies such as the United States. Its successes, though, may be predicated on the fact that it is a very homogeneous society with a population that shares many of the same values. More recently, increases in immigration into Denmark have inspired anti-immigration political movements that is making Denmark, along with many other European democracies facing similar issues, increasingly less stable. Inequality is growing in Denmark and there are also worries about the efficacy and efficiency of its universal healthcare system.

While many would like to achieve the successes apparent in countries like Denmark, it is fair to say that not everyone believes that it is the best possible social and economic system to aspire to. When elected governments are benevolent and implement policies supported by a homogeneous population all may go well. However, as the population becomes more diverse, due to immigration - or older, due to shifting demographics - the system may not be able to deliver on its promises. Substantial government provision of public goods and corrections from market imperfections may also, in time, result in growing economic inefficiencies if competition is greatly discouraged. Remember that incentives are often lost when goods and services are provided by government, as sometimes occurs in national healthcare systems, and can result in a less dynamic and slower growing economy. These are the valid worries of the right-leaning groups who would aspire to something other than Denmark.

One major problem impeding this process is the rise of radical left and radical right ideologies around the world today who have a completely different vision of the world. These radical ideologies do not seek compromise and democratic debate, but rather the imposition of a fixed and determinate set of values to the exclusion of everything else.

On the radical left are those who view capitalism as evil and seek to destroy the market system in favor of government control over the means of production. Radical left groups also are openly hostile to the inequalities that arise between peoples of different races, colors, religions and genders, et.al., and seek ways in which government can force the maintenance of individual rights that will eliminate these inequalities.

On the radical right are those who seek to maintain the current status of preferred groups, often in the name of individual freedom. This has led to the rise of xenophobic reactions to immigration and the growth of nationalism and other forms of group identifications such as white-supremacy, ethno-centrism, and religious intolerances.

The only viable way to achieve any of these radical outcomes, whether on the right or left, is via the destruction of democratic institutions and the imposition of an autocratic government that will bend policy in the direction the radical group desires. Democracies, especially in countries that are sufficiently diverse, would never arrive at solutions that favor a particular group over others and are intolerant of the diversity of opinion that exists across society. Indeed, one of the most important elements of democracy is that it is a method to provide a voice to the many disparate opinions that exist within society.

Preservation of democracy is key to the establishment of effective and prosperous economic systems. Although there are examples in history in which benevolent autocrats propel a country to success, these successes rarely last more than a generation and are continually subject to takeover by less benevolent leaders. Democracies too, even long-lasting ones like in the United States, have recently demonstrated difficulties maintaining the acceptance of democratic institutions and rule of law in the face of populist and nationalistic movements.

The principles of economics covered in this textbook concludes here not with the answer for the best economic system, or the best method to organize the economy to promote human happiness. Rather, the textbook offers guidelines establishing the pros and cons of moderate economic proposals on both the right and left of the political spectrum. Democracy can flourish if we can create a political system that recognizes there isn't one correct answer. Right leaning policies have merit and associated problems. (Milton Friedman is right in many instances.) Left-leaning policies also have both merit and associated problems. (Joseph Stiglitz is right in many instances). More radical positions on both sides have much less merit. The appropriate question we face is not whether to have government intervention in the economy, or not. The appropriate question is the extent of government involvement and the types of policies to implement. The right and left differs in their prescriptions and this is fine as long as we have thoughtful leaders on both sides who are trying to promote the most effective economic and social system possible.

An economic process worth aspiring to may look something like the following. Moderate right-leaning groups would debate policy proposals with moderate left-leaning groups to decide upon which policy options to pursue. Over time, some countries, or states, would implement more right-leaning policies while other jurisdictions would implement more left-leaning policies. Economists and other social scientists could evaluate the success and failures of these policy experiments using advanced empirical techniques and provide guidance for policy discussions. In addition, it is important to enable individuals to freely move between jurisdictions, as they are able to do between states and provinces. This provides an additional democratic force as households and businesses gradually move to the locations with policies that conform more to their own policy preferences. More successful jurisdictions would witness net immigration while the less successful would suffer from emigration. Less successful jurisdictions would also feel pressure to revise their policies and adopt something closer to the policies of the more successful. These political dynamics would thereby establish a competitive environment for political systems and economic policies and encourage the gradual movement to better and better economic systems in the future.

This type of outcome is surely possible as there have been moments in some democracies in some eras where we have come tantalizingly close to achieving this. But this ideal has never expanded worldwide and we are currently stepping away from this ideal internationally rather than towards it. The two keys to reversing this trend are firstly, the reversal of autocratic tendencies with the renewal of democracies across the globe, and secondly, a significant reduction in the effects of monopoly capitalism. Both autocracy and monopoly capitalism are like a cancer, or parasite, that operates from inside the democratic system and slowly and inexorably subverts the well-being of the majority in the population. If either, or both of these tendencies continue to expand around the globe, then prospects for the continuing expansion of human happiness are greatly diminished. If however, we can somehow reverse these tendencies and solve these two problems, then we might finally realize something akin to Fukuyama's notion of "the End of History."[4]

[4] See Fukuyama, Francis. The end of history and the last man. Simon and Schuster, 2006.