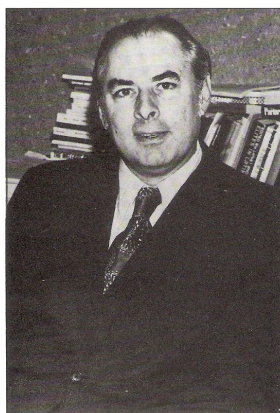


# **ESSAYS IN SOCIAL ECONOMICS: A TRIBUTE TO WILLIAM R. WATERS**

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*William R Waters*

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## EDITOR'S PREFACE

### PLAN OF THE COLLECTION

The plan for *ESSAYS IN SOCIAL ECONOMICS: A TRIBUTE TO WILLIAM R. WATERS* is simple enough. A number of senior members of the Association for Social Economics, of which William Waters has been a most faithful member since the 1940s, were contacted in spring 1994 with regard to preparing an essay for a collection dedicated to Waters and presented to him on the occasion of his 75th birthday in 1995.

No detailed instructions relating to content were supplied other than a reminder as to Bill's own views on the three components of social economics:

philosophical foundations or premises,  
careful description of the economy as it truly is, and  
economic policy.

The prospective essayists were urged to prepare a piece that rather than plowing old ground by means of the customary tedious scholarly documentation tries to engage the mind at the frontier of social economics through postulates, speculation, hypotheses, and propositions. To accommodate as many contributors as possible a limit of 6,000 words per essay was suggested. Thirteen persons responded enthusiastically to the task, each one proposing a preliminary title for his/her essay.

The essays were reviewed on a flow basis and returned to the essayist for whatever changes seemed to be appropriate. To meet the 75th birthday deadline, a rather quick turn-around was instituted and maintained. For the most part, they were able to conform to the 6,000 word limit.

The considerable experience of each one of the essayists in social economics and the social economy, along with their professional respect and personal affection for Bill, assured the quality of the essays that would be submitted. What was not known at the beginning was how the collection would be organized.

As the essays began flowing to the editor, the specific internal organization of the collection emerged quickly and easily. The essays would be organized according to specific content and grouped as follows:

on the origins of values and premises in social economics

on producing efficiently,  
turning a profit, & investing it  
on justice, solidarity, and community  
on repairing the dysfunction of capitalist economies  
on the transition from command economies

Each of these five main sections begins with two or three quotations from Bill's own professional publications which effectively help to link this collection with his interests and concerns as a social economist.

This collection of essays is special in social economics in that no one in the Association for Social Economics is more highly regarded as a social economist and as a human being than Bill Waters. His service as editor of the *Review of Social Economy* for 20 years and later as president of the Association does not begin to describe his contributions on the personal level as teacher, friend, confidant, mentor, advocate.

John Henry Newman's description of the educated man reads as if it were written with Bill in mind: "a cultivated intellect, a delicate taste, a candid, equitable, dispassionate mind, a noble and courteous bearing in the conduct of life." Bill is the Association's pre-eminent gentleman. In turn Bill has evoked from the contributors a small but singular collection of essays which we respectfully submit should instruct and inspire anyone with a special concern for social economics and the social economy.

**WILLIAM R. WATERS:  
DISTINGUISHED MEMBER OF THE ASSOCIATION FOR SOCIAL ECONOMICS <sup>1</sup>**

The social economics of William R. Waters begins with and centers on "a view of human beings as unique persons affirming their individual absoluteness but sharing a common humanity as purposive, responsible and free; as transpersonal beings moving toward community with others to reflect the ultimate dignity of each; and as creative in that an essential makeup is the need for accomplishment." Bill, as he is known to his friends, is a social economist who is firmly rooted in the three main activities of the academic life: teaching, research, and service. No one-dimensional specialist, Bill is a special blending of all three.

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<sup>1</sup> From *Review of Social Economy*, Summer 1990

For the past 40 years, Bill has made his academic home at DePaul University. Earlier this year, his beloved DePaul presented him with the prestigious *Via Sapientia Award* -- the highest honor that the University can confer on a member of the faculty. The citation reads in part: "You have impressed upon generations of students that economics is not the coldest of the social sciences but rather a humanistic discipline, in which the dignity of the individual is paramount."

His accomplishments as a teacher are formidable. During the early years at DePaul, he was the pillar of the undergraduate program in the College of Arts and Sciences. In the 1950s he taught no fewer than nine different courses including history of economic thought, European economic history, intermediate macroeconomics, money and banking, and a seminar on Marshall.

Schumpeter, the subject of his doctoral dissertation at Georgetown University, has been a central figure in Bill's teaching from the very beginning. Not surprisingly, Schumpeter appears prominently in his December 1987 presidential address to the Association.

... A realistic explication of the nature of the economy focuses upon this mechanism of [economic] change. The empirical reality is dynamic. Starting with this emphasis, the central role is given to the creative person as an alternative to the utility-calculating individual and is thus more compatible with the solidarist philosophical position than with the dominating classical one.

The economic process is ... essentially Schumpeterian centering upon a creative vision, supported by funding that gives the economic creator access to society's resources and brings forth an innovation. Characteristics of the innovational process [include] some Schumpeterian favorites such as dynamic competition, resistance, creative destruction and the universality of cyclical behavior in a private enterprise society ...

In addition to Georgetown University, Bill has studied at Loyola College (A.B.), Yale University (with the U.S. Air Corps), University of Maryland, Johns Hopkins University, Northwestern University, and University of Chicago. Even in retirement Bill is ever the student of social economics and the social economy, taking detailed notes at professional meetings. He has been known to share with his colleagues notes that were taken more than forty years ago.

Bill's research accomplishments are equally impressive and special. For twenty years he served as editor-in-chief of the Association's *Review of Social Economy*, expanding the journal from two issues per year to four including a special thematic issue. This expansion was nearly inevitable given Bill's gracious openness to perspectives that challenged his own. In the very first issue of the *Review* under his editorship, Bill opened the doorway with these words: "... these pages are open to *competitive* theories of social economy with the hope that progress in socio-philosophical theorizing

may continue" (emphasis in the original). Like a Schumpeterian father, Bill has supplied the creative energy, the scholarly wisdom, and the personal sacrifice that have helped make the *Review* the journal of choice for social economists. Probably more so than anything else, Bill's contributions to social economics as editor of the *Review* made him the first person to receive the Association's *Thomas Divine Award* in 1986.

Program chairman and editors delight whenever Bill accepts the challenge to contribute a paper. His work is on time, well written, instructive, generous to his friends, and kind to his adversaries. His admirers look forward to a steady stream of important writings on social economics, economic development, economic education, and economic thought in the years ahead.

For more than 25 years, Bill has made vital contributions to Chicago -- a city that recently he admitted to "falling in love with, again." Education, conservation, and economic development have been his special interests mainly in the city's Lincoln Park area where DePaul University is located and where he chose to make his home long before Lincoln Park's recent and truly remarkable renaissance.

Bill is married to Regina whom he and their many friends call "Jean." They have four children and two grandchildren. He celebrates his 75th birthday on March 5, 1995.

#### A SYNOPSIS OF THE COLLECTED ESSAYS

Three essays form the core of the first main section on the origins of values and premises in social economics. In "Economic History as a Source of Socioeconomic Normative Value" Lewis E. Hill argues that, instead of being mere statements of metaphysical opinions and dogmas, socioeconomic normative values are logical or scientific conclusions induced empirically from previous economic history and verified empirically by reference to subsequent economic history. In this regard, Hill presents several hypotheses on how socioeconomic values grow out of economic history, including Henry Margenau's theory of normative value, the axiological aspects of pragmatic philosophy, John Dewey's instrumental theory of normative value, and the institutionalist value theories of Thorstein Veblen and Clarence Ayres.

Hans E. Jensen's "John Stuart Mill: A Herald of Social Economics" argues that Mill was a precursor of two main strands of contemporary social economics: the institutionalism of Clarence Ayres and the humanism of Amitai Etzioni. As to the first strand, the reader will note the connection to the preceding essay by Hill. As to the second, Jensen calls attention to Etzioni's synthesis of neoclassicism and deontology. To support his claim regarding Mill's role as a precursor, Jensen points to Mill's theory of human behavior, his embryonic neoclassicism and institutionalism and their linkages to poverty, his institutionalist social economics, and his insistence on the role of universal education in promoting the good society.

John E. Elliott's "Philosophical Foundations of Social Economics: Marx, Schumpeter, and Keynes" explicates the major philosophical foundations of social economics: philosophy of history, metaphysics, epistemology, moral philosophy, and aesthetics. In examining the implications of each of these domains of philosophical reflection for the social economy and, thereby, the differentiating perspective of social economics, the essayist directs special attention to the contributions of Marx, Schumpeter, and Keynes.

The second main section of the collected essays, which relates to producing efficiently and making and investing profits, consists of two essays. In his "Gain-seeking: The Economoral Nexus," Peter L. Danner asserts that economic morality requires a blending of economic rationality and moral principles to produce standards of conduct which are economically practical and efficient and, at the same time, just, temperate, and consistent with life's ultimate goals. Gain-seeking is represented as a human aspiration which effectively blends the economic and the moral. In identifying gain-seeking as a distinct and universal appetite as well as the force that drives the economy, Danner concludes that gain-seeking is subject to both the economic and the moral which can be blended successfully to form a consistent code of conduct called economic morality.

In the 1991 encyclical *Centesimus Annus* John Paul II stoutly affirms the moral legitimacy of private ownership, the free market, and profit. At the same time, however, he soundly condemns consumerism as a monstrous vice, a threat to civilization and global justice. For some, these positions seem to be logically inconsistent. Stephen T. Worland in "The Investment Decision as Moral Choice: The Perspective of *Centesimus Annus*" resolves this apparent inconsistency by recalling key factors in the Church's teaching on private property as an instrument of autonomy, obligations as to the deployment of "superfluous income", and the place of capital formation in achieving the "common use" of private resources in a modern market system. Participants in the "affluent society" are called upon to repudiate consumerism and to deploy the income thus saved to finance investment and employment in the production of "really useful goods." Pension fund managers are identified as the custodians of the "superfluous income" of a developed economy whose social function is to consolidate the community's aggregate savings and channel such funds into appropriate real, productive investment. In making such a decision, they are to seek out and fund those projects with the higher rate of return.

Two essayists contributed to the third main section on justice, solidarity, and community. Kishor Thanawala in "Solidarity and Community in the World Economy" addresses solidarity in the international context, examining first the concept of solidarity and community as developed by William Waters and then presenting the views of the papal encyclicals on poverty and justice among countries. His essay also explores problems relating to international development, selected aspects of economic justice, the welfare implications of economic theory, and issues of efficiency and equity in the international context.



Elba K. Brown-Collier's "Self-Interest, Economic Efficiency, and the General Welfare" explores the conflict between the self-interested individual and the interest of society. She notes that, even though Adam Smith recognized that unbridled self-interest could be detrimental to the general welfare and asserted the need for moral restraint, the neoclassical economists -- Smith's modern-day disciples -- do not share his concern. Their stance is that in a world of perfectly competitive markets and in the absence of market failures all trades are beneficial or they would not take place and that a harmony underlies the market system which leads each of us to act in a way that is automatically beneficial to ourselves and to others. The conflict that troubled Smith, in others words, is assumed away. The neoclassical paradigm asserts that competitive forces drive the economy towards economic efficiency in a Pareto optimal sense and that the pursuit of self-interest routinely achieves the ends of distributive justice and commutative justice. Social economists, Brown-Collier argues, see the need for more than just these two principles of justice. To fill this void, she then examines Catholic social thought on solidarity and community, leaning heavily on the social teachings of John Paul II.

In the fourth section on repairing the dysfunction of capitalist economies there are three contributed essays. Mark A. Lutz's essay "Doubts About Competition" surveys apprehensions about the principle of competition as a social regulator from the history of mainstream economic thought and the humanistic economic tradition. Then Lutz's attention turns to two new developments likely to heighten concern about competition: the rise of corporate competition and the contemporary push for unregulated global trade under GATT. His purpose is to show that modern competition has a high potential for dysfunctional outcomes and needs to be reined in by the principles of cooperation and solidarity.

Edward J. Kane's "Ethical Conflicts in Managing the S&L Insurance Mess" asserts that taxpayers lost money in the S&L insurance mess not because federally insured S&Ls lost money but because public officials in Washington systematically mishandled S&L losses. For several decades, officials covered up S&L losses, denying that these losses were progressively undermining the solvency of the FSLIC. Authorities used this informational cover, Kane says, to delay indefinitely the recapitalizations of hundreds of economically insolvent "zombie" S&Ls. From at least 1975 on, the proliferation of living-dead insured S&Ls distorted funding and investment decisions throughout the industry, compounding S&L losses until the red ink was passed through to the taxpayers on a massive scale. Kane's essay develops a hypothetical case for indicting top regulators, members of Congressional banking committees, and presidents who served between 1975-1988 on charges of fraud, influence peddling, and gambling at imprudent odds with taxpayer money. He concludes with an analysis on how to change managerial incentives in public service to avoid such debacles in the future.

"The Civil World of Business: Evolving Systems of Social Accountability" by Severyn T. Bruyn begins with his concern for the major dysfunctions of capitalism -- poverty, crime, drugs,

homelessness, environmental damage, disenfranchisement, among others -- and for the lack of any self-correcting alternatives within the capitalist system. Further, governments continue to grow in an attempt to address these dysfunctions through regulatory agencies and monitoring systems, but in the process become command bureaucracies, oppressive in themselves. Worse yet, he says, there is no social vision that would turn capitalism into a system of self-regulation and social justice. Borrowing from a vision shared by Adam Smith and Karl Marx of a self-governing, civil economy which operates in the public interest, Bruyn asks How are systems of accountability -- formal structures requiring people to act responsibly on the basis of fairness and justice -- being created which help solve problems of dominance and exploitation? Such systems have been evolving in business for over a century in the United States, he continues, but today they are becoming noteworthy for their capacity to reduce the need for government control over the economy, expanding the self-regulatory capacity of the economy and building a publicly-oriented, social market in the private sector. Bruyn then presents several cases of accountability systems which, though flawed, show promise of actually reducing government control and operating in the public interest.

The fifth and last section on the transition from command economies consists of three essays. For more than 30 years William Waters and Thomas Nitsch have engaged in a friendly disagreement as to whether the Catholic church has and promotes a particular economic model as a remedy for the specific dysfunctions of the market economy on the one hand and the command economy on the other. Waters consistently has argued in the affirmative. In like fashion, Nitsch has taken the opposite stand. Nitsch's " Catholic Social Doctrine and the New World Order: Does the Church Have Models?" offers additional evidence that papal support for a "definite" model is not to be construed as endorsement of a "definitive" model.

Christine Rider's essay "Ethical Policy Making in the Transition Economies" broadens the recommendations offered to the socialist economies of Eastern Europe and the former Soviet Union in transition by suggesting a new and different role for the state based on Keynes' theory of the state. She asserts that a market economy does not "just happen" and cannot produce a socially desirable outcome without conscious direction aimed at controlling the negative aspects of capitalism by providing oversight and coordination functions, by involvement in investment allocation to avoid income inequity and economic fluctuations, and by encouraging innovation and other behaviors that support outcomes that are satisfactory in the economic order and the political order.

Finally, in "Telkom Teletra: A Polish Manufacturer in Transition from State Enterprise to Private Company", Edward J. O'Boyle presents his first-hand observations of a Polish state-owned and operated manufacturer of telecommunications equipment functioning in a command economy but in transition to a private company operating in a market economy. His report derives from on-site conversations with the company's senior management before privatization in 1991 and after the

buyout in 1993. O'Boyle's essay focuses on the management of the firm, its shop-floor operations, and concludes with his opinions as to its prospects for long-run survival in a market economy.

This collection of essays has none of the splendor and protocol of a stately banquet where every guest is formally attired and is served the same courses with great precision, wherein much depends on the hospitality of the host and hostess and the talents of the chef. Instead, these essays have the serendipity and spontaneity of an outdoor food festival where everyone is dressed casually, is free to choose where to start, what to sample, and how much to eat, wherein much depends on how well each one of the many cooks has responded to the challenge implicit in the festival. Accordingly, we are pleased to present the following "taste of social economics."

## ON THE ORIGIN OF VALUES AND PREMISES IN SOCIAL ECONOMICS

A research program, such as neoclassicism, may be defined as a series of theories which share a common "hard core" belief which is irrefutable by decision of the protagonists. An example of part of the hard core is the premise of certainty or correct knowledge of an economic situation found in the neoclassical or orthodox strain of economics. The research programs of Keynes or Schumpeter, on the other hand, presume the opposite; an uncertainty premise making their research programs essentially different from neoclassicism. Such hard core elements of a research program may not be so well articulated ... It is in fact, not in the nature of a research program to question the hard core. One should not confuse the axioms of a theoretical framework (say, perfect competition or maximizing profits in neoclassicism) with the hard core beliefs. The former are stated very specifically, the latter are given a silent treatment and are thus protected from conscious scrutiny.

William R. Waters, "Evolution of Science in General and Economics in Particular," *Forum for Social Economics*, Fall 1986, pp. 62-63.

Economic sociology's importance is that it identifies values, ideas, institutions, organizations and motivations including property rights, ideologies, cultural, political and all related structures in society as they impinge upon material welfare. if economic science is meant to explain reality, how can the economist do without it?

William R. Waters, "Schumpeter The Sociologist - A Review Article," *Forum for Social Economics*, Fall 1991/Spring 1992, p. 51.

## **ECONOMIC HISTORY AS A SOURCE OF SOCIOECONOMIC NORMATIVE VALUE**

Lewis E. Hill

For the purposes of this essay, social economics may be defined as the socioeconomic analysis of human behavior within a broad economic, social, and political context for the purpose of improving the quality of life and enhancing human welfare. All social economists are dedicated to the quest to achieve social and economic justice. Social economists have always been especially concerned with the impoverished people who have been denied the opportunities and the privileges that have been so easily available to the more affluent component of our population. Social economics is an applied policy science that seeks to solve problems of social injustice and economic privation (Hill 1978).

Professor William M. Dugger, in one of his most insightful and forceful essays, has correctly identified the emphasis on socioeconomic normative value as the first among five characteristics which specify the essence of social economics (Dugger 1977, pp. 300-2). One of the reasons for this emphasis on normative value can be induced from the nature of social economics as a policy science. Any policy science must use normative value judgments as a necessary technique in the formulation of socioeconomic and politico-economic policy. The purpose of any policy is to plan and to implement a course of action which is intended to avoid a set of consequences that is judged to be undesirable and to achieve an alternative set of consequences that is judged to be desirable. The judgments concerning whether a set of consequences is undesirable or desirable are always normative value judgments. Socioeconomic normative values, therefore, provide the only possible basis for differentiating between the undesirable consequences which should be avoided and the desirable consequences which should be achieved; therefore, socioeconomic normative values are the essential basis of any successful policy.

The other reason for social economists' emphasis on socioeconomic normative value judgments inheres in their concern for social justice and human welfare. Both of these concerns can be defined and specified only in terms of normative values. Social justice is a set of normative values which define and specify ethically correct relationships among persons. Human welfare is a set of normative values which provide a standard for the measurement of well-being of a people. Socioeconomic normative values, therefore, provide the very essence of social economics.

If it is accepted that socioeconomic normative values are the essence of social economics, then the question remains concerning the origin and nature of these values. Dugger and others have argued that these values originated from the Judeo-Christian tradition (Dugger 1977, pp. 300-2), but this is a metaphysical rather than a scientific answer. The purpose of this essay is to seek and to find a scientific answer to the question concerning the source or origin of socioeconomic normative values

and the manner in which these values are verified or authenticated. The hypothesis of this essay holds that socioeconomic normative values are induced from the previous economic history of a people through the application of inductive logic to that history and verified by reference to the subsequent economic history of that people.

### HENRY MARGENAU'S THEORY OF NORMATIVE VALUE

Certainly the most systematic and probably the most scientific theory of the origin or source of socioeconomic normative values has been developed and articulated by Henry Margenau, who is a distinguished philosopher of science. Margenau contended that ethical theory can be derived through the use of a methodology that is analogous to the scientific method. In order to explicate this theory of ethics, therefore, it is first necessary to summarize his version of the scientific method. According to Margenau, the scientific method consists of two domains: the perceptual domain, which includes the empirical facts that are discovered through the application of inductive logic, and the conceptual domain, which includes the analysis of the empirical facts through the application of deductive logic (Margenau 1964).

Scientific inquiry begins in the perceptual domain with the collection and inductive analysis of the relevant empirical facts. The empirical facts imply a set of postulates, which are basic assumptions or preconceptions that cannot be proven empirically. These postulates provide the basis for the scientist to enter the conceptual domain and to apply deductive analysis of the empirical facts. This deductive analysis creates theoretical models from which conclusions concerning empirical reality can be derived. The verification of these conclusions requires the re-entry into the perceptual domain, which can be achieved through the acceptance of a set of verification principles. These verification principles, like the postulates, cannot be proven empirically. Verification procedures and techniques, which are derived from the verification principles, are then applied to test and to verify or falsify the conclusions (Margenau 1964, pp. 9-53).

Margenau argued that methods of ethical analysis exactly parallel the methods of scientific analysis. In ethical analysis, values replace facts in the perceptual domain, and imperatives or commandments replace postulates the transition into the conceptual domain. Ethical theories are then derived from the imperatives or commandments through the utilization of techniques of deductive logical analysis. The commitment to apply these ethical theories to personal conduct replaces scientific verification principles to facilitate the re-entry into the perceptual domain. The verification procedures and techniques consist of the actual application of these ethical theories to govern our personal conduct. This working methodology of ethical analysis always begins in the perceptual domain with the empirical observation of the normative values that have been induced from the historical experience of the people. Imperatives or commandments are then generalized from these values through the further use of inductive logic, and these commandments facilitate the transition

from the empirical perceptual domain into the rationalistic conceptual domain. Deductive logic is utilized to achieve the conceptual analysis that is involved in the elaboration of the commandments into systems of normative principles which become ethical theories. The verification principle is replaced by the commitment to apply ethical principles to the life process. If the application of the ethical principles results in survival, happiness, and self-fulfillment, then the ethical system has been verified and, therefore, it will endure (Margenau 1964, pp. 98-180).

Margenau's methodology of ethical analysis clearly implies that people induce socioeconomic normative values from their past economic history through the application of techniques of inductive logical analysis to that historical experience. These values then become the basis for the imperatives or commandments which provide the rules that define ethical behavior. These imperatives or commandments are elaborated into ethical theories, which are verified by their application to the life process. In this manner, socioeconomic normative values are induced from previous economic history and verified by reference to subsequent economic history.

### THE PRAGMATIC THEORY OF NORMATIVE VALUE

Pragmatic philosophers and economists approach the problem from a different perspective but reach a similar conclusion. Pragmatism is a philosophy which holds that all reality has practical consequences and that, therefore, certainly the best way and perhaps the only way accurately to know and correctly to understand reality is through an analysis of practical consequences. Pragmatism was originated by Charles Sanders Peirce during the late nineteenth century. Peirce captured the essence of the pragmatic philosophy in his well-known imperative: consider what effects, which might conceivably have practical bearings, we conceive the object of our conception to have. Then, our conception of these effects is the whole of our conception of the object (Peirce 1966, p. 124).

Peirce believed that the only legitimate way to define an idea and to specify its true content was to list all of the practical consequences that are implied by that idea. The truth of an idea is embodied in its practical consequences. If an idea has no practical consequences, then the idea is false (Peirce 1966, pp. 113-36).

Peirce's concept of normative value is found in his theory of Christianity. According to Peirce, the essence of Christianity is embodied in the Doctrine of the Two Ways. The Way of Life symbolizes love and the other creative propensities of the human personality which characterize true Christianity. The Way of Death symbolizes hatred and the other destructive propensities that characterize the Anti-Christ and the forces of evil. Peirce found normative value in the Way of Life; he found normative disvalue in the Way of Death (Peirce 1966, pp. 353-7).

Although Peirce's concept of normative value seems to be a declaration of metaphysical belief, it also includes a logical and scientific content. In pragmatic reality, both the Way of Life and the Way of Death are defined by the historical experience of the people. It can be concluded, therefore, that both the socioeconomic normative values that are implied by the Way of Life and the socioeconomic normative disvalues that are implied by the Way of Death are induced by the people through the application of inductive logic to their previous economic history. It also follows that socioeconomic normative values and disvalues are verified or authenticated through the application of inductive logic to the subsequent economic history of the people.

William James, who popularized pragmatism, gave this philosophy a functional or instrumental emphasis which was more psychological than logical. According to James, an idea should be evaluated as true or false dynamically according to what it does, rather than statically according to what it is. The truth of an idea requires not only that the idea correspond to an external reality, but also that it proves to be useful in helping the person to adapt to that reality and to achieve a harmonious relationship with reality. The truth of an idea is a prediction of its usefulness; the usefulness of an idea is the verification of its truth (James 1908, pp. 197-238).

Within this functional or instrumental context, value becomes a verb as well as a noun. Primarily, value as a verb refers to the process through which people evaluate ideas as true or false and their consequences as good or bad. Secondly, value as a noun denotes the conclusions which specify the ideas that have been classified as true and good, and the ideas have been classified as false and bad. The ideas which are classified as true and good become values; the ideas which are classified as false or bad become disvalues. The values and disvalues are induced from past historical experience through a process of inductive logic because people learn how to evaluate ideas from their previous experience. Moreover, a person's set of values is the accumulation of outcomes from the inductive evaluations of ideas which have occurred during that individual's personal history. Socioeconomic normative values, therefore, are induced from previous economic history through the application of inductive logic to that historical experience and verified and authenticated by reference to subsequent economic history.

#### JOHN DEWEY'S INSTRUMENTAL THEORY OF NORMATIVE VALUE

John Dewey, the last of the founding fathers of the pragmatic philosophy, completed the transition from Peirce's logical pragmatism to James' instrumental or functional pragmatism. Dewey always conceived ideas to be instruments or tools to be used to solve problems and to integrate the various diverse aspects of a person's experience. The exclusive purpose of logical or scientific inquiry is to solve practical problems, and the best method of solving problems is through the application of the instrumental process (Dewey 1938, pp. 280).



According to Dewey, the instrumental process of logical or scientific inquiry is motivated by an antecedent condition, which is a disequilibrium between a person and his environment. Because of this disequilibrium, actions produce unintended bad or undesirable consequences, instead of the intended good or desirable consequences which the person is seeking to achieve. The instrumental process of logical or scientific inquiry proceeds through four steps or stages. The first step or stage is to define the problem as a set of undesirable consequences which are occurring or which have already occurred. It is helpful, also, to specify a set of desirable consequences which would constitute a satisfactory solution to the problem. The second step is to analyze the problem to identify and specify all of the relevant facts and all of the cause-and-effect relationships that are involved in the problem. The third stage is to conceive ideas concerning how the problem might be solved. These ideas must be evaluated and symbolized. The fourth step is to use the ideas in the formulation of a plan of action that is designed to solve the problem. The final stage is to implement the plan of action in order to solve the problem and to transform the problematic antecedent condition into a determinant condition from which the problem has been eliminated (Dewey 1938, pp. 101-19).

In order to utilize Dewey's instrumental process to solve problems, a person must make two kinds of value judgments. First, he must evaluate the practical consequences of actions to distinguish between the good consequences which he should seek to achieve and the bad consequences which he should seek to avoid. A person must also evaluate positive facts and cause-and-effect relationships in order to determine which facts and relationships are relevant to the problem and its solution and which facts and relationships are irrelevant.

Dewey always insisted that both of these types of value judgments were instrumental rather than metaphysical. He contended that ordinary people are entirely capable of applying inductive logic to their past experience, of inducing instrumental values from that experience, and of using these instrumental values to make normative value judgments which are perfectly valid (Dewey 1929, pp. 254-86). Dewey refused to recognize any difference between judgments of normative value and judgments of positive fact. He argued that both judgments of value and judgments of fact are made through the same process of applying inductive logic to past historical experience and for the same purpose of making practical decisions and solving problems. In a similar manner, Dewey refused to distinguish between means and ends, which he insisted were theoretical abstractions that do not exist in the real world. Reality consists of a series of events each of which is both the end of previous events and the means to subsequent events.

Dewey's pragmatic instrumentalism holds that historical scholarship is a special case of logical or scientific inquiry. Dewey believed that a true idea would help a person to relate the various aspects of his experience and to integrate the diverse elements of that experience into a coherent whole. This integration occurs in two dimensions. The cross sectional dimension integrates the events that are

occurring simultaneously. The chronological dimension relates past experience through the present into the future. People learn how to apply inductive logic to their past historical experience and to induce conclusions concerning socioeconomic normative values and positive facts. These conclusions are then extrapolated through the present and into the future in such a manner as to provide the basis for solving present problems and planning future policy that is designed to enhance human welfare and to improve the quality of life (Hill and Owen 1984).

#### THORSTEIN VEBLEN AND CLARENCE AYRES

Meanwhile, Thorstein Veblen, a pragmatic economist and economic philosopher of the late nineteenth century and early twentieth century, had established the institutionalist school of economic thought. Veblen based his theory of normative value on his belief that man is a social animal whose behavior is driven by opposing sets of instincts and propensities. The affirmative and benevolent instincts and propensities motivate creative, productive, and useful behavior; the negative and malevolent instincts and propensities motivate destructive, exploitative, and wasteful behavior. Socioeconomic normative value consists of the affirmative aspects of the human personality and of the creative, productive, and useful behavior that they motivate. Socioeconomic normative disvalue consists of the negative aspects of the human personality and of the destructive, exploitative, and wasteful behavior that they motivate (Tool 1977).

Veblen accepted and advocated that the economy is an organic whole which should always be conceived at the social level of generalization. The contemporary social economy has resulted from a process of cultural evolution which reaches back through time to the origin of man on this planet. Veblen insisted, therefore, that economics should be an evolutionary science (Veblen 1950, pp. 215-40). The personality characteristics and behavioral patterns that constitute socioeconomic normative value and disvalue have been created by this process of cultural evolution. In this manner, socioeconomic normative value and disvalue emerge out of previous economic history. The process of cultural evolution continues into the future to revise and to verify these socioeconomic normative values and disvalues during subsequent economic history.

One of Veblen's greatest disciples was Clarence Edwin Ayres, an economic philosopher who was a professor of economics at the University of Texas from 1930 to 1970. Ayres founded and became the acknowledged leader of the Texas or western group of institutionalists. His greatest contribution to the development of institutionalism was to formulate a theory of economic progress, which consisted of two component parts. The first part was a theory of socioeconomic normative value which can be used to identify progressive socioeconomic change and to distinguish between progress and regress. The second part was a theory of economic causation which can be used to identify the causes of progressive socioeconomic change that should be sought and the causes of regressive socioeconomic change that should be avoided. According to Ayres, the essential feature

of both the theory of socioeconomic normative value and the theory of economic causation is technology, which he believed to be inherently and inexorably dynamic and progressive.

Ayres' theory of socioeconomic normative value is a synthesis of the procedural aspects of Dewey's instrumental value theory and the substantive aspects of Veblen's theory of value. Ayres agreed with Dewey that ordinary people can learn from experience how to apply inductive logic to their personal histories in order to induce normative values and value judgments from their prior experience and to verify these normative values and value judgments by reference to their subsequent experience. This theory is purely procedural. It specifies a procedure through which a person can induce normative values and value judgments from his personal history, but the theory tells us nothing about the substance of the values and value judgments, which the person should induce. Ayres added a substantive dimension to the instrumental theory of socioeconomic normative value by updating and elaborating Veblen's theory and value (Hill and Owen 1984).

Veblen had found value in the affirmative aspects of the human personality and in the creative, productive, and useful behavior that they motivate; he had found disvalue in the negative aspects of the human personality and in the destructive, exploitative, and wasteful behavior that they motivate (Tool, 1977). Ayres invented the instrumental or technological life process to summarize and symbolize the benevolent propensities and the creative patterns of behavior that inhere in the human personality. Ayres believed that life is worth living and that, therefore, life is a basic socioeconomic normative value. Moreover, he believed that the life process is essentially instrumental or technological, and that technology is inherently progressive. The technological life process becomes the exclusive source from which all socioeconomic normative value can be induced. Anything which facilitates, encourages, or accelerates the progressive technological life process constitutes affirmative socioeconomic normative value; anything which inhibits, discourages, or decelerates the progressive technological life process constitutes negative socioeconomic normative disvalue. It also follows from this inductive logic that this progressive technological life process is the essence of economic history (Ayres 1994, pp. 205-30; Hill and Owen 1984).

Technology is the driving force in Ayres' theory of economic causation. Ayres contended that economic history has recorded a continuous conflict between technology, which is inherently dynamic and constantly changing, and a set of socioeconomic institutions, which resist change because they are inherently static. Technological innovation causes all progressive change; institutions resist progressive change and inhibit socioeconomic progress. Most socioeconomic problems are caused by these inhibitory institutions resisting the progressive change and socioeconomic progress that are driven by the dynamically progressive technology (Ayres 1944, pp. 105-202).

## CONCLUSION

The instrumental or technological life process, therefore, not only is the source of all socioeconomic normative value and the cause of all progressive change, but also is the essence of economic history. Socioeconomic normative values emerge from economic history as enlightened people apply inductive logic to their past experience. People then utilize these socioeconomic values to make value judgments that are involved in their efforts to solve practical problems and to improve their quality of life. If the values and value judgments prove to be useful in solving problems and improving the quality of life, then these values and value judgments will be verified and authenticated by the application of inductive logic to the future experience of individual persons and to the future economic history of social groups.

Many people have long believed that normative values are metaphysical pronouncements from some supernatural prophet or deity, but the arguments that have been developed in this essay support a contrary belief. These arguments demonstrate that socioeconomic normative values are instrumental and corrigible. These values are induced from previous economic history through a process of logical inquiry which is at least analogous to the scientific method. Moreover, socioeconomic normative values are verified and authenticated by reference to an inductive logical inquiry into subsequent economic history. After normative values have been verified and authenticated, they should be regarded as having the same level of validity as a fully verified statement of a positive fact. Judgments of socioeconomic normative value and judgments of positive fact are induced from previous economic history through the application of inductive logic to that historical experience. Judgments of value and fact are utilized for the same purpose of solving practical problems in order to enhance human welfare and to improve the quality of life. Judgments of value and fact are verified by the application of identical inductively logical inquiry to subsequent economic history.

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## JOHN STUART MILL: A HERALD OF SOCIAL ECONOMICS

Hans E. Jensen <sup>1</sup>

In his perceptive examination of contemporary social economics, Mark A. Lutz identified four major strands -- Catholic solidarism, Marxist socialism, American institutionalism, and humanism (Lutz 1990, pp. ix, x) -- the last two of which are of special interest in what follows principally as regards the contributions of Clarence E. Ayres to the third strand and of Amitai Etzioni to the fourth. It is my thesis that John Stuart Mill is a precursor of Ayres's instrumentalism and of Etzioni's deontological socioeconomics and that part of Mill's work may be viewed as an early form of social economics, or "social economy," as he put it himself (CW 4, p. 320).<sup>2</sup> To be specific, Mill operated with concepts of technology and institutions *a la* Ayres who argued that "technology is a dynamic force" that, when the cultural setting is right, may prevail over "the static force of institutions" with the result that the relevant "institutions . . . [will be] undergoing modification" (Ayres 1952, pp. 60, 59). Moreover Mill constructed his social economics through a synthesis of what may be viewed as his embryonic neoclassicism and his slightly less embryonic institutionalism, both to be discussed below. He did so in a manner similar to Etzioni's when he, Etzioni, fashioned his social economics by means of a combination of the "neoclassical paradigm" and "an emerging deontological paradigm." By the latter, Etzioni understood a Kantian "ethic that sees human beings as subject to 'binding duties'" (Etzioni 1990b, p. 1; and 1990a, p. 221).<sup>3</sup>

Mill's concepts of human nature and behavior are crucial elements in his neoclassicism as well as in his institutionalism. Hence I shall start my inquiry with a discussion of "Mill on Human Nature and Character." It will be followed by sections on "Mill's Embryonic Neoclassicism," "Mill's Institutionalism" and "Mill's Institutional Social Economics." I shall close with some speculative comments about the legitimacy of viewing Mill as a herald of the Etzionian type of humanistic social economics.

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<sup>2</sup> References to Mill's works are to the *Collected Works of John Stuart Mill*, annotated CW followed by volume number and page number(s).

<sup>3</sup> "To make this point, Kantians draw on a distinct realm of rights and obligations, of moral values, set apart from that of satisfaction and goods" (Etzioni 1987, p. 31).

## MILL ON HUMAN NATURE AND CHARACTER

Mill distinguished between "human nature," on the one hand, and "human character," on the other. By human nature, he understood an "ensemble" of "instincts," among which "selfishness" and "sympathy" are preeminent. Hence he employed the term human nature as a "general designation of those parts of our mental and moral constitutions which are . . . innate, in contradistinction to those which are acquired" (CW 10, pp. 393, 374, 393, 394, 399). Those parts of the human make-up that are acquired constitute the human character. As Mill put it, a person's "desires and impulses . . . are the expression of his own nature, as it has been developed and *modified* by his own *culture*." Such a person is therefore "said to have a character" (CW 18, p. 264; emphasis added).<sup>1</sup> Consequently, when he marveled at the "astonishing pliability of our nature," Mill was referring to that culturally conditioned part of the human personality that he called character. And, he averred, human character could be improved "under an enlightened direction of social and educational influences" (CW 18, p. 145; and CW, 1, p. 187).

Thus it is the *character* of the economic agents that determines their behavior in the specific capitalist order analyzed by Mill in part with tools that have a *neoclassical* hue.<sup>2</sup> When he turned institutionalist, Mill explained how the human character is molded by customs and he constructed his institutionalist *social economics* in order to demonstrate how the human condition may be improved through the institutionalization of customs that are superior, ethically and socially, to those that govern behavior in capitalism.

## MILL'S EMBRYONIC NEOCLASSICISM

Mill forged what may be termed his neoclassical tools of analysis with special reference to the type of human character that, in his opinion, had been molded in the course of "the economical progress of [capitalist] society" (CW 3, p. 752). Consequently, Mill conceived of man in that society "as a being who desires to possess wealth, and who is capable of judging of the comparative efficacy of means for obtaining that end." These means are in the form of labor and saving. But all economic actors in the capitalist drama have an "aversion to labour, and [a] desire of the present enjoyment of costly indulgences" (CW 4, p. 321).

It was this concept of man as a rational balancer of desires for real income and aversions to labor and saving that provided Mill with the ingredients for a theory of value and a theory of economic growth

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<sup>1</sup> When he endeavored to explain how the culturally nurtured character functions, Mill employed a "Psychological Theory" of "Experience and Association" (CW 9, p. 178; and CW 1, p. 269) that is an echo of his father's, James Mill's, psychological associationism (J. Mill 1967).

<sup>2</sup> A neoclassical hue in the sense that Mill formulated some of those concepts and ideas on which Alfred Marshall built his neoclassical economic theory.



-- both pertaining to an "industrial system [that] is entirely founded on purchase and sale" (CW 3, p. 456).

Thus Mill opined that in order for an article to have "exchange value," which is reflected in its money "price," it "must not only have some utility," i.e. a "capacity to satisfy a desire," there "must also be some difficulty in its attainment" (CW 3, pp. 457, 462, 456, 462). This difficulty is caused by "obstacle[s]" in the form of a relative scarcity of human and nonhuman resources. Consequently, these resources command a price that Mill called "cost" of "labour" and of "capital." Labor cost is the product of the "quantity of labour" employed times its "remuneration" and the cost of capital consists of the "Profit" that the capitalists demand as a "return for [their] abstinence" from consumption (CW 3, pp. 464, 481, 479, 481). These observations were Mill's way of saying that the demand for and the supply of any article are determined by utility and disutility, respectively.

How the exchange value is related to supply and demand, Mill explained thus: "the utility of a thing in the estimation of the purchaser, is the extreme limit of its exchange value" because there are no individuals who "will give, to possess a thing, more than the utmost value which they themselves put upon it as a means of gratifying their inclinations." Given the utility functions of the demanders, there will be a "demand for a certain quantity of the commodity [in question] at its . . . cost value, and to that the supply in the long run endeavors to conform." In other words, the forces of demand and supply make "market value gravitate towards Cost of Production" (CW 3, pp. 462, 457, 475, 476).

Driven by their desire to maximize utility, and to minimize the disutility suffered in providing the means to the achievement of that objective, the more fortunate members of "mankind [are ceaselessly] accumulating wealth, and employing that wealth in the production of other wealth" (CW 4, p. 322). The result is economic growth, but a growth that produces an end that Mill viewed as an abomination.

I must repeat my conviction [said he], that the industrial economy which divides society absolutely into two portions, the payers of wages and the receivers of them, the first counted by thousands and the last by millions, is neither *fit for*, nor *capable* of, indefinite duration (C 3, p. 896; emphasis added).

It was in order to discover the roots of this problem that Mill turned institutionalist.

### MILL'S INSTITUTIONALISM

Contrary to the opinion of most twentieth-century institutionalists of the Ayresian persuasion, Mill took the position that an institution is both "a structural category" and a "functional category" (Ayres 1952, p. 42). His emphasis was on institutions as functional categories because he considered them to be the loci of behavioral traits that have been customized, so to speak. As he saw it, behavioral



patterns "pertain to customary circumstances, and customary characters." Mill identified two kinds of customs, however. One set is static and change-resisting because this kind of customs fosters a type of institutionalized behavior that preserves the *status quo*. "[C]onformity is the first thing thought of" so that a person's principal "facult[y]" becomes an "ape-like one of imitation." Consequently, the "despotism of [static] custom is everywhere the standing hindrance to human advancement" (CW 18, pp. 262, 265, 272).

Fortunately for the fate of humankind, Mill found that there exists another kind of customs, namely customs that have been "cultivated in . . . [a] direction" that leads to an "ultimate improvement" of the human character and the human condition (CW 10, p. 230; and CW 1, p. 239).

But why is it that "habits can be . . . moulded" into institutionalized behavior either by past-binding and static customs or by forward looking customs? The answer lies in the aforementioned "astonishing pliability" of the human character (CW 4, p. 380; and CW 18, p. 145).

As far as the existing capitalist society was concerned, Mill found that it was an assemblage of four groups of institutions that caused the "condition of [large] numbers . . . even in England and France . . . [to be] more wretched than that of most tribes of savages who are known to us." That was so, he argued, because three of the four classes of institutions were so powerful that they had been successful in bringing about a situation in which the "very idea of distributive justice . . . is in the present state of society so manifestly chimerical as to be relegated to the regions of romance" (CW 5, pp. 713-4). The fourth category of institutions was so deprived of power that those whose behavior was associated therewith accepted without objection a state of poverty that had been bestowed upon them by the income-distorting activities of the other three sets of institutions. The economically powerful institutions were the super-institution of the state, educational institutions, and the institution of private enterprise. The powerless group consisted of the numerous households of the institution of the working-class family.

*The State as the Guardian of Property.* According to Mill, the state was a super-institution in the sense that it was the guardian of "that primary and fundamental institution, on which . . . the economical arrangements of society have always rested," namely the "institution of individual property." In performing their function as conservators of property, the makers of "legislation" had, in cooperation with the executive and judicial branches of government, taken "much pains to aggravate the inequality of chances arising from the natural working of the principle" of private property. The consequences of the working of this principle were "sufferings and injustices" (CW 2, pp. 200-1, 207-8) because

the institution of private property necessarily carried with it as a consequence, that the produce of labour should be apportioned as we now see it, almost in an inverse ratio to the labour -- the largest portions to those who have never worked at all, the

next largest to those whose work is almost nominal, and so in a descending scale, the remuneration dwindling as the work grows harder and more disagreeable, until the most fatiguing and exhausting bodily labour cannot count with certainty on being able to earn even the necessities of life (CW 2, p. 207).

The powers that be were fully aware that a continuation of the existing distribution of property, and hence of income, depended on the fulfillment of two conditions: In the first place, a continuously forthcoming supply of decision makers in government and business who possessed a politically correct *Weltanschauung* and, secondly, a continuous willingness on the part of the masses to accept unquestionably their present station in life. As Mill saw it, the state had vested educational institutions with the responsibility for the achievement of these objectives.

*Education and Lack Thereof.* According to Mill, in Great Britain of his day, "all classes, from the highest to the lowest, . . . [were] wretchedly ill-taught." At the levels of the universities and the secondary "schools for the higher and middle classes," the problem was not lack of schools or resources. "There are enough of them," said he, "and they have funds enough, to give a good education." Nevertheless, he continued, "[w]e are . . . a most unlearned nation. Those 'venerable institutions' have nearly rooted out learning from among us." "Why is this?" Mill asked and he answered: "Because the teachers are unfit for their work, or, at all events do not do it." The faculties inculcate their students with opinions and ideas that belong to bygone ages. In other words, "the business for which they are paid, is not to make the human mind advance but . . . to keep it where it is" (CW 28, p. 322; CW 1, p. 429; CW 28, p. 322; and CW 26, p.349).

"The elementary schools for the children of the working classes, are still worse" than the universities and the "grammar schools", observed Mill. Although a "large . . . portion of our people are still destitute of any means of instruction whatever," he argued that the "*quantity* of teaching is a secondary consideration to the *quality*." "[M]ind must be taught by mind" but there was a shortage of minds qualified to teach. "Even if we were to think with the vulgar, that anyone who knows a thing can teach it -- even so the bulk of the existing schoolmasters could teach nothing, for they know nothing; no *thing*, no *words* even." Hence the "children do not at present even learn to read." And of course, "[n]o attempt is made to communicate ideas, or to call forth the mental faculties" of the pupils (CW 6, pp. 199-200). As result, the uneducated did not feel any "want of the mind," or any "want of being wiser and better" (CW 4, p. 213). Being therefore both ignorant and blissfully unaware thereof, the masses were gullible and accepted uncritically the justification for, and celebration of, the existing socioeconomic order as they were exhorted to do by the institutions of state and education.

If, however, the institution of private property were to bestow its blessings upon those who laid claim to it, still another institution was needed to ensure that income would be distributed "in an

inverse ratio to the [volume of] labour" supplied by the major classes of income receivers (CW 2, p. 207). Through its policy of *laissez-faire*, the state delegated this allocating function to the institution of private enterprise.

*Private Enterprise and Markets.* Private enterprises and markets for goods and services were the institutions that regulated the activities of all economically active persons in that capitalist order that Mill analyzed. It was an order in which the accumulation of capital was propelled by entrepreneurial employments of an increasing volume of new "mechanical inventions" that caused a continuous expansion of the "fund from which savings can be made." The institutional arrangements in the market for labor ensured that the bulk of this surplus ended up as "returns to the capitalist" rather than being funneled into the "wages-fund" that sustained the worker (CW 2, pp. 189, 160-1, 337).

The wages paid out of this fund "depend mainly upon the demand and supply of labour." The "existing habits" of the working classes, in conjunction with the capitalists' customary search for maximum "profits," caused wages to gravitate toward a level that the workers viewed as a minimum subsistence rate. The workers' habits in question were of a kind that made them heedless of any "inducements not to marry." Consequently, they exercised hardly any "control . . . over the animal power of multiplication" (CW 2, pp. 337, 188, 402, 347, 354).

The ceaseless process of accumulation, and the resultant increase in the demand for labor, tended occasionally to engender a temporary jump in wage rates. Hence marriage became suddenly affordable for more young people than in the immediate past. The results were a swelling of population, a consequent increase in the supply of labor and, following on its heels, a downturn of wage rates. Thus in spite of temporary deviations there from, the outcome of these gyrations would be the establishment of a long-run "rate of wages, [that was] either the lowest on which the people can, or the lowest on which they will consent, to live." And "though they would gladly have more, [they] will live on that (as the fact proves) rather than restrain the instinct of multiplication" (CW 2, p. 361).

Moreover, there were customs abroad in markets for commodities that contributed to the misery of the working classes. These were customs that molded business behavior in such a manner that "competition either [was] not taking place at all, or producing its effect in quite a different manner from that which is ordinarily assumed to be natural to it." In the first place, there were market forms similar to those labeled monopolistic competition today, namely a kind of "competition . . . [that] often, instead of lowering prices, merely divides the gains of the high price among a greater number of dealers." Secondly, there were cartel-like arrangements in trades where "competitors are so few, [that] they always end by agreeing not to compete. They may run a race of cheapness to ruin a new candidate, but as soon as he has established a footing they come to terms with him" (CW 2, pp. 239, 243, 142). Thirdly, because of the introduction of new technologies, there were at Mill's time "many

cases in which production is made much more effective by being conducted on a large scale" by means of "expensive machinery" which "supposes a large capital." Large capitals were formed "by the combination of many small contributions; or, in other words, by the formation of joint stock companies" (CW 2, pp. 131, 133, 135). This technology-driven modification of the institution of property spawned another alteration of that institution, namely a separation of ownership from control: "shareholders" own a joint-stock company but its "administration . . . is, in the main, administration by hired servants" (CW 3, p. 897; and CW 2, p. 137).

Because of the "increased effectiveness of labour" in the large-scale corporation, such a business has acquired the "power of permanently underselling," and hence of eliminating, its "competitors" who then "either sink into the condition of hired labourers, or become dependent on others for support" (CW 2, pp. 133-5). The fact that "business of all kinds [is being thrown] more and more into the hands of large . . . joint-stock companies" gives each of these institutions the power to engage in private price administration (CW 18, p. 136).

Given the tendency of money wages to gravitate toward a minimum subsistence rate, the upward creep of prices occasioned by their administrators made it increasingly onerous for the working classes to perform their institutionally assigned role as the premier victims of the mal-distribution of nominal income.

*The Working-Class Family.* Because of their mis-education and poverty, Mill likened the "labouring masses" to an "uncultivated herd" (CW 1, p. 239). One consequence of their ignorance was that both men and women of the working-class families accepted the ancient institution of gender inequality "which entirely subordinates the weaker sex to the stronger." Thus although women of the educated classes might differ in this respect, working-class women were "consenting parties" to the "rule of men over women." This rule was "accepted voluntarily" by the latter class of women because they were "brought up from the very earliest years in the belief that their ideal of character is . . . submission, and yielding to the control of others" (CW 21, pp. 264, 270-1).

Mill was convinced, however, that discrimination against women was a "relic of the past [that was] discordant with the future." Hence it "must necessarily disappear" (CW 21, p. 272). The removal of the institution of sexism was only one part of his plans for an improvement of the condition of the working classes, however. And hinting at the nature of the needed reforms and at the institution that was to initiate such reforms, Mill observed that he knew "of no branch of the general culture of the mental faculties, which is not a fit subject for a State provision." In short, a state-supported system of "national education" for all was to provide a solution of the problem of poverty (CW 6, p. 227; and CW 21, p. 63).

## MILL'S INSTITUTIONALIST SOCIAL ECONOMICS

Mill's vision of the good society of the future, to be achieved by means of reform, was one in which a solution had been found to the problem of "how to unite the greatest individual liberty of action, with a common ownership in the raw material of the globe, and an equal participation of all in the benefits of combined labour." He "saw clearly," however, "that to render such a social transformation either possible or desirable, an equivalent change of character must take place both in the uncultivated herd who now composes the labouring masses, and in the immense majority of their employers" (CW 1, p. 239). As intimated above, Mill was convinced that such a revolutionary change of the human character could be brought about only through the establishment of schools "for all" children and of "schools for teachers." Without the latter, the former "would be of little value." And Mill repeated his often-stated conviction that in making such an investment in the future formation of human capital, the state would pursue "that highest and most important of all the objects which a government can place before itself" (CW 21, p. 63).

Given the fact that Mill was convinced that the institution of the state was *the* guardian of private property and hence the architect of the malignant neglect of education for and of the poor, it might be asked how he could be so optimistic as to assume that the very same state would take steps that, in the opinion of the powers that be, would undermine the institution of private property. The answer is that Mill did not assume that the state as *presently* constituted would promote educational reforms. He did believe, however, that the government could be prompted at some future date to take the necessary steps if a sufficiently powerful demand for education should arise. "It is to the public mind, therefore, that those who desire any change must address themselves" (CW 21, p. 64). This is exactly what Mill decided to do.

In writing on educational issues, Mill emphasized the impact of education upon the growth of population, upon the institution of private property, and upon the role and place of women in society, in particular those of working-class women.

*Population.* In spite of the fact that "[r]eligion, morality, and statesmanship have vied with one another in incitement to marriage, and to the multiplication of the species," Mill was convinced that this impulse could be restrained, but not "until the producing of large families is regarded with the same feelings as drunkenness" (CW 2, p. 268, p. 268n). Such a sentiment on the part of adults could be generated only by their education in childhood and youth. Although he refrained from discussing in detail "either the principles or the machinery" of the requisite education, Mill was of the opinion that its purpose should be to foster the idea "among the labouring class, that the competition of too great numbers was the special cause of their poverty; so that every labourer looked . . . upon every other who had more than the number of children which the circumstances of society allowed each, as doing him wrong." Mill was therefore confident that if "the opinion were once generally established

among the labouring class that their welfare required a due regulation of the numbers of their families," the educated members "of the body would conform to the prescriptions" (CW 2, pp. 375, 371-2).

Although education for population control was necessary for a solution of the problem of poverty, it was not sufficient. It had to be combined with other types of education designed to provide the members of the working class with those abilities, skills, know-how and patterns of behavior that they would have to possess if they were to bring about that alteration of the institution of property that Mill found to be indispensable if the war against poverty were to be won.

*The Institution of Property.* Mill was confident that the plight of the working class might be alleviated before long in consequence of a potential convergence of two evolving phenomena in society. One was a fact and the other was a potentiality. The fact was that technological advances had made labor "more productive on the system of large industrial enterprises" than in small-scale businesses (CW 3, p. 768). The potential phenomenon was in the form of those newly honed faculties that the working classes would possess if Mill's recommendations for educational reform were implemented.

When the two forces coalesce at a future date, the workers' formal education will have been supplemented by informal education on the job in large-scale factories where they will have learned the art of cooperation because they had been thrown into a situation in which they had "to work with or for one another in relations not involving dependence." Once the workers have reached this point in their human development, they will be ready to shed their status as wage earners. Hence "I cannot think," said Mill, "that they will be permanently contented with the condition of working for wages as their ultimate state" (CW 3, pp. 768, 766). This status will be reserved for that minority of "workpeople whose low moral qualities render them unfit for anything more independent." The well educated workers, on the other hand, will enter into "partnership, in one of two forms: in some cases, association of the labourers with the capitalist; in others, and perhaps finally in all, association of labourers among themselves." And Mill was optimistic enough to believe that "if mankind continue to improve," the form of association that "must be expected in the end to predominate" will be the "association of the labourers themselves on terms of equality, collectively owning the capital with which they carry on their operations, and working under managers elected and removable by themselves" (CW 3, pp. 769, 775).

In Mill's opinion, large-scale producer cooperatives would be more efficient than large-scale corporations. In the first place, co-operatives would be managed more efficiently than corporations. In the former, the "capital would be employed carrying on a business with which all the persons concerned are alike familiar" and to which "their whole attention" is given daily. Consequently, they would "keep a much better control over the managers" than do the directors in corporations, and "be



much better judges of who would be the best managers" than are the corporate directors (CW 5, p. 426). Although they "are supposed to superintend the management," the directors "have no pecuniary interest in the good working of the concern" because the shares they hold "are always a very small part of the [joint-stock] association, and in general but a small part of the fortunes of the directors themselves." Secondly, the cooperative form of organization "tends, still more efficaciously, to increase the productiveness of labour" because the workers would be placed, "as a mass, in a relation to their work which would make it their principle and their interest -- at present it is neither -- to do the utmost, instead of the least possible, in exchange for their remuneration" (CW 2, p. 137; and CW 3, pp. 791-2).

But how are the cooperatives to be financed? It seems that Mill was of the opinion that the workers themselves would be capable of providing some funds. "I think," said he, that "there is much more advantage to be gained to the working classes by this than by any other mode of investing their savings." He also seems to have assumed that the "security for good management" in the cooperatives might be attractive to some members of the *petite bourgeoisie* "whose savings are small." And once a cooperative is a going concern, its expansion could be financed by its "members who, instead of consuming their share of the proceeds, might chose to save it, and add it to the capital of the association" (CW 5, pp. 410, 425, 411).

The achievement of financial independence for the cooperatives marks the beginning of the end of the capitalist institution of property:

As [cooperative] associations multiplied, they would tend more and more to absorb all work-people, except those who have too little understanding, or too little virtue, to be capable of learning to act on any other system than that of narrow selfishness. As this change proceeded, owners of capital would gradually find it to their advantage, instead of maintaining the struggle of the old system with work-people of only the worst description, to lend their capital to the associations; to do this at a diminishing rate of interest, and at last, perhaps, even to exchange their capital for terminable annuities [issued by the cooperative associations]. In this, or some such mode, the existing accumulations of capital might honestly, and by a kind of spontaneous process, become in the end the joint property of all who participate in their productive employment (CW 3, p. 793).

And Mill concluded: "assuming of course that both sexes participate equally in the rights and governance of the association[s]," this transformation "would be the nearest approach to social justice, and the most beneficial ordering of industrial affairs for the universal good, which it is possible at present to foresee" (CW 3, p. 794). Women would be capable of entering into partnership with men because they would have been liberated in the course of the very same process that led to the abolition of the capitalist institution of property.

*The New Position of Working-Class Women.* At the same time as men were being educated to accept women as equal partners, each working-class woman had "to be so educated, as not to be dependent either on her father or her husband for subsistence" (CW 21, p. 42). This meant education for a change in attitude as well as for industrial employment. Echoing his wife, Harriet Taylor Mill (Taylor in CW 21, p. 400), Mill declared that the resultant "opening of industrial occupations freely to both sexes" would have the effect, not only of increasing aggregate production, but also of removing a hitherto "forced dissimilarity of [the] social functions" of men and women. Among other things, the "industrial and social independence of women," and hence their admission "to the same rights of citizenship with men" would greatly reduce the "evil of overpopulation. It is by devoting one-half of the human species to that exclusive function, by making it fill the entire life of one sex, and interweave itself with almost all the objects of the other, that the animal instinct in question is nursed into the disproportionate preponderance which it has hitherto exercised in human life." The gainful employment of women would reduce that preponderance. "[P]opulation, therefore, will bear a gradually diminishing ratio to capital and employment" (CW 3, p. 765; CW 2, pp. 372-3; and CW 3, pp. 766, 765).

*Mill's Predictions.* Mill was confident that, if implemented, his proposals for reform would prevent the materialization of David Ricardo's dismal "stationary state." A stationary state would come about, but it would be a virtuous one that would "exhibit these leading features" (CW 3, pp. 752, 755):

a well-paid and affluent body of labourers; no enormous fortunes, . . . but a much larger body of persons than at present, not only exempt from the coarser toils, but with sufficient leisure, both physical and mental, from mechanical details, to cultivate freely the graces of life . . . . This condition of society, so greatly preferable to the present, is not only perfectly compatible with the stationary state, but, it would seem, more naturally allied with that state than with any other (CW 3, p. 755).

Hence Mill looked forward to a future when, in a setting of "just institutions, the increase of mankind shall be under the deliberate guidance of judicious foresight." Only then "can the conquests made from the powers of nature by the intellect and energy of scientific discoverers, become the common property of the species, and the means of improving and elevating the universal lot" (CW 3, p. 757).

And all this would have to be brought about by education that would replace the change-resisting static customs of the major economic actors by change-promoting dynamic customs.

## CONCLUSION

Is one justified in arguing that Mill anticipated at least some of the Ayresian strand and some of the Etzionian elements in the humanistic strand of modern social economics? As for the first strand, Mill



argued *a la* Ayres that dynamic technology may modify institutions. Unlike Ayres, however, who viewed technology and institutions as being separate and "oppos[ing] each other" (Ayres 1952, p. 59), Mill maintained that an institution harbors both dynamic (technological) and static (ceremonial) elements. Mill seems, therefore, to be closer to some of Ayres's followers than to Ayres himself. These latter-day Ayresians assert that technological aspects and ceremonial aspects "are intertwined within the institutional structure" (Bush 1988, p. 129).

With regard to his anticipation of the second strand, Mill substituted an institutionalist analysis for Etzioni's deontology. But then Mill merged his institutionalism with his embryonic neoclassicism just as Etzioni synthesized neoclassicism and deontology. Moreover, Mill's emphasis on the role of economics as a springboard for reforms is in accord with Etzioni's claim that his branch of social economics "seems promising as a guide for action and hence for *policy analysis*" (Etzioni 1990b, p. 238).

It seems, therefore, that Mill anticipated both the Etzionian and the institutionalist strands in modern social economics. In one fundamental sense, he out-Etzionied Etzioni and out-Ayresed Ayres, however. There is no indication in the writings of Ayres and the Ayresians nor in the works of Etzioni that they believed that it would be possible -- by means of institutional reform -- to alter human aspirations and behavior so completely and so radically as postulated by Mill. In other words, Mill was much more of a Utopian than Etzioni or the institutionalists.

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# **PHILOSOPHICAL FOUNDATIONS OF SOCIAL ECONOMICS: MARX, SCHUMPETER, AND KEYNES**

John E. Elliott

The "philosophical foundations of social economics" has been one of William R. Waters' continuing, life-long, scholarly interests. This essay seeks to identify and examine as systematically as possible within the confines of brevity the leading implications for social economics of certain broad foundations or basic ideas of a philosophical nature.

By "philosophical foundations," we usually mean those fundamental, often presupposed or unexamined, ideas which underlie one or more of the various "sciences." The sciences presumed here are social, humanistic, and historical, that is, sciences which pertain to what Thorstein Veblen called the evolution of the "life-process" of human beings in social context and interaction over historical time.

It is common to divide philosophical foundations into views concerning: (1) history (philosophy of history); (2) the ultimate nature of nature and human nature (metaphysics); (3) rules concerning the validation of ideas, that is, the (un)certainty of our knowledge (epistemology); (4) the ethical principles guiding or emanating from our studies (moral philosophy); and (5) the "beauty" of the order or form which guides the construction and communication of our discourse (aesthetics).

Succeeding sections will consider, in turn, each of these topics. In the spirit of a *festschrift*, footnotes and references will be kept to a minimum.

## **ON HISTORY AND HISTORICAL CHANGE**

Joseph A. Schumpeter, in his monumental work on the history of economic ideas (Schumpeter 1954) designates economic history (together with economic theory, economic statistics, and economic sociology) as one of the four components of economic analysis. Indeed he goes so far as to say that if we had to pick only one of the four components, that component should be history.

The great economists of the past, for instance, Karl Marx, Joseph Schumpeter, and John Maynard Keynes, all put their theories down in history. Specifically, they all understood "capitalism" as a historical phenomenon, changing and evolving over historical time. Marx, for example, identified four major stages of capitalist evolution as mercantile-, manufacturing-, industrial-, and monopoly-capitalism, each with its differentiating properties and each rooted in its predecessor(s) and leading to its successor(s). Schumpeter differentiated between small-scale, competitive, proprietary capitalism and large-scale, oligopolistic, corporate capitalism. He defended the shift

from the former to the latter on economic grounds, and lamented the social, political, and psychological forces which were driving the latter on toward its eventual destruction and to "socialism" as capitalism's "heir apparent." Keynes made an essentially similar distinction to Schumpeter's, and attributed endemic uncertainty, downward drifts in marginal efficiencies of capital, and worsening cyclical depressions significantly to the phenomena of corporate capitalism, such as separation of management from ownership and the enlarged role of stock market speculation and "animal spirits."

History may be understood, in a narrow sense, as nothing more than a "mere inventory of episodes and incidents." But for social economists, socially-oriented economists who do not expressly describe themselves as "social economists" (such as Marx, Schumpeter, and Keynes), and economic sociologists such as Max Weber (Weber 1978), what makes history truly "history" is that "events are observed as belonging to a process, a continuity that has some direction, passes through stages, and crosses some thresholds" (Lewin 1991, p. vii). In short, for social economics, the historical pertains chiefly to a blending of theory and history, ultimately rooted in general ideas about historical change.

One classic (and typically distorted) example is the nineteenth century debate over "materialism" versus "idealism." This debate is sometimes presented as one in which contending philosophies line up and oppose one another in terms of the dominance of ideas versus material forces (or, even more murkily, "mind" versus "matter") in society and historical change. Karl Marx and George Hegel, for instance, are characteristically pitted against each other as expounders of opposing philosophies of history. In an over-simplification (in Marx 1967, I, Preface), Marx indulged himself by saying that he found Hegel upside-down, and turned him right-side-up. Actually, Marx never used such expressions as "dialectical materialism" or even "historical materialism." He preferred such expressions as "materialist interpretation of history," which generally embodied: (1) the study of people as members of social classes or groups (for example, landowners, capitalist, workers), rather than as socially undifferentiated individuals; (2) an emphasis on the socioeconomic structure of production and property relations as a central topic for investigation; and (3) the placement of these two themes in a historical setting or context entailing mutual interconnections among changes in such things as technologies, markets, property, politics, and ideologies.

The twentieth century has witnessed the horrors of the Holocaust and the Gulag. It is difficult to accept earlier notions of the inevitability of human progress or perfectibility. Still, one of the enduring themes in religious and philosophical literature which retains significance for social economics is the interpretation of history as having meaning or purpose. For Hegel, for example (Hegel, 1956), History tells the story of the evolution of Freedom. In the classical Oriental despotisms, the despot was free. In ancient Greek and Roman slave-owning societies, the slave-owners were free. In the civil or bourgeois societies of the Italian cities of the Late Middle

Ages and the Renaissance, a middle class of master craftsmen and merchants became free. In Marx's extension of this vision, in a post-capitalist society, all working people would freely and equally share sovereignty and authority over the economic and political decisions which affected their lives. In Marx's futurist extension, rooted in his analysis of an evolving capitalism which progressively extended freedom, albeit for a relatively wealthy and privileged minority, realization of the vision is not inevitable, because it depends crucially on the solidarity and capability of working people to break away from an existing, but evolving, social order to create a new and, in Marx's view, freer one. Perhaps what is most important, however, is recognition and explication of the idea of human potentiality; that is, people as they are at a given moment (or past set of moments) of time does not exhaust what they can potentially become in the future (Macpherson, 1977). And the fact that historically human beings have changed, and at times for the better, gives at least some support for a hopeful and progressive twist to the age-old question of whether and to what extent past and present may help guide, if not invariably foretell, the future.

### ON THE NATURE OF HUMAN NATURE

In standard neoclassical theory, individuals, given "tastes," technologies and resources, institutions, and prices of all goods, are confronted by scarcity of all human and non-human capacities relative to human wants. This confrontation elicits a highly rationalist, strictly individualist, process of calculation and allocation, leading to a stasis or equilibrium of each individual and, through purely impersonal processes of market coordination, over which none has any control, to equilibrium between contending market forces of demand and supply as well.

This conceptualization of human action and interaction pre-supposes an extremely limited, some would say impoverished, view of the nature of human nature as excessively rationalist, calculative, and individualist. It ignores processes of learning and change, omits social and cultural conditioning, and abstracts from social, class or other differentiations of human beings in different times or contexts. As a "philosophical foundation" for social economics, it raises more questions than it answers.

The three economists mentioned in the preceding section, that is, Marx, Schumpeter, and Keynes, propound or imply broader conceptualizations of human nature and thereby richer and more variegated foundations for social economics. Keynes, for example, postulates that human beings, notably, in their decisions as consumers, are habitual creatures, who adjust their consumption patterns slowly over time (Keynes 1936, pp. 97-98). Under conditions of systemic uncertainty, investors are highly conventional, adopting the convention that things will go on as they have been unless or until they have been starkly invalidated by new facts. Stock market speculators, according to Keynes, make their decisions based not on long-run prospects of profitability, but in "foreseeing

changes in the conventional basis of valuation a short time ahead of the general public," that is, "in anticipating what average opinion expects average opinion to be" (Keynes 1936, pp. 154, 156).

Schumpeter also presents a variegated interpretation of human natures by distinguishing between "entrepreneurs" and others. Schumpeter conceives entrepreneurs as those who commercially introduce new ideas or innovations. In sharp contrast to the narrowly calculative "economic man" of classical and neoclassical theory, entrepreneurs are men of vision and daring, who are willing to strike out into the unknown in opposition to settled patterns of business, and to take great chances in hopes of unusually large profits. The entrepreneur is a "heroic" figure. He exhibits "the drive and the will to found a private kingdom" as a "captain of industry"; the "will to conquer," to fight for the sake of the fight rather than merely financial gain; and the desire to create new economic conditions. His motivation is not hedonistic in the customary sense; indeed, it is "[in] capable of being satisfied by the consumption of goods" (Schumpeter 1983, pp. 92-93).

Marx provides several important insights concerning human nature. His fundamental point is to differentiate between "human nature in general" and "human nature as modified in each historical epoch." In general, man is both a "natural" being, with needs and capacities to eat, sleep, work, rest, and so on, and a human natural being, with distinctly "human" needs and capacities. Among these, Marx identifies the free, conscious, purposive exercise of creative intelligence in productive "life activity" as "exclusively human." What "distinguishes the worst of architects from the best of bees" is that "the architect raises his structure in imagination before he erects it in reality" (Marx 1967, I, pp. 609, 177-78). Moreover, like Aristotle, Marx believes humans are, by nature, social and political creatures. On the one hand, their production and exchange "confirms [their] real social life" (Marx in Bottomore, 1963, pp. 126-28). On the other, men are community builders. Together, they construct public lives and relationships. Lastly, free, creative, social labor is a human need as well as capacity. The individual, Marx contends, "needs a normal portion of work, and of the suspension of tranquility"; the overcoming of obstacles in the pursuit of aims "is in itself a liberating activity," a means of "self-realization, objectification of the subject, hence real freedom, whose action is, precisely labour," when the aims are posited by the individual himself (Marx 1973, p. 611).

Whereas human nature "in general" pertains to those qualities that distinguish human beings from other animals, human nature "as modified in each historical epoch" connotes the fact that "history is nothing but a continuous transformation of human nature" (Marx and Engels 1976, 6, p. 192). As modes of working and producing change, patterns of living understood as "naturally human" also change. "By thus acting on the external world and changing it man at the same time changes his own nature" (Marx 1967, I, p. 177). In short, it is human nature to change human nature.

Moreover, different classes of people demonstrate different "natures" because of their alternative conditions of life-activity. Workers, for example, are embedded in what Marx called the C-M-C

economy. Because they sell their labor power for a money wage and use that to purchase commodities, it is natural that they focus on commodities and use values. By contrast, capitalists are enveloped by a M-C-M economy, wherein they start and end with money exchange; commodities, both the labor power and other things which they purchase and the produced commodities which they sell, are merely means to the attainment of monetary enrichment and accumulation.

### ON KNOWING TRUTH WITH (UN)CERTAINTY

Ineradicable uncertainty is an integral component of the theories of such socially oriented economists as Marx, Schumpeter, and Keynes. For Marx, market uncertainty is ever-present, and economic crises are always possible:

Every seller does not bring his buyer to market with him. ... No one can sell unless someone else purchases. But no one is bound to purchase because he has just sold. ... If the split between the sale and the purchase become too pronounced, the intimate connexion between them, their oneness, asserts itself by producing -- a crisis (Marx 1967, I, pp. 113-14).

For Schumpeter, uncertainty is built into the very processes of capitalist innovation and development, in the form of "perennial gale[s] of creative destruction" (Schumpeter 1950, p. 84), wherein the creation of new products, methods of production, sources of supply, and so on destroy old ones. For Keynes, uncertainty concerning future interest rates is the "necessary condition" for existence of a speculative demand for money and uncertainty concerning future asset prices and hence expected profit rates is the most powerful single factor explaining fluctuations in investment and thus economic activity in general (Keynes 1936, p. 168).

Real-world economic uncertainty is a primal foundation for uncertainty concerning the validity of economic theories. Precisely because human beings are free, purposeful, and creative, and because human natures change irreversibly over historical time, the nature of economics in general and social economics in particular is discordant with that presupposed by the canonical approach to epistemology which underlies standard economic theory.

The epistemological perspective underlying most economic theory in the twentieth century has been that of "logical positivism" (or "logical empiricism"). The conceptualization of scientific endeavor embodied in this philosophical approach to science identifies the following main steps: (1) construction of assumptions or axioms (A); (2) deduction of theories or theorems (T) from specified axioms; (3) derivation of specific predictions (P) from theorems; (4) testing of the validity of predictions by assessing the extent of their correspondence with real-world evidence or experience (E). Thus:  $A \rightarrow \rightarrow T \rightarrow \rightarrow P \rightarrow \rightarrow E$ .



What we have earlier called the "canonical" approach to testing scientific theorems in economics is associated especially with the writings of Karl Popper (Popper 1959). According to Popper, we do not know truth with certainty, and hence are unable to prove that a scientific theory is definitively correct. But it is possible to demonstrate that one theory is falsified while another is not. The favored example of science illustrating this procedure is classical, Newtonian physics, wherein the following conditions hold:

all changes are reversible,  
all outcomes are predetermined and conceivably predictable,  
an appropriate means of testing [a] statement is through the precise prediction of specific outcomes, and  
time is without substantive content but only constitutes a space for the unfolding of predetermined relationships (Solo 1991, p. 22).

Social economics, however, is not "like" these elements of classical, Newtonian physics. Because of irreversible historical change, the nature of human nature, and systemic uncertainty, the content of economics (especially, social economics) is quite different from physics.<sup>1</sup> Also, when competing assumptions yield divergent theories or a theory provides more than one outcome, it is "impossible to tell" which "set of outcomes is different enough from a predicted set to falsify the theory" (Solo 1991, p. 29).

Moreover, contending social and economic theories typically focus, not on specific predicted outcomes, but on "tendencies" or "essential qualities," as, for example, in the tendency for the rate of profit to fall (Marx), the process of creative destruction to engender cyclical fluctuations (Schumpeter), or the economy to settle into low-level "equilibrium with less than full employment" (Keynes). In this event, the falsification of a specific prediction not only does not, but strictly speaking cannot, falsify a tendential theory. In any event, the canonical procedures for falsifying theories have not been followed in scientific practice as Kuhn (Kuhn 1962) and others have persuasively observed. Consequently, the "best we can do" in terms of testing theories is to gather the facts as best we can, to "weigh the evidence pro and con," and then to render our best judgment. This makes our "system of social judgment" more akin to that of the "courts and their processes of counter-advocacy before judge and jurors" than to "science" in the classical, canonical sense (Solo 1991, pp. 95-96).

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<sup>1</sup> Twentieth century quantum mechanics has substituted uncertainty and falsifiability through probabilities for the certainty of classical, Newtonian physics.



## ON SOCIAL ECONOMICS AS MORAL PHILOSOPHY

According to Keynes, in a letter to Roy Harrod (Harrod 1938, p. 297), "economics is a moral science and not a natural science. That is to say, it employs introspection and judgments of value." Normative elements are also clearly found in the economic thought of Schumpeter and Marx. Each of these three economists represents a classic alternative position concerning the normative assessment of the ethical consequences of capitalist economy. Because, by common consensus of social economists, normative evaluation is essential to, and in any event impracticable if not impossible to evict from economic analysis (Elliott, 1980), this reinforces their designation as scholars who contributed significantly to the moral philosophical foundations of social economics.

Schumpeter provides a "conservative" normative evaluation of capitalism. According to Schumpeter, capitalism has generated not only remarkable long-term economic growth and development, but, over time, has delivered these benefits widely to the masses of the population. Capitalism's problematic features, for example cyclical fluctuations, unemployment, monopoly, and inequality, (1) are essentially short-run in nature and, in any event, (2) are in effect the price that society pays for capitalism's long-term dynamic growth and development. In addition, capitalism had made contributions to civilization extending far beyond the economic, as in science, medicine, support of the arts, democracy, social legislation, and a proclivity toward peace in international affairs. In short:

Not only the modern mechanized plant and the volume of the output that pours forth from it, not only modern technology and organization, but all the features and achievements of modern civilization are, directly or indirectly, the products of the capitalist process. They must be included in any balance sheet of it and in any verdict about its deeds or misdeeds (Schumpeter 1950, p. 125).

Marx, by contrast, provides a "radical" critique of capitalist civilization. This critique implies a sort of "love-hate" view of capitalism. On the one hand, capitalism and its dominant social class, the bourgeoisie, has been an immensely creative force in modern civilization:

The bourgeoisie cannot exist without constantly revolutionizing the instruments of production, and thereby the relations of production and with them the whole relations of society. ...

The bourgeoisie ... draws all, even the most barbarian nations, into civilization. ...

The bourgeoisie has subjected the country to the rule of the towns. It has created enormous cities. ...

The bourgeoisie, during its rule of scarce one hundred years, has created more massive and colossal productive forces than have all preceding generations together (Marx and Engels 1964, pp. 7-10).

On the other hand, Marx indicts capitalism for engendering, indeed enlarging, alienation, exploitation of labor, large inequalities, great depressions and mass unemployment, and monopoly. Although reforms may help to ameliorate some of these social evils, the working class can achieve a genuine human emancipation, for society as a whole as well as itself, and thereby attain liberty, equal sovereignty, and authentic community only by constructing a post-capitalist society embodying these qualities. Marx believes that, over time, capitalism's contradictory and destructive features rise relative to its creative ones. Therefore, the uneasy balance between admiration and moral critique of capitalism in Marx's thought tilts increasingly toward condemnation as capitalism evolves. His moral vision and socioeconomic insight remain complementary, however. It is not necessary for analysis of the True to "determine" the Good by reductionist derivation from [history's] inexorable "laws," nor for the vision of the Good to idealistically prejudge the True on the basis of "eternal," invariant moral codes because each co-validates the other through an interactive process in which real, living, conflicting, and creative human beings both make and are made by their own history (Elliott 1987, p. 42).

Keynes takes an intermediate, "liberal," position in his ethical assessment of modern economic society. On the one hand, "individualistic capitalism," through "decentralization and the play of self-interest," contributes greatly to economic efficiency. "[I]f it can be purged of its defects and its abuses, [it] is the best safeguard of personal liberty [because it] greatly widens the field for the exercise of personal choice. It is also the best safeguard of the variety of life, which emerges precisely from this extended field of personal choice..." (Keynes 1936, pp. 317, 380).

On the other hand, contemporary capitalism, as constituted prior to World War II, had two "outstanding faults," namely "its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes." To remedy these problems, Keynes propounded the greater use of "central controls" and a "large extension" of the "traditional functions of government." To "ensure full employment" and to temper inequitable wealth and income distribution, the "State will have to exercise a guiding influence on the propensity to consume," partly through taxation and partly through monetary policy, by "fixing the rate of interest." An activist, typically expansionary, monetary policy is also needed as one, although by itself probably insufficient, means to foster private investment. Beyond these measures, a "somewhat comprehensive socialization of investment," notably a substantial program of public infrastructure investment to supplement private investment, will be necessary as the "only means" to approximate full employment. Finally, both because high and downward sticky interest rates discourage investment and because "interest today

rewards no genuine sacrifice, any more than does the rent of land," Keynes proposes vigorously expansionary monetary and fiscal policies so as to expand the stock of capital and thereby push the rate of return on capital to a "very low figure." The result would be the "euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital." Overall, these programs would stop significantly short of "State Socialism," but would constitute a "new system," characterized by a considerable "enlargement of the functions of government" and a supersession of the "rentier aspect of capitalism" (Keynes 1936: pp. 375-76, 378, 380-81).

The value judgments inherent in the kinds of normative and policy assessments provided by such economists as Marx, Schumpeter, and Keynes interact with, indeed require, the general theoretical and empirical judgments of social economics. On the one hand, normative evaluations imply empirical judgments, for example, to predict the effects of monetary and fiscal policies on prospective reductions in unemployment. On the other, value judgments are akin to empirical assessments in that both entail weighing pros and cons of evidence and experience and rendering judgments based on such inquiry (Elliott 1980).

A value judgment, however, goes beyond theory and empirical research, in that it "asserts an obligation, a moral command. Hence it allows of no inferential prediction or falsification through the failure of prediction" (Solo 1991, p. 113). Still, normative discourse is contributive to social economics, especially in the context of democracy, where we presuppose that informed judgments by many ordinary citizens, for most issues and in the long run, are less likely to be wrong, both morally and empirically, than the specialized and narrow judgments of "experts" or a small number of persons, as in autocracy or oligarchy.

Specifically, normative discourse in social economics can yield several significant benefits, as Robert Solo (Solo 1991, pp. 113-14) usefully summarizes. First, it can "drive value imperatives out into the open" and make them subject to scrutiny and explicit assessment. Second, it opens policy discussions to an awareness of the nature and limitations of normative discourse; that is, to both the "absolute necessity" of value judgments and the "vulnerability" of value judgmental claims to authoritative status. Third, normative discourse contributes to discovery of "common denominator[s] of moral commitment" and thereby to forging the adjustment, compromise, and "consensus required for effective public action." Fourth, it provides a "forum" where value judgments can be "creatively formulated, propounded, challenged, [and] critiqued" and "alternative value-based systems can be contrasted and compared." Fifth, it can link empirical and ethical inquiry more effectively, by examining the empirical effects of values and the ethical effects of empirical changes, "so that judgments on both counts might be better informed."

## ON THE AESTHETICS OF DISCOURSE

One of the most prominent innovations in the methodology of economics in the twentieth century has been the mathematization of its discourse. Paul Samuelson's *Foundations* (Samuelson 1947) translated the leading ideas of economic theory from verbal into mathematical language, thereby not only contributing to the cohesion, clarity, and rigor of the discipline, but also stimulating generations of successors to follow his lead, thus transforming the character of the discourse.

Alfred Marshall, although highly qualified in mathematics, took a different, tripartite, tack, in the several editions of his master work, *Principles of Economics* (Marshall 1924). The text of this work was strictly literary and verbal. All graphical diagrams, which constituted elaborations of various points first developed verbally in the text, were placed in footnotes. Mathematical formulations of various theoretical issues, first raised in the text or in footnotes, were relegated to appendices. Marshall's dictum was that if a proposition could not be stated (first) verbally, it should not be discussed at all.

Today, from the perspective of economic theory, proponents of mathematical economics might well claim that Marshall went too far. It may well be that some statements in economic analysis (for instance, Walrasian general equilibrium) are so complex or intricate that they can be best (or only) expressed in mathematical language. It is unlikely, however, that this argument provides a persuasive rationale for the essential abandonment of verbal inquiry for mathematics in economics. In any event, from the perspective of social economics, Marshall perhaps did not go far enough. Mathematical language has its limitations as well as contributions; verbal and literary discourse is not simply vulgarization of mathematical systems, but has its zone of superiority as well as inferiority.

Insofar as economics is akin to classical, Newtonian physics, "then surely mathematics is the preferred language of discourse." In brief, the main conditions of classical mechanics entail: reversibility of all changes and functional relationships; predetermination and predictability of outcomes; irrelevance of qualitative heterogeneity, variability, and evolution; and cardinal measurement of all variables. Under these conditions, mathematics is surely "unmatched." Mathematical modes of communication are superior to verbal ones in charting "distant inferences over the horizons of possible consequences, thereby both explaining phenomena and, through inferential prediction, testing the credibility or establishing the limitations" of theorems (Solo 1991, pp. 22, 99, 101).

But when, as in social economics, the conditions of classical Newtonian physics are not met, then the argument for the superiority of mathematization "collapses." In social economics, we confront

irreversible changes through historical time, qualitative differentiation and evolution, variables which are not subject to cardinal measurement, and "radical indeterminacy" because of the free and purposive character of human nature. Essential elements of economic action, interaction, social and cultural context, and socioeconomic organization cannot (or cannot easily) be "encompassed by or accommodated to the symbolic structure of mathematics" (Solo 1991, pp. 99, 101).

Moreover, the character of discourse in social economics, especially in its empirical, policy, and normative aspects, is such as to maximize the need not for "specific inferential prediction," but for practical judgment based on mixed and conflicting evidence. Mathematical language is precise and unequivocal, whereas verbal language is imprecise and equivocal. But mathematical communication has these otherwise admirable qualities because it "abstracts from sensual experience." Judgment, especially judgment of "essential" properties or "tendencies," requires images, in fullness and rich variegation, of the sensual, "experienced reality" under consideration "that can only be conveyed," however imperfectly, "through verbal discourse" (Solo 1991, pp. 101, 103-04).

Finally, just as Marshall wanted to be understood by businessmen, democratization impels us today to be able to communicate to ordinary citizens. Although mathematics can play a "supportive, service role," especially when economists communicate to one another, verbal language is the "only rational way of establishing or challenging the credibility" of economic theories if we want to link them integrally to empirical judgments, normative values, or public and private policies in a democratic society (Solo 1991, pp. 104-05).

Despite these problematic elements in the use of mathematics in social, historical, empirical, policy, and normative inquiry, mathematization of communication and discourse was welcomed, installed, and became dominant in economics after World War II. It is reasonable to suppose that a paramount, perhaps the single most important, reason for this conquest is *aesthetic*. As Samuelson somewhere put it, encountering Slutsky's system of equations concerning utility theory was to him "like a breath of fresh air." But beauty and elegance of form and order, of rigor and precision, have been purchased at a high price in terms of sterility and loss of relevance, applicability, and communicability. Moreover, rhetoric is an integral component of the problematic of mathematical language no less than it is of verbal language, although possibly more difficult to detect in the former than in the latter.

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## ON PRODUCING EFFICIENTLY, TURNING A PROFIT, AND INVESTING IT

Schumpeter's position on the priority of investment over savings is patently clear, although unlike Keynes and Robinson he neither wished to be a rebel nor to reject the classical tradition of self-regulation. Nevertheless, to him the funds (savings, financial capital) are not prior; rather, the process of change originates on the investment side with the innovating entrepreneur. The economic system accommodates the entrepreneur by creating the funds. History illustrates lack of development when change is started on the funding side. Iberia's development in the 16th and 17th centuries, for example, was retarded rather than quickened by the expansion of new circulating media flowing in from Mexico and Peru. Inflationary influence from new precious metal is almost wholly destructive... Producers and investors, not savers or consumers, are the key to development. They initiate the process and typically work out the funding. This is often a difficult task, but bankers cooperate by forcing saving. Producers proceed when they get funds to force new products upon the consumers, who typically resist them.

William R. Waters, "Social Economics: A Solidarist Perspective," *Review of Social Economy*, October 1988, p. 124.

The most interesting part of "Can Capitalism Survive?" [cf. Swedberg, *Joseph Schumpeter, the Economics and Sociology of Capitalism*] is why capitalism succeeded in the first place. The answer is threefold: because it is built on the profit system; because of the way it selects its leaders, and, finally, because it is free.

William R. Waters, "Schumpeter The Sociologist - A Review Article," *Forum for Social Economics*, Fall 1991/Spring 1992, p. 56.

## **GAIN-SEEKING: THE ECONOMORAL NEXUS**

Peter L. Danner

Solidarity has long been a key dimension in Bill Waters' conception of social economics. The solidarity Waters espouses, transcending party, class, ethnic and other narrower kinds, is derived from the social and moral nature of the human person. In that spirit this exploration of the basis of personal integrity in economic action, is dedicated to Bill as a way of thanking him for his many years of friendship to me and invaluable service to our Association.

Discussing the economic and moral principles, which relate to economic acts, calls for at least scanning the basic logic involved. When an object of inquiry or research falls within the provinces of several sciences, full understanding of the object requires blending the insights of all the relevant sciences in so far as they pertain to the object's nature and/or functions. For example, eating is subject to both dietician's advice about healthy diets and moral principles about over-indulgence, disgusting manners and sharing with others in need. Since gain-seeking is both the driving force of economic activity and an appetite with a unique object, it falls under the purview of both economics and morality, among other sciences. Therefore, understanding gain-seeking fully as human action requires blending the relevant economic and moral principles into a guide of conduct, called economic morality.

This conclusion usually evokes an obdurate skepticism is due to the long history of contention about the role and value of gain-seeking. Reviewing this in context with the changing content of economic wealth might remove such doubts.

### **A HISTORY OF WEALTH AND GAIN-SEEKING**

Throughout the Classical and Medieval period the appetite for gain and the sense and acquisitive appetites were so intertwined that moralists made little effort in discussion to separate them. This made sense because most wealth consisted of lands, homes, furnishings, apparel, slaves, and stores of coin, things, while due to past gains, which were useful, pleasurable and bestowed economic power. Some wealth like merchants' ships and stores, artisans' shops and manorial fields needed working. But all such wealth was 'real' as distinguished from today's 'paper wealth.' Keeping this in mind helps explain why philosophers did not differentiate gain-seeking from the other vital and acquisitive appetites.

Of the ancients Plato was most inclined to see gain- and wealth-seeking as functionally linked to the other appetites, alternately feeding and motivating each other. For him a personal internal harmony

consists in reason's controlling the unruly appetites and in being content with one's economic lot (Plato 1952a, IV, pp. 430-44). In the *Laws*, he argues for limiting both population and personal wealth and restricting foreign trade to necessities. In effect Plato would suppress net gain-seeking, insisting that a stable and moral society required a zero-growth economy (Plato 1952b, V, pp. 740-46). Aristotle agrees with Plato in linking undue gain-seeking to disordered sense and acquisitive appetites (Aristotle 1952a, Book 2, Chapter 7). But since economic goods have two uses, the primary and proper use, pertaining to goods and services produced and consumed in the household to satisfy human wants, and the secondary or improper use, pertaining to goods produced for exchange, Aristotle did distinguish somewhat gain-seeking from the other appetites (Aristotle 1952b, Book 1, Chapter 9). Production being for consumption, wealth and income should be limited to living well, moderation steering between over-indulgence and repression. Trade, however, since it has no natural limit, lacks a defined purpose and is *per se* immoral. But since accumulating wealth beyond sufficiency will inevitably occur, Aristotle adapts the virtue of liberality as guide to using surplus wealth, keeping the mean between prodigality and niggardliness (Aristotle 1952a, Book 4). In this way Aristotle can at least tolerate commerce and trade.

The pragmatic successors of Aristotle and Plato like the Stoics and Epicureans, while disagreeing on basic principles, differed little in ethical practice. A scholar-politician like Cicero reflected both ethics, comfortably combining Stoic philosophizing with amassing wealth by exploiting the provinces and living luxuriously. Indeed, Christian hermits, fleeing urban turpitude, were the most faithful practitioners of Epictetus' rigid Stoicism. The Christian Platonist, Augustine, who experienced both Roman decadence and Vandal barbarism, warns the faithful on their pilgrimage to the Eternal City against setting their hearts on this world's pleasures, using but not enjoying the goods it offers (Augustine 1952, Book 1, Chapters 3-4). The saying, ascribed to him, that merchants seldom, if ever, were pleasing to God, cast a pall of suspicion on gain- and wealth-seeking for a millennium.

Following both Augustine and Aristotle, Aquinas condemns greed for gain as a root of moral evil, since money as means for the other appetites is the more universal object desired (Aquinas 1952, I-II, q.84, a.1). He echoes Aristotle in asserting that the "infinite appetite for wealth" manifests a disordered concupiscence and in tending to excess violates both justice and moderation. Acknowledging, however, the benefits of trade, Aquinas justifies profits, if earned justly and intended to subserve one's family or the common good (Aquinas 1952, II-II, q.77, a.4). This mild concession to profit-seeking helped nudge Medieval ethicists to accept grudgingly the universal possibility of economic gain. But merchants and bankers, despite their roles in provisioning cities and circulating money, were still generally suspected by Christian moralists of sensuality, avarice and pride.

One of the first to part this cloud of suspicion was John Calvin. Despite his doctrine of salvation by divine predestination, Calvin held that, while people could not be saved by means of good works, they could not be saved without them (Calvin, p. 798). Like his contemporaries condemning usury, business malpractice and injustices to the poor, Calvin preached that accepting one's vocation in life meant living industriously, frugally and soberly, using and enjoying in moderation the good things of life (Calvin, pp. 719-25). In Geneva, which he ran like a theocracy banning both licentiousness and dishonesty, Calvinism became a blue-print for economic success.

The French political theorist, Montesquieu, though not a Calvinist, carried this idea one step further: "When a democracy is founded on commerce, private people may acquire vast riches without corruption of morals...because the spirit of commerce is naturally attended with that of frugality, economy, moderation, order and rule." (Montesquieu, Book V, Chapter 7, Section 6). Transported to England, this idea provided a comfortable conscience for scholars of the 17th and 18th centuries, keen about Britain's burgeoning commercial empire (Roll 1961, Chapters II and III). Then Bernard Mandeville took the next step: economic ambition and unbridled sensuality generated prosperity, puritan frugality and sobriety caused depression (Mandeville 1723). This cynical sophistry set off the altruism-egoism debate, basic to economic self-interest, which engaged the most important moralists of the era.

Amongst them Francois Quesnay, David Hume and Adam Smith are important for the final disengagement of the gain appetite from the sense and acquisitive appetites. In conceiving the economy as a system, driven by self-interest, of countering flows of goods and money, Quesnay located this dynamic principally in the class of entrepreneur-farmers, working and investing to increase the stuff of material wealth (Schumpeter 1959, pp. 233-43). Hume, in turn, universalized this drive as an instinctive urge to compete for profits (Hume 1930, pp. 452, 53) and Smith's Invisible Hand emancipated gain-seeking from both the other appetites and moral control. Because economic self-interest requires mutuality, reciprocity and harmonizing economic goals, personal gain-seeking can effectively achieve the public good (Smith 1952, Books 1 and 2), Smith in effect denying the need for moral principles and tutelage. Thus stripped of moral implications, gain-maximization is on the way to becoming in Classical and later Neoclassical analysis an amoral principle of economic common-sense, the premise for choosing among alternatives. No longer deemed an appetite, it is stripped of normative content and freed from moral control.

Simultaneous with this 'de-moralization' of the wealth and gain incentive was the tremendous increase in 'working wealth', now called capital goods, which the Industrial Revolution generated. This, in its turn, caused further travail for the principle of gain-seeking. Probably the most enduring economic fear is that gain- and profit-seeking inevitably generate a slow-down and even permanent stagnation. This theme, first demonstrated in David Ricardo's taut logic that increasing output

lowered prices, reduced profits and thus production (Ricardo 1963, Chapters 1-8), was repeated again and again in the century and a half since Ricardo and surfaces at every economic downturn. Marx went further, predicting that the capitalist compulsion for surplus value (profits) would inevitably transform Capitalism into Communism (Roll 1961, Chapter VI). Countering him, Social Darwinists argued that human freedom and economic growth necessitated unrestricted private property, untrammelled competition and absolute freedom to gain (Hofstadter 1955).

Economists since then continue to differ over gain-seeking, some defending it as the universal cure-all, others as the cause of every ill-besetting economies. Despite its amoral role as an economic principle, a moral streak of varying shades has tinted the arguments for and against gain-seeking. J.S. Mill would limit legislation about the morality of gain-seeking to protecting the rights of others (Mill 1952, pp. 304-12). Hegel is more liberal in asserting society's right and duty to substitute its ends for personal extravagance (Hegel 1967, III, Paragraph 240). Tawney goes further in detailing the evils of the profit motive and, undermining its moral sanction, argues with the Fabian Socialists for controlling it by taxes, unions, industrial democracy and nationalization (Tawney 1921).

Recently the arguments have become more technical. Often joined by scholars from the physical, moral, social and health sciences, economists have predicted every kind of catastrophe from declining innovation and investment, diminishing job opportunities, depleting natural resources, destroying the atmosphere, polluting the earth and people proliferating beyond the earth's ability to feed them, for all of which gain-seeking is causative. All the while, paradoxically, the de-materialization of wealth has proceeded apace. While the rich today still live sumptuously, much wealth has no sensual content. Today the larger part of great fortunes and much of modest ones, consists in rights to incomes, interests, dividends and other rights to property, none sensually appealing, though highly desired. Much too of contemporary wealth consists of rights to and control over capital goods, which to be profitable require others' gain-seeking collaboration. Finally, money itself has lost its materiality, becoming almost exclusively the credit of banks and other financial institutions, giving the credit-worthy further purchasing power. All of this means that even sizable fortunes may not support sybaritic living and are subject to radical and sudden change. These changes and controversies also urge further analysis of gain-seeking and its economic role.

## GAIN-SEEKING

Gain-seeking is usually not an end in itself: gain is most often a means to the goods and services and the benefits people want. The question, "Why gain is necessary?" forces returning to scarcity as the universal and inevitable economic fact. The universality of scarcity is obvious from the ubiquity of prices: goods must be rationed by pricing, because and whenever more is wanted than is currently available. Prices, therefore, testify to scarcity, a condition true of almost all things most of the time. Scarcity, furthermore, is not only universal but inevitable. For material things to be 'price-less', they

would have to be so abundant that all could have as much of everything they would ever want. Clearly such abundance would so glut the earth that there would be no room for people. By contrast to that impossible condition, economic scarcity requires that things desired for consumption and use must be produced in a continuous process, involving the cooperation and collaboration of almost everyone.

Scarcity, therefore, mandates not only some trade-off in order to get what is wanted but also efficiency in using resources and satisfying wants. Efficiency in turn requires gain-seeking in this sense, that people, as consumers, producers, workers or whatever, are required to sacrifice what is less wanted and valued for what is more wanted and valued. In short, they must seek to gain: gain-seeking drives their participation in the economic process. Further, since scarcity is universal, gain-seeking is competitive. But economic competition is unique: unlike sports, politics and similar win-lose contests, in economic competition one gains by offering more to another, sellers heeding buyers' gain-seeking and buyers sellers'. Moreover, producing what is wanted almost always involves the collaboration of skills, resources and financing of those participating for the sake of gain. All in all, scarcity mandating gain-seeking is one of the most potent forces which generates social intercourse. That social nature cannot but be reflected in gain-seeking itself.

Generally, however, gain-seeking is modified as self-interested, implying for many a radical egoism. But this flies in the face of human experience, that self-interest is essential to all human and moral action. Obviously, what people do consciously and intentionally, they must be interested in doing. All the more so every moral act is self-interested, because people must be interested in doing what they see as good. Economists often go further in identifying self-interest with selfishness, opposing it to altruism and benevolence. In economic analysis they even define self-interest in a way that makes it impervious to considerations of the good of others or of the public good. In this they fly in the face of everyday experience that self-interest and self-love almost always include involvement with and care for others. They even forget the words of no less than Adam Smith, who really established self-interest as essential for economic activity: "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortunes of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it" (Smith 1922, p. 1).

This confusion is a problem for many economists because they identify self-interest with self-benefit. It is especially so for gain-seeking where the assumption is even more ingrained that the gain sought is always and exclusively for the benefit of the agent. But cursory examination of exchange-- more accurately, the transfer of property-- reveals a continuum ranging from theft at one end through various kinds of fraudulent deals on to relatively honest and voluntary exchange to different patterns of reciprocal giving then to completely voluntary gifts, no strings attached.

Obviously, benefit varies all along the continuum: from stealing with all gain less risks to the thief and all loss to the victim; to voluntary exchange where the gain, net of costs, accrues to each party; and on to the no-strings gift like grandma's payment of junior's tuition which clearly benefits the donee but also garners goodwill for the donor. Similarly, in employment and employing there are the same continua of exchange and benefit. Employment can, for example, range from enslavement through various labor contracts to volunteerism, gain and benefit varying as with property transfers. In all cases some gain is realized, even though the benefits and beneficiaries change.

Analysis to this point suggests that gain-seeking, as mandated by scarcity, permeates the economic process. Economists indeed identify three forms of gain, consumer surplus, economic rent and profit which relate to the three moments of that process, consumption, production and investing-enterprising. Most people are involved in the first two functions but many in all three. Hence, the economic process can be represented as a triangle: consumption, the end and purpose of the process, and production, the means to that end, being linked by investment-enterprise. The three functions, however, are so bonded in a dynamic tension that the three mutually act and react on each other, reciprocally causing and being caused. Further, every such individual process is inextricably enmeshed in a complex of economic action, reaction and interaction. Throughout, this dynamic is driven by the three forms of economic gain. A word about each.

Consumer surplus, the least known, is the most universal and necessary. It arises in every voluntary consumer purchase since the buyer presumably achieves a more desired state by obtaining the good and surrendering money. This is more obviously so in professional buying or when a clear-cut bargain has been gained. Economic rent, another strange term, applies to a common situation when, for example, a worker gets a better paying job, though doing essentially the same work. A like situation would be the sale of a resource at a higher price than now received. Finally, profit, the most well-known of the three, drives the enterprise just as loss spells demise. The conclusion is clear: gain-seeking in all three moments of the economic process, while not the end and purpose of the economy as such, is absolutely essential for keeping it going.

As an aside it should be mentioned briefly that every gainful economic act carries a social gain-loss penumbra, which cannot be captured in the gain concept but should be considered, if only passingly. Not every economic good is all good but is attended with entropic consequences: every use of energy results in some dissipation, energy which cannot be recaptured in useful form; all human actions, even death, will produce some pollution of the human habitat, industry causing most; finally, all production and consumption generate garbage and waste, the remnants of useful things which cannot be put to use completely. Countering entropy, of course, are benefits beyond the gain: ingenious research, adroit mechanization, skill development, imaginative management, and intelligent investing, all essential features of an affluent economy, driven by large doses of



gain-seeking. With that the most important functions of gain-seeking have been sketched. The need now is to look at what gain really is.

What is obvious is that gain is about prices. Profit in its simplest sense is the difference between a set of prices called costs of production and a stream of prices called product sales. Economic rent is also a price differential between what labor or other resource can bring in another use than the present. Even consumer surplus involves the difference between prices paid for goods or services and the expected benefits. Gain, therefore, is usually, although not exclusively, expressed in price terms.

Price itself is an interesting reality, an everyday phenomenon whose nature few could define, other than seeing it as necessary in buying/selling. It is easiest seen in a simple setting. The Itu and the Og families somewhere in the Neander valley many millennia ago come to realize that trading is better than stealing. So they negotiate the exchange of three stone axes for two caribou skins. The realities of this transaction are, of course, the trading parties and the things exchanged. But also essential is the rate of exchange, two skins for three axes. Indeed, as trading expands to other families and tribes and involves more and more items, more complex rates, reflecting peoples' changing preferences and differing abilities to produce, arise out of the trading process itself. Out of this matrix emerges a complex rate of exchange for each product, which, however difficult to calculate, is the good's value in exchange. This then, once money comes into general use, becomes a price. Prices function, therefore, to help effect exchange. But what is their reality? What kind of a thing is a price?

Since a thing's price may change constantly, the good remaining the same, neither its substance nor any of its qualities changing, a price is obviously circumstantial, not pertaining to the essence, nature or physical features of a thing. Nor does a change in price affect a product's functions or the use or pleasure it gives. While non-physical, a price is mathematical and measurable. Though it cannot be sensed, it relates goods with people and one good with others in the exchange process. In this sense, price is social because it arises from the social process of trading. All this considered, price is a strange kind of reality: mathematical, relational and arising from and functioning in the exchange of goods and services. It is, therefore, a mathematical, social and economic construct, a necessary means for exchange and thus for all economic activity, just as words are necessary for conveying thoughts and feeling.

As with literature, economics has created a vast vocabulary of prices to express not only individual exchanges, but price trends, relations, statistics, probabilities, indexes and so forth. Gain, as shown, is the difference between two prices or sets of prices, costs of production versus sales income. Wealth is now more accurately seen as the accumulated prices one's current property can command in the market. Income is the stream of prices received over a given time period. Even something like employment is price-related, being human activity which is assessed by a price. As arising out of

exchange which is mandated by scarcity, prices are the raw material of economic science. While adding nothing to the reality of what is produced and consumed as useful, desirable and pleasurable, prices direct production and consumption and are, therefore, the unique objects of gain-seeking. With gain-seeking's nature, functions and object being defined, it is now possible to see how also it can be an appetite subject to moral science.

### GAIN-SEEKING AS APPETITE

The nexus, bringing both economic and moral principles to bear on gain-seeking, is the fact that the seeking of gain not only drives economic action and growth but is a human tendency, proclivity or appetite, present to some degree in all people. An economoral guide for gain-seeking, therefore, requires blending economic rationality and relevant moral criteria into a functional behavioral attitude. Preliminary to this is to show gain-seeking as the same "infinite appetite for wealth", which troubled philosophers of old but has now been disentangled from the sense and acquisitive appetites.

While 'appetite' is no longer a fashionable term, being replaced by 'drives', 'motives,' 'needs' and the like, it still has some use here because it ties into the philosophical survey presented above and because it covers all kinds of human tendencies and propensities, the vital, sense, and acquisitive as well as the spiritual like the craving for knowledge, beauty and the good. It is apparent that this subject can open vast areas of psychological discussion and research. This can, however, be skirted by sticking to the obvious facts of human experience, that people do have propensities and inclinations for various things and have built-in capacities or organic adaptations which are connatural to and receptive of different aspects of objects. The eye, for example, is adapted to perceiving color, the sex organs to mating, the mind to understanding reality.

Despite the need to leave the subject largely to psychologists some very general remarks are necessary. It has already been implied that the human person has quite an arsenal of appetites, some functioning through physical systems, alimentary, sexual, circulatory, emotive and the like, their objects for the most part necessary for human survival. Others function to garner sense knowledge, color, taste, quantity, odor and sound. Finally, the spiritual faculties, intellect, will and aesthetic sense seek an object's being, goodness and beauty. While inclined to specific objects, each zeroing in on objects connatural to it, appetites do not operate in isolation but usually conjointly, the appetitive agent combining the various objects into a unified perception. Despite this marvelous facility, appetites are still distinguished by the properties of things to which they are naturally inclined. A final comment advises that pleasure, no matter how motivating, is never the object of appetency. Pleasure does signify that an appetite is functioning well on an appropriate object. Conversely malfunctioning appetites may yield pain. Pain and pleasure, therefore, are important barometers of an appetite's functioning. But, as Aristotle points out, they only supervene and complete the act and are not the appetite's end and purpose (Aristotle Book X, Chapter 5). This point becomes

dramatically clear when an appetite, its proper object over-indulged, changes from pleasurable to painful.

With that, these very general observations will help in differentiating the gain appetite from the other sense, vital and acquisitive appetites. Accordingly, gain-seeking will be distinguished from the others by its unique object and percipient organ or faculty, by how it is generated and develops and by the excesses to which it tends and the ways they can be controlled.

Gain as the object of the gain or economic appetite, while pertinent to getting all scarce material goods, is, nevertheless, quite distinct from them. As a universal means, gain cannot be identified with any of the things, services, properties, contracts and the like which it can obtain. Obviously also, it shares none of the materiality of such objects, being a mathematical, relational reality. Capable of giving great pleasure and joy, it is devoid of sensible and spiritual qualities. As the difference between sets of prices, it is generated in and by the very activity of seeking it, that is, in the exchange process itself. To repeat an earlier conclusion, gain is a social and economic construct. That, in turn, suggests in which human faculty gain-seeking is located. Since gaining consists essentially in comparing, balancing and calculating what is gotten against what must be given up and since gain is devoid of materiality and sensualness, this appetite must function through a spiritual faculty, not a physical organ. In fact, therefore, gain-seeking is an act of the practical intellect, that ability, as opposed to theorizing, to grasp factual situations and to guide action thereto.

While the universality and inevitability of scarcity requires some minimal gain-seeking of all but those who are unable to function economically, the drive varies greatly from person to person. It can be aroused to a quite operational level in young children but generally they need some tutoring "about the value of a dollar" and experience of living within a budget before the gain appetite becomes functional. Given the fluidity of prices, the transience of wealth and the volatility of gain, this appetite usually needs considerable training and cultivation for everyone before it becomes the rational and sophisticated instrument of the economically successful. Still, some have honed it to such keenness that they seem almost to smell bargains, deals and profitable investments.

Gain-seeking is potentially stronger than most sense and acquisitive appetites because its objects are more universal. Money, economic value, gain, profits, income and wealth are all generic goods which can command many things or none. Conversely, the objects of sense and acquisitive appetites are specific: this steak, this minivan. Once consumed or possessed they cease as objects. But more income is always welcome and wealth, especially the paper kind, can always be added to because the gainer is under no compulsion to use them up. They can be kept for future contingencies because gain kept gives power, the power to purchase and derivatively prestige.

From the above it should be clear that gain-seeking, its natural propensity becoming excessive or transformed into addiction, poses considerable moral danger. The accumulation of wealth beyond what one could reasonably derive benefit or be of use to others is not like other appetites subject to physical satiation. Rather like a collector's mania gaining much is likely to stimulate the desire for more. Nor does age and the decline of physical powers abate the greed for gain. Wealth-addiction, moreover, unlike addiction to drugs, alcohol or other bad habits, brings no social obloquy, to the contrary, increased social respectability. Great wealth, no matter how acquired, usually trails an aura of social reverence. Hence the paradox that objects of no sensual appeal may evoke irresistible desires, more generating greater wanting. It is evidenced by the fact that most of the world's crime is provoked by greed for wealth and gain. It is confirmed by the repeated story of lofty aspirations succumbing to materialistic ambitions.

Excessive gain-seeking is kept under control for most people most of the time by the fact, as discussed earlier, of its social nature. Competition for gain is probably the most effective means for sharing gain broadly and moderating most people's hopes and aspirations. The evidence, of course, is that most people's economic success groups around the average for a particular economy. Competition, in turn, is assisted by the other two C's of economic control: cooperation and collaboration. When gain-seekers engage in exchange each constrains the other. Similarly, when collaborators are needed to produce goods and service for profitable sale, the gain-seeking of all involved must be accommodated. Nothing sets workers' collective teeth more on edge than denying wage increases while giving big bonuses to management and hefty dividends to stockholders.

On the other hand, the stories of greedy gain-seeking are too plentiful and familiar to concede that the inherent social restraints on gain-seeking are universally effective in keeping the drive for more under control. Time and again greed for gain has destroyed the very businesses which were its source. Economic crimes have blighted many successful careers. All suggest the need for the personal controls which moral virtues afford. In this respect, gain-seeking as appetite is no different than all the other appetites whose excesses harm both the good sought and the seeker. Furthermore, moral controls in corroborating the controls competition, cooperation and collaboration build into gain-seeking may, even at the expense of temporary gain, insure a longer lasting and more profitable course.

Editorial limitations restrict showing how the two sets of control mutually support each other. Indeed full elaboration would require volumes. But some suggestions can be proffered. Justice, specifically in recognizing that gain is socially produced and in acknowledging every collaborator's right to share in gain, will provide at least the ground rules for sound industrial relations and market fairness. Accepting scarcity as a condition facing all peoples all the time will temper one's own drive for more and encourage sharing with others, not only for whom one is obliged but for whoever one

knows to be in need. Perceiving gain not as an end in itself which is useful or pleasurable but strictly as a means to other ends can lead to promoting one's own gain-seeking to ends and purposes which transcend economic and materialistic aspirations.

However far a person may want to pursue these themes<sup>1</sup>, the trail starts with the realization that the pursuit of gain is both what economists have brought to light, the motive force driving the economy, and what philosophers have always held, a powerful appetite, but now differentiated from other appetites. Given this nexus, both moral and economic principles not only can but should be brought to bear on people's gain-seeking, blending them into a consistent attitude and behavioral guide. Hopefully this can help people preserve their moral integrity in a course of conduct strewn with what is diversive and devious.

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## THE INVESTMENT DECISION AS MORAL CHOICE: THE PERSPECTIVE OF *CENTESIMUS ANNUS*<sup>1</sup>

Stephen T. Worland

Commentators who would minimize the support for the market economy coming out of *Centesimus Annus* (CA §36 -- "the decision to invest...is always a moral choice" (McBrien 1992) -- to show that John Paul II repudiates the controlling ideology of capitalism. In apparent agreement *Commonweal* editor Margaret O'Brien Steinfels glosses CA §36 with the comment: "So much for the magic altruism of the Invisible Hand" (Steinfels 1991).

For a reply to such commentators it might be appropriate to follow up a recent suggestion by Michael Novak. What the modern world needs is a "new Aristotle" to come on the scene, rewrite the classic table of the virtues, and in the process clarify our understanding of market institutions (Novak 1993, p. 201). Such clarification, so Novak indicates, will reveal that the rise of capitalism derives not from the jettison of moral restraint (as alleged by social scientist Karl Polanyi; romantics Ruskin and Wordsworth; moralists R. H. Tawney or G. K. Chesterton) or from Deistic faith in an Invisible Hand. What produces the emergence and eventual legitimation of the market system is the gradual, cumulative perception of a new range of human possibility. In defiance of centuries of grim experience and in repudiation of an overly monastic understanding of the Christian message, modern man at the Industrial Revolution came to the realization that unremitting poverty need not be accepted as the inevitable lot of the great masses of mankind. This fundamental shift in perspective led eventually to the discovery of a new range of moral excellence, to discernment of virtues (e.g.) of "diligence, industriousness ... fidelity in interpersonal relationships" (CA §32). And it is love of the good to be instantiated in these virtues, rather than the "greed" cited by critics of capitalism, that motivates, inspires, and encourages modern man to seek progress, economic growth and optimal efficiency in the production and distribution of wealth.<sup>2</sup>

The capitalist ethic demands fidelity in contracts, honesty in exchange that is, compliance with the requirements of commutative justice. But as Novak notes there are moral virtues in addition to individualistic justice connected with the use of wealth (Novak 1993, p. 7). So in response to McBrien and Steinfels the question emerges: According to the social magisterium, what is the role of moral virtue in the decision to invest? What are the virtues that come into play in the process of

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<sup>1</sup>The encyclicals referred to in this essay are: *Quadragesimo Anno* (1931); *Divini Redemptoris* (1937); *Laborem Exercens* (1981); *Sollicitudo Rei Socialis* (1987); *Centesimus Annus* (1991). They are cited in the text with the initials of the Latin title and paragraph number (§).

<sup>2</sup> Cf. Jesuit Father John Pederit's conclusion that the "fundamental values" identified by the natural law require society to accept "efficiency as principle of justice" (Pederit 1993, p. 121).



savings and investment, capital accumulation and allocation? Identifying such virtues clarifies the Pope's assertion that the investment decision involves moral choice and in the process suggests an answer to the deeper question Does John Paul II's conception of the investment decision in fact weaken the justification for capitalism provided by *Centesimus Annus*?

#### PROPERTY: INSTRUMENT OF AUTONOMY

For an analysis of the investment decision it is important to note a critical duality in the Church's teaching on the ownership and use of wealth Man stands at the top of the food chain -- "plants ... exist for the sake of animals ... animals for the sake of man" (Aristotle, I, 8). But according to the well-known Aristotelian exposition, man seeks not merely to live, but to live the "good life" of wisdom, moral and cultural perfection. It is love of the good exemplified in virtue, not the desire to satisfy mere biological need, nor the pleasure-seeking egoism typically assumed in textbook economics, that for Aristotle provides the root incentive to acquire and utilize wealth. If material wealth is to function as an "instrument" in the pursuit of such noble purpose, so Aristotle concludes, in a well-ordered polity and for the sake of "efficiency, order, and peace" a system of private ownership must be put in place. Such a deep level conception of the relationship between private property and moral excellence is taken over and decisively rectified in the development of the social magisterium.

Vatican II affirms the cosmic significance of man's relationship to nature, but interprets such a relationship as biological. The "elements of nature... raise their voice in free praise of the Creator" as they are subsumed into the human life process (*Gaudium et Spes*, §14). Responding to a cultural threat produced by modern industry John Paul (LE) pushes beyond the biological dimension to offer a deeper analysis of the man-nature relationship and of the case for private property. In the industrialized production process, so he warns, there is operative a deadly tendency for technology (the "material cause") to displace and subsume the free moral choice of the human agent (the "efficient cause."). To counter such a threat, society must recognize that there are important moral excellences, for example the virtue of "industriousness," to be exemplified in the process of production. Classical philosophy may have taught that "there is nothing ennobling about a workshop" (Cicero as quoted by Pius XI, DR §36). Karl Marx might insist that the capitalist workplace is the site for worker exploitation and alienation. In contrast, John Paul affirms that though concerned with the provision of useful goods, the industrial production process -- like the beauty engendering work of sculptor, composer, or painter -- has its own self-justifying value and significance. The worker on the shop floor must be allowed social space to exercise moral choice in the pursuit of virtue. And private property is to serve as the instrument for such choice. Perceiving potential beauty in the depths of his soul, the moral agent "utilizes the things of this world ... as instruments" (CA §43) to bring that potential to external exemplification -- to his heart's delight, the joy of his fellowmen, the praise and glory of his Creator.

In a traditional society peasant proprietorship and artisan workshop provide the worker with the resource control needed to exercise personal autonomy. In the modern economy where the producer works with advanced technology, more sophisticated institutions must be developed so that private property can continue to serve its instrumental role in the worker's drive to exemplify virtue. To note a point crucial for understanding the moral legitimacy of market institutions, capital formation and allocation play a critical role in allowing the modern worker to achieve such moral autonomy.

### CONSUMERISM: THE PREDOMINANT FAULT OF CAPITALISM

As regards capital formation, in a culture formed by "Lockean individualism, "it is important to recall the medieval formula -- as regards the control of productive resources (*poetstas procurandi et dispensandi*), ownership should be private, but as for the teleological objective to be achieved by such control, property must be "common as to use." The cosmic orientation of the resource base intended by the Creator -- toward sustenance and use by the whole family of mankind -- must be forever respected. According to the formula adopted by John Paul II at the historic Puebla conference and regularly repeated thereafter, there is a "social mortgage" on all private property (*Puebla* III, 4; SRS §42).

In an archaic culture, resources are diverted from common use, the poor are deprived, as resources are squandered in dysfunctional tribal ceremony. In a Renaissance society resources that could produce sustenance for the poor are misallocated to feed a Prince's vanity. In a high-tech society, according to the repeated admonition of John Paul II, the pathology is democratized. The economy generates a bounteous flow of commodities. But the resulting plenty is diverted from feeding, clothing, and housing the poor into gratifying the insatiable, ever shifting desires of a culture John Paul II early in his pontificate (RH) identifies as a "consumer civilization." In such a culture, "a consumer attitude uncontrolled by ethics" is allowed to drive masses of the population into misery and destitution. Mincing no words, he characterizes such a society as the modern world's "gigantic development" of the Dives and Lazarus parable (RH §16).

The denunciation of consumerism appears as a persistent theme in the Pope's later pronouncements. In *Sollicitudo Rei Socialis* he refers to a "form of super-development... the so-called civilization of 'consumerism.'" "Blind submission" to the consumerist life style obliterates the distinction between "having" and "being," between the mere pleasure-generating enjoyment of goods, and using wealth "in the realization of the human vocation as such," e.g. in the exemplification of moral/cultural excellence. Submission to such "crass materialism," surrender to a consumerist attitude actualized through the play of international market forces, generates world-wide systemic injustice in the distribution of "goods and services originally intended for all" (SRS §28).

His conception of consumerism as the predominant fault of a capitalist society is refined and developed in *Centesimus Annus*. In the earlier stages of economic development, when "man lived under the weight of necessity ... his needs ... determined by ... his physical make-up" (CA §36), it is indeed appropriate that production and distribution be oriented toward the satisfaction of basic, biological need. But as he explains using a term perhaps borrowed from J. K. Galbraith, as society turns the corner to "affluence" (CA §19) continued exclusive concentration on the satisfaction of biological need reflects a lack of cultural/moral discernment. The "phenomenon of consumerism" appears and when it does, society becomes committed to "having more in order to spend life in enjoyment as an end in itself" (CA §36).

As Father James Schall has noted the Pope's identification of consumerism as a sign of moral retrogression recalls Aristotle's dire warning (Schall, p. 28). With the introduction of money as medium of exchange and store of value man is readily led to misidentify the "good life" as one given over to unlimited accumulation for the sake of unlimited pleasure. The consumerist culture loses sight of the principle that wealth is to be used not only as a source of biological sustenance, but also as an "instrument" in the instantiation of moral/cultural perfection. In consumerist-capitalism, the common good of the economic order -- an authentic *bonum honestum* to be achieved through the efficient utilization of productive resources -- is recognized as a proper objective of social policy by such an "end" is not properly integrated into the more inclusive, nobler "common good" of the cultural system. Such a society implements only the first half of Jacques Maritain's formula for social progress -- *distinguer pour unir*.

As for the ways to deal with consumerism, a key difference between the Marxian model of advanced capitalism and John Paul II's analysis should be noted. Adam Smith found that the division of labor needed to achieve economic progress deprived the worker of every opportunity to exercise his intelligence and thus left him "as stupid and ignorant as it is possible for a human animal to become" (Smith, Book V, Chapter 1). Seizing on the point with malicious glee, Karl Marx went on to claim that the degenerative pleasures of consumerism are the anodyne grasped by workers to ease the pain of workplace alienation. Alienation produced as mindless technology forestalls the exercise of worker initiative is, so John Paul II affirms in LE, a grave threat to modern society. But in repudiation of Marx, the Pope also insists that the working of capitalist institutions -- business firms and households interconnected through commodity and resource markets -- allows for the discernment and exercise of a wide range of virtue. Connected with other domains of the social system by the master practical virtue of *phronesis*, workplace virtues can contribute to the moral rectification of the culture. To borrow a metaphor from Richard John Neuhaus, the business firm in a modern society functions as one of Edmund Burke's "little platoons" where citizens acquire the local loyalties and first training in virtue necessary to maintain a free society (Neuhaus 1992, p. 240). Karl Marx might disagree, but according to John Paul II, the market economy can be maintained, its moral possibilities purified, while measures are adopted to eliminate the vice of consumerism.

## CONSUMERISM: THE CULTURAL ANTIDOTE

A crucial first step in correcting such a vice requires a change in the cultural system. In the perspective of John Paul II, moreover, the cultural change required is basic and fundamental. At the present stage of global economic development when large sectors of the world population still flounder in poverty and misery, what is needed is a "concerted world wide effort to promote development" (CA §52). Such a concerted effort requires not an international version of the welfare state, but the taking of effective measures which will allow the poor to make their place within the modern circle of exchange and productivity. "For this to happen," so John Paul II affirms in direct challenge to the affluent, "requires above all a change in life-styles, of models of production and consumption, and of established structures of power" (CA §58). Overcoming the marginalization of the poor, he says elsewhere "may mean making important changes in established life styles...to limit the waste of resources, thus enabling...all people to have a sufficient share of these resources" (CA §52).

In accordance with the labor theory of value, Marxians may insist that it is "unequal exchange" causing an invisible transfer of wealth from labor intensive to highly capitalistic sectors of the world economy that generates Third World poverty. Proponents of the preferential option for the poor make the claim that it is the modern world's adherence to the Lockean belief that there are no natural limits to the acquisition of wealth that victimizes the poor (Byrne 1993, p. 239). For John Paul II the miscarriage of productive efficiency that victimizes the poor originates on the demand side, in the degenerate tastes of the affluent made effective by their superior purchasing power.

In a market economy, however, a wholesale effort to eliminate consumerism through cultural change will have its difficulties. As the Fable of the Bees indicated long ago, the repudiation of luxury, a society-wide outburst of frugality would be the ruination of trade, casting thousands of workers into immediate unemployment and poverty. Consumerism, as Richard John Neuhaus explains is a "cultural and moral problem requiring a cultural and moral remedy." Introducing cultural changes to deal with consumerism, however, "must be done in a way that does not destroy the free market itself." Emphasizing the difficulty, commenting on John Paul II's call for a change in life styles, Neuhaus comes to the heart of the matter: "Should we all consume less...and how will that help include the poor within the circle of production and exchange?" (Neuhaus, pp. 53, 58, 224).

In reply to such a question, it might be noted that the Church's condemnation of consumerism is not new. "He who spends too much is a robber," wrote St. Ambrose in the 4th century. Applying such an insight to the stratified society of medieval Europe, St. Thomas offered what came to be a standard emendation of the teaching on private property. "Whatever certain people have in superabundance (i.e. in excess of that required to maintain a given social position) is due by natural law to the...succoring of the poor." (Aquinas, II-II, Q.66.a.7). To allow for common use of private property,

the rich are morally obligated to expend their "superfluous income" in almsgiving. In an advanced capitalist society, those who heed John Paul II's warning about the evils of consumerism will enjoy a kind of "superabundance" like that referred to by St. Thomas. In accordance with the duality in Aristotle's conception of property, having recognized that they have more wealth than required to satisfy biological need, the rich are to find ways to use their "superfluous wealth" as an instrument of virtue. For understanding the decision to invest it is important to note how the social magisterium develops guidelines for such converts from affluence.

Writing in the 1930's Pius XI both recalls traditional teaching and anticipates the condemnation of consumerism. The spectacle of thousands floundering in "real misery" while others around them "spend huge sums...on useless things and frivolous amusements" so he wrote in 1937, is sad proof that justice is poorly served in the modern world. Using powerful prophetic language he warned that those who refuse "to distribute their abundance to the poor" risk the gruesome fate predicted by St. James. They will one day "howl and weep" as their "cankered gold" turns to rust that "shall eat your flesh like fire" (DR §44). Luxury consumption in the face of poverty is not condoned as private vice become public virtue, but denounced as the monstrous evil that it is. Moreover, Pius XI also identifies the antidote for such a destructive practice with a sophisticated updated version of the teaching on private property.

#### CONSUMERISM: INVESTMENT AS THE ECONOMIC ANTIDOTE

According to what is now a well-known story of Vatican intrigue, Pius XI bypassed his official advisors, known for their commitment to an "organic" view of society as the alternative to "modernism," and turned for composition of the encyclical *Quadragesimo Anno* to the then young Jesuit, Oswald von Nell-Breuning. Fortunately for the development of the magisterium, Nell-Breuning was an expert in the use of neoclassical economic analysis. The fact is apparent in many passages of the document he prepared for the papal signature. Thus, the "end" or teleological objective to be attained by operation of the economic systems is carefully distinguished both from the purpose of the family and from the comprehensive "common good" of the wider cultural/political system. Such an objective is said to be attained when "all and each are supplied with all the goods that the...resources of nature, technical achievement, and social organization can furnish" (QA §75) i.e. when resource base and technology are used to generate a maximal flow of useful commodities (In an apparent effort to drive this crucial point home, the passage is repeated verbatim in DR §52). In anticipation of John Paul II's assertion that the "free market is the most efficient instrument for utilizing resources" (CA §34), that particular balance in the wage/price structure recognized in neoclassical economics as "Pareto optimality" is identified by Pius XI as a crucial necessary condition for achieving such a maximum (QA §75). It is this body of analysis which provides the framework for the encyclical's teaching on more specific matters -- e.g. how to achieve the adjustments necessary to allow workers to earn a living wage; the warning that excessive

wages can drive a firm into bankruptcy, the conclusion that a nonviable enterprise is to be closed down rather than propped up with subsidies. Such a sophisticated understanding of modern market economy also provides the background for an updated, post *gemeinschaft-to-gesellschaft*, restatement of the teaching on property, especially of the obligations connected with the use of "superfluous income."

Pius XI recapitulates the teaching of Scripture and the Fathers: the rich who receive "superfluous income" are "bound by a very grave precept to practice almsgiving" (QA §50). He then proceeds immediately to a very significant extension of the traditional principle. He identifies the classic virtue of "munificence" ("liberality" in some translations) as a moral excellence to be exemplified through the use of superfluous income. The perfection referred to, moreover, is not identical with the "magnificence" that might have inspired the outfitting of a ceremonial fleet in Athens or the amassing of an art collection in Renaissance Italy. In the modern world --where the ages-old belief that a life of poverty is the unavoidable lot of the laboring class has been rejected -- "Munificence" is to be instantiated through "expanding larger incomes so that the opportunity for gainful work be abundant." In implicit rejection of the cynical Fable of the Bees argument -- i.e. luxury consumption contributes to sharing the wealth -- Pius XI attaches a crucial necessary condition for the practice of *munificence*. It is essential that the employment generated by "applied to producing really useful goods" (QA §51).

Pius XI's identification of a moral excellence to be implemented through the act of investment, like his repudiation of the labor theory of value, and his identification of Pareto optimality as a necessary condition for attaining the economic common good, goes a long way toward affirming the legitimacy of capitalist institutions and business practice. Latter day analysts purportedly guided by the "preferential option for the poor" are disturbed by such doctrine. Evidently claiming economic insight superior to that of Nell-Breuning, Donal Orr describes the notion as having "a certain air of unreality; it could give the impression that such investment is an act of generosity." Vatican II discussion of investment replicates Pius XI's principle but so Orr notes, without specifically identifying the investment decision as a virtuous act. "One may surmise," so he tells his readers, that the authors of *Gaudium et Spes* "did not wish to give the impression that the Council Fathers saw capitalist investors as great benefactors of humanity." (*Option for the Poor* 1983, p. 129). No monuments for the Rothschilds, thundered Ferdinand LaSalle in denunciation of 19th century capitalist apologetics. The Vatican II Fathers, so Orr indicates, would agree.

Pius XI on the connection between a classic virtue and the use of superfluous wealth might disturb a practitioner of liberal theology. But the principle comes to play a very significant role in the economic analysis developed by John Paul II. A striking instance is provided in his dramatic address to the residents of a Brazilian *Favela*, July 1980 (*Origins*, Vol. X, pp. 122-24).



Expounding the Beatitudes, he warns the rich and powerful: "May this truth upset them...May it be a continuous warning and challenge to them." The rich are called upon to become "poor in spirit": "if you have a lot, you must give a lot." But according to the Pope's message, the rich are not to become poor in spirit merely by divesting themselves of their extra wealth. As with Pius XI, in the modern world almsgiving is not enough. Rather, the rich are called upon "to think how to give." They are challenged to "organize all socio-economic life, and each of its sectors so that this life will tend to equality among men...so that at least gradually the abyss that divides the few 'excessively rich' from the multitudes of the poor...may disappear."

The message at Vidigal would seem to apply most directly to an LDC struggling to achieve the turn to modernity. As for the use of superfluous income in an advanced capitalist society, according to John Paul II's conception of the role of profit in a market economy and his updated version of the teaching on theory of private property, it is the *process of investment* which provides the linkage between the rejection of consumerism and outreach to the poor.

#### INVESTMENT: RESPONSE TO MARKET SIGNALS

The Marxian labor theory of value and its chief corollary, the "profit" earned in an enterprise represents "surplus value" produced by labor but seized by capitalist employers, was explicitly rejected by Pius XI in the second of the social encyclicals. In accord with such a rejection, Pope John Paul II acknowledges the "legitimate role of profit" in an enterprise. Earning a profit -- the going, normal rate of return on investment -- is an indicator that (i) "productive factors have been properly employed" (the firm has adopted the appropriate least-cost technology) and that (ii) "corresponding human needs have been duly satisfied" (the firm has selected an appropriate product line). As such, "profit is a regulator of the life of a business," though as John Paul II immediately adds, "not the only one" (CA §36).

John Paul II is well aware of the distinction economists regularly make between "rent seeking" -- e.g. "investment" by a PAC committee to guarantee the enactment of a tariff -- and profit as reward of real productive activity. He employs such a distinction to update the teaching on private ownership of the means of production. As the Pope re-reads "the relationship between...private property and the universal destination of material wealth" (CA §43), he affirms that private property in the means of production is "just and legitimate if it serves useful work" (CA §43). Such ownership is not legitimate, however, if used "to gain a profit which is not the result of overall expansion of...the wealth of society" (CA §43), but is instead employed for example in "exploitation, speculation, or the breaking of solidarity among working people." (CA §43) The power connected with resource ownership is not to be used to seek a profit through "union busting" or exploitation of employees. On the contrary, property must be used so as to serve "useful work." Such a conception of the proper use of property seems to justify a very important conclusion.



When the rich and famous finally allow their hearts to be touched by the plight of the world's poor, when conversion brings them to repudiate the consumerist life style, they are called upon to use their "superfluous income" not in the practice of almsgiving -- "it is not merely a matter of 'giving from one's surplus'" (CA §58) -- but rather to finance the kind of investment that generates useful employment. As they do so, they exemplify a moral perfection, the classic virtue of *munificence*. In the process they contribute effectively to the common use of resources. Workers are granted access to the resource base, including not only physical capital -- land, buildings, and equipment -- but also to "the full use of the benefits offered by science and technology" (SRS §32).

Finally, to consider the point that in the opinion of McBrien and Steinfels seems to undercut John Paul II's case for free markets and capitalism. Both Pius XI and John Paul II insist that the use of superfluous income to finance investment must serve "useful work," contribute to the production of commodities that are "really useful." But as the principle -- "the decision to invest in one place rather than another is always a moral choice" (CA §36) -- indicates, John Paul II is aware of the fact that some commodities are more useful than others. So the investor determined to make responsible use of his superfluous income, committed to using his property in a manner conducive to the common good, is left with a further decision. Granted that he will forego the affluent life style, granted also that he will invest in the support only of really "useful work," is he to invest in the production of Brand X, Brand Y, or Brand Z?

In an advanced capitalist economy, the accumulation of corporation retained earnings and depreciation reserves, of public and private pension funds, of household liquid assets generates a supply of investible savings. The need for capital to finance residential and commercial construction, the acquisition of new and replacement equipment, the purchase of durable consumer goods by households generates the demand for such funds. Supply and demand meet through the operation of the economy's financial intermediaries: S&L's and banks; insurance companies, broker's offices and stock markets. As an institution designed to mobilize and allocate the flow of society's savings, the capital market serves as a functional complement for that "free market" in finished goods which, according to CA §34, is recognized as "the most efficient instrument for utilizing resources and responding to needs."

The day to day operation of the capital market generates a pattern of interest rates (reported daily in the financial press). This pattern of interest rates provides market signals to guide the investment decision. According to exposition of the role of profit in a market economy, commodity prices provide the signal to guide the firm in its choice of product line. If the price of Commodity X is the appropriate signal to guide an entrepreneur's decision on product line, then rate of return on investment (ROI) on capital invested in the production of Commodity X would seem to be the

appropriate signal for an investor, for CALPERS, for instance, or other major pension fund. As the investor responds to such market signals, he contributes to the attainment of an efficient allocation of society's productive resources. His investment decisions complements "useful work", allows workers access to both physical capital and scientific technology, and contributes to attainment of that teleological objective identified by Pius XI as the "end" for economic activity: the attainment of maximal per capita living standards.

As the world wide process of economic development goes forward -- as currencies and exchange rates are stabilized, productive enterprises appropriately privatized, barriers to the free flow of commodities and capital dismantled -- the process of capital formation and allocation is globalized. Capital and technology move across international boundaries into the Third World, facilitating modernization, generating jobs, bringing productive scientific knowledge to the service of the whole human family. As Michael Novak has indicated, there is no better, quicker way for the modern world to implement the "preferential option for the poor."

## CONCLUSION

To conclude, according to John Paul II those responsible for society's investment decisions -- e.g. banks, insurance companies, pension fund managers and their clients -- carry a fearsome responsibility. As professionals, they may not be called upon to make what theologians call the "special way" commitment to the poor: leaving their board rooms to take station in a soup kitchen. But they would be required to adopt the "general way of implementing the preferential option," by contributing to reform and reorientation of those institutions wherein they perform their social functions (Byrne 1993, p. 239). As good citizens anxious to practice the virtue of social justice, they must make their due contribution toward rectifying the cultural system and thus altering the pattern of consumer tastes fed into the market. With John Paul II they must recognize that there are crucial "public goods" -- including the kind of basic research that affords immensely useful, but non-appropriable productive knowledge -- that cannot be provided through the market. Having discharged a basic citizen's responsibility, and in accordance with the principle of subsidiarity they are called upon to rectify defects in the operation of financial institutions: to contribute to the improvement of SEC rules and procedures, of stock market trading rules, of NASD disciplinary procedures.

Finally, as economic agents, as the latter day custodians of society's "superfluous income," they make their contribution to the efficient use of resources by searching out and funding those investment opportunities paying the higher ROI.<sup>1</sup> They are called upon to finance the "change in life

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<sup>1</sup> As Michael Novak has noted (Novak 1994, pp. 5-9) the business corporation is "not a welfare agency" but rather an "economic association" that serves the common good by producing goods of real value and creating new wealth. However, he points out that the business firm also has an ancillary moral responsibility to, among other things,

styles, "the conversion from affluence" called for by John Paul II. As the repudiation spreads through the cultural system, return on investment in the symbols of affluence such as luxury condos falls. As the poor expend the purchasing power generated by expanded employment opportunities, the rate of return on "useful goods" such as affordable housing rises. Pension fund managers fail in their civic duty if they do not make the appropriate rational adjustment to such shifting market signals.

In an advanced market economy, it is the love of virtue operating in the souls of investment bankers, brokers and financiers, rather than the "magic of the Invisible Hand" that is to motivate and guide capital accumulation.

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"contribute to making the surrounding society...a better place." A similar blending of economic responsibility with a concern for wider social objectives is beginning to be recognized as included in the social function of pension fund management. Fund managers are called upon first of all to contribute to efficient resource allocation by seeking a maximal rate of return. But they can also be expected to use their considerable economic power to work for other social goals -- e.g. a more humane workplace. Cf. Ferguson (1994, p. A19).

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## ON JUSTICE, SOLIDARITY, AND COMMUNITY

Cooperation or solidarity is the hallmark of traditional solidarism. The eminent European social ethicist Johannes Messner said in an article on Pesch that the fundamental law of both the social order and the economic order is the principle of solidarity.

William R. Waters, "Evolution of Social Economics in America," in *Social Economics: Retrospect and Prospect*, Mark A. Lutz (editor), Kluwer-Nijhoff Publishers, 1990, p. 109.

Social justice is a very helpful but ambiguous term. It is used in both broad and narrow senses. In the broad sense that the institutions of society and their operations must be just, it is synonymous with what Aristotle called legal justice and medievalists called general justice. It is more useful in the narrow sense of an obligation to contribute to society to make it just -- to reconstruct it ... Social justice focuses on obligations and opportunities for *production* for the common good and visualizes an environment for individuals to begin contact with the social economic (vocational) groups ... Sometimes social justice is confused with other narrow forms of justice: namely, commutative and distributive. Often it is used with no precise meaning at all ...

William R. Waters, "Evolution of Social Economics in America," in *Social Economics: Retrospect and Prospect*, Mark A. Lutz (editor), Kluwer-Nijhoff Publishers, 1990, p. 113 (emphasis in the original).

... the key to an effective American foreign economic policy is carefully selected investment projects on the frontier of development to which we shall direct our scarce resources after cooperative decision making in small ad hoc, broadly representative, planning committees. Such a strategy involves team work by all important sectors: large firms, organized labor, the community, bankers and government. We should not expect the market to do what people, by way of their political-economic, democratic system, will not permit it to do. It probably is not capable of doing it anyhow.

William R. Waters, "The Structure of American Economic Policy: An Exploration," *Forum for Social Economics*, Fall 1990, p. 12.

## SOLIDARITY AND COMMUNITY IN THE WORLD ECONOMY

Kishor Thanawala

Solidarity and community are two ideas which have interested William R. Waters over a long period of time and about which he has written more than once.<sup>1</sup> He was a principal force in organizing a conference<sup>2</sup> on solidarity for social economists with the theme "Community Dimensions of Economic Enterprise." As editor of the *Review of Social Economy*, he found a place where these ideas could be discussed in a sympathetic as well as critical environment.

Since beginning as editor I have observed that economics scholarship differs according to alternative hard cores, especially those of conventional or classical on the one hand and solidarist on the other. Conventional economists stress the market as having a crucial decision-making role in the economy and stable equilibrium as a natural end of the significant economic variables, and the economy as having a strong homeostatic quality and competition as the only reliable instrument to attain efficiency and economic well-being. On the other hand, social economists with solidarist hard core premises stress other qualities in their attempt to explain the effective and equitable economy: personal community-based institutions, crucial decisions effected by cooperation, disequilibria caused by innovators and the widespread need for humanization of the economy. The heart of the difference between these two kinds of economists is in their respective conceptions of the nature of the economic unit. To conventional economists it is the utility calculating individual; to the solidarist it is the *person* who has by his sacred nature a status in the

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<sup>1</sup> The following are some of the published writings of Waters, where one can find his views on solidarity:

"On the Theory of Social Economy," *Review of Social Economy*, 1965.

"Development of Solidarist Economics in the US," *International Journal of Social Economics*, 1984.

"The Thrust of Solidarity: An Introduction," *Review of Social Economy*, 1984.

"First Annual Divine Award Presented to Dr. William R. Waters," *Forum for Social Economics*, 1987.

"Social Economics: A Solidarist Perspective," *Review of Social Economy*, 1988.

"A Review of the Troops: Social Economics in the Twentieth Century," *Review of Social Economy*, 1993.

"The Influence of the Encyclicals on the Solidarist Theory of Social Economy" in *On The Condition of Labor and the Social Question One Hundred Years Later*, edited by Thomas O. Nitsch, Joseph M. Phillips, Jr. and Edward L. Fitzsimmons, Lewiston, (NY): The Edwin Mellon Press, 1994.

<sup>2</sup> The papers presented at this Conference were published in *The Review of Social Economy*, December 1984.

community that is not reducible to maximizing utility (Waters, 1987, p. 60; emphasis in the original).

In his presidential address to the Association for Social Economics in 1987, Waters stated that solidarism was older than classicism and identified four components of the hard core of solidarism: (1) institutions; (2) person; (3) uncertainty; and (4) status. In an earlier article (Waters 1984a), he stated:

There are three key characteristics of this social or economic system. The first is a conception of the nature of the individual as the social unit in a socio-economic model. To the solidarist, the individual is the "person." The concept person is to be understood in contrast to the maximizing "economic man" of conventional economics, and to man as an insignificant parcel or atom in a totally socialized society. The second characteristic is "cooperation" in the productive sector as opposed to either the proposed sovereignty of impersonal competitive market forces, or to the domination of centralist authority. The third one is solidarity at large, from which this kind of economics and economic system gets its name: the goal of an organic social integrity (Waters 1984a, p. 100).

This "tripartite structure of solidarism," thus consists of "an alternative socio-economic organization, namely, an emphasis on the dignity of each person acting in the economy, cooperation in the workplace (where workplace implies the *loci* of all economically productive agents) and solidarity in the decision-making apparatus directed to the common good of the whole society (Waters 1984a, p. 100). In this sense, solidarism is not just a compromise between liberalism and socialism. Following Briefs, he postulated that the person, a key component of solidarism, is "a member of mankind, the community of all persons, where justice and love will either prevail or chaos will reign. It is quite different from the secular concept of the social as an aggregation of groups and organizations to which the individual enters or leaves at will" (*ibid*, page 107).

For Waters the ethical reconstruction of economics has always been quite critical. In the paper presented at the Sixth World Congress of Social Economics he wrote:

...social economic theory was defined as comprising "the principles that shape the economic sector of society" and supply "the means to evaluate principles, welfare models and planning" (Waters 1965, p. 115).

Further, it is that body of knowledge that explains the nature of economic reality in a broad (social) sense and evaluates the ethical validity of its institutional structure. The best choice of name for the theory that developed under the influence of the



encyclicals is probably solidarist, although no name is completely satisfactory in an area where names (liberal, capitalist, socialist and so forth) are emotionally charged. Solidarism is most often used to identify the personalist approach, pioneered by the German Jesuit social economist and intellectual *grand pere*, Heinrich Pesch (1854-1926), so closely identified with this tradition (Waters 1994, pp. 471-72).

Waters has expressed dissatisfaction with the word "solidarism": "The name solidarism, or solidaristic economics, while preferred, leaves something to be desired" (Waters 1984a, p. 115). But he is clear about what it means. It means for him a social reorganization of the kind suggested in the Papal encyclical *Quadragesimo Anno*. Indeed, the title of one of his papers is "The Influence of the Encyclicals on the Solidarist Theory of Social Economy."

### THE PAPAL ENCYCLICALS

What, if any, is the relevance of solidarist economics in the context of the world economy? Let us first consider the views expressed in some of the Papal encyclicals on some of these issues.

The elements of a conflict are unmistakable; the growth of industry, and the surprising discoveries of science; the changed relations of masters and workmen; the enormous fortunes of individuals and the poverty of the masses; the increased self-reliance and the closer mutual combination of the working population; and finally, a general moral deterioration. The momentous seriousness of the present state of things just now fills every mind with painful apprehension; wise men discuss it; practical men propose schemes; popular meetings, legislatures, and sovereign princes, all are preoccupied with it ... and there is nothing which has a deeper hold on public attention (*Seven Great Encyclicals* 1963, p. 1).

What makes *Rerum Novarum* so timeless is its proclamation of what were perceived as the fundamental conditions for justice in the economic and social situation of 1891.

... when there is the question of protecting the rights of individuals, the poor and helpless have a claim to special consideration. The richer population have many ways of protecting themselves, and stand less in need of help from the State; those who are badly off have no resources of their own to fall back upon, and must chiefly rely upon the assistance of the State. And it is for this reason that wage-earners, who are undoubtedly among the weak and necessitous, should be specially cared for and protected by the commonwealth" (*Seven Great Encyclicals* 1963, p. 18).

These remarks are especially relevant today, in view of disturbing evidence about increasing poverty, both absolute and relative, to be found within countries (less developed and industrialized) as well as between countries. *Rerum Novarum* forcefully stated that the more that individuals are helpless, defenseless within a society, the more they need and require the care of others. And, if this care is not forthcoming voluntarily from more fortunate individuals and private organizations, it is the obligation of the government to see that the basic needs of the less fortunate are met. In today's international economy, this statement can be and should be applied not merely to individuals within a particular society but also to individuals in any society and indeed to societies generally. In other words, the principle of solidarity is valid both in the internal order of each society and in the international order.

Whereas *Rerum Novarum* equated the "social question" with the issue of relations between labor and capital, *Quadragesimo Anno* (On Reconstructing the Social Order) widened the scope of the discussion by taking into consideration the then (1931) prevailing economic conditions during the depression. Noting the failure of the economy to provide full or near-full employment at just wages, *Quadragesimo Anno* focused on the reconstruction of the social order within a country. *Mater et Magistra* (On Christianity and Social Progress) explicitly stated in 1961 that the social question posed by *Rerum Novarum* in 1891 had become worldwide or international.<sup>1</sup> *Mater et Magistra* identified the imbalance between rich and poor countries as the most challenging problem in the world. It stated that everyone must share responsibility for this problem because everyone belongs to the human family and because of the increasing interdependence among countries. *Mater et Magistra* was published in 1961 when the belief that a rising tide would lift all boats was quite popular. It reflected the prevailing faith in the Western World in the ability of the existing institutions within the democratic capitalist societies to bring about a just and humane life for everyone. However, while *Mater et Magistra* reiterated the Church's long-held position about the rights of private property, it recognized the multiplication of social relationships in the increasingly complex interdependence among individuals and among countries and, more significantly, accepted the need for governmental intervention in the economy to a greater degree. It also recommended initiatives by state authorities to remedy imbalances within countries as well as between countries. By stating a clear case for a policy of social reforms which would benefit the poor people in a country as well as low-income countries, *Mater et Magistra* set a new direction in Catholic social teaching. It rooted the call for help to the poor countries in the name of solidarity of the human race. It advocated emergency assistance and scientific, technical and financial cooperation so that poor countries would eventually be in a position to make economic progress on their own, without help from the wealthy countries.

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<sup>1</sup>This is perhaps the first time that the Catholic Church has extensively discussed, in one of its official publications, the problem of international inequality of incomes.

*Populorum Progressio* (On the Progress of Peoples) explicitly and specifically discussed the problem of international poverty and called for bold transformations in the structure of the prevailing international order. It stated that free trade was not fair when the partners were very unequal. It called the prevailing trade relations neocolonialist in nature. It identified imbalances in power relationships as a cause of unjust international trade. It argued that such imbalances tended to offset, at least in part, the benefits of international trade.

...the needy nations grow more destitute, while the rich nations become richer...

It is evident that the principle of free trade, by itself, is no longer adequate for regulating international agreements. It certainly can work when both parties are about equal economically; in such cases it stimulates progress and rewards effort. That is why industrially developed nations see an element of justice in this principle.

But the case is quite different when the nations involved are far from equal. Market prices that are *freely* agreed upon can turn out to be most unfair...

- . ..when two parties are in very unequal positions, their mutual consent alone does not guarantee a fair contract; the rule of free consent remains subservient to the demands of natural law. In *Rerum Novarum* this principle was set down with regard to a just wage for the individual worker; but it should be applied with equal force to contracts made between nations: trade relations can no longer be based solely on the principle of free, unchecked competition, for it very often creates an economic dictatorship. Free trade can be called just only when it conforms to the demands of social justice” (Paul VI 1981, pp. 193-94; emphasis in the original).

*Populorum Progressio* stated that the conditions for equality of bargaining power do not exist between wealthy and low-income countries. Therefore, limits need to be established to make competitive markets just and fair. In order to establish general norms for regulating certain prices, for guaranteeing certain types of production, and for supporting new industries, international agreements were called for, agreements which would reduce the degree of inequality in international trade relations. *Populorum Progressio* stated that there is an obligation of sharing-based solidarity for wealthy individuals as well as for countries. Individuals, it argued, should be willing to contribute in the form of higher taxes and higher prices on commodities imported from poor countries. Wealthy countries, it stated, should be willing to devote part of their production to meet the needs of poor countries and to train engineers, teachers and scholars prepared to put their knowledge at the disposal of poor people.

Just as the Papal Encyclicals *Rerum Novarum* and *Quadragesimo Anno* discussed the condition of workers from a non-Marxist perspective, so too *Sollicitudo Rei Socialis* and *Centesimus Annus* explain the Church's concern about international dependence from the same perspective:

...one must denounce the existence of economic, financial and social *mechanisms* which, although they are manipulated by people, often function almost automatically, thus accentuating the situation of wealth for some and poverty for the rest. These mechanisms, which are maneuvered directly or indirectly by the more developed countries, by their very functioning favor the interests of the people manipulating them. But in the end they suffocate or condition the economies of the less developed countries (John Paul II 1988, pp. 26-7; emphasis in the original).

Justice will never be fully attained unless people see in the poor person, who is asking for help in order to survive, not an annoyance or a burden, but an opportunity for kindness and a chance for greater enrichment... It is not merely a matter of 'giving from one's surplus,' but of helping entire peoples which are presently excluded or marginalized to enter into the sphere of economic and human development. For this to happen, it is not enough to draw on the surplus goods which in fact our world abundantly produces, it requires above all a change of lifestyles, of models of production and consumption, and the established structures of power which today govern societies. Nor is it a matter of eliminating instruments of social organization which have proved useful, but rather of orienting them according to an adequate notion of the common good in relation to the whole human family... There is a growing feeling that (this) increasing internationalization of the economy ought to be accompanied by effective international agencies which will oversee and direct the economy to the common good, something that an individual state, even if it were the most powerful on earth, would not be in a position to do. In order to achieve this result, it is necessary that there be increased coordination among the most powerful countries, and that in international agencies the interests of the whole human family be equally represented (John Paul II 1991, pp. 108-09).

## INTERNATIONAL ECONOMIC SYSTEM

It is thus clear that Catholic social teaching has recognized that the structure of neither capitalist nor socialist system has proved adequate to the challenge of meeting the basic needs of poor people, especially those living in developing countries. Even though global interdependence has increased over the past few decades at an accelerating pace, the economic, political and social structures largely reflect the period when national autonomy was dominant. What is even worse, there does not

seem to be a well-recognized or widespread feeling that the present institutional structures are inadequate as well as dysfunctional. For example, very large international flows of capital dramatically can, and do, shift the resource base and employment levels of countries. Multinational enterprises can, and do, transfer capital, products and technology from one country to another and they do not face the responsibility for the effects of their actions in any country. Such business and industrial practices which are conducted in an institutional setup characterized by national sovereignty and fragmented markets have wide-ranging effects. Neither the practices nor the effects by and large fall within the purview of any local, national or international organizations.

In the aftermath of the collapse of governments in Eastern Europe and the breakup of the erstwhile Soviet Union, the world economy is dominated by the rules of the game of capitalist market systems. Indeed, many commentators and several scholars have concluded that capitalism and democracy have triumphed over socialism and authoritarianism. But the key question is: what are the features of capitalism and of democracy that are responsible for this victory and that are worth preserving and worth extending from the national to the international economic structures?

For Schumpeter, a capitalist society is one which "entrusts its economic process to the guidance of the private businessmen" (Clemence 1951, p. 184). Such a society has, according to Schumpeter, three features: private ownership of the physical means of production, private profits and private responsibility for losses; and the creation of means of payments (banknotes and deposits) by private banks. On the other hand, a socialist society for Schumpeter, is characterized by "an institutional pattern in which the control over means of production and over production itself is vested with a central authority -- or, as we may say, in which, as a matter of principle, the economic affairs of society belong to the public and not to the private sphere" (Schumpeter 1947, p. 167).

Three assumptions govern the rules of the game under capitalism. The first assumption pertains to self-interest. This refers to the belief that if each individual takes care of his/her basic self-interest, everyone will be taken care of. This assumption is extended to groups of persons as well as societies. In the international economic context, the assumption states or implies that a country will act in its own self-interest. The second assumption relates to the role that the price mechanism plays in coordinating the interaction of participants in the market. It is assumed that each individual has access to marketable resources with which to earn a living and to participate in mutually beneficial exchanges executed through the price mechanism in the market. The free choices of individuals, groups or societies in the marketplace will lead to a maximization of total good or utility. In other words, voluntary exchanges in the market with free movement and equal access for all participants will lead to the most desirable outcome for individuals, groups or countries. In the international context, we assume that each country has some goods and services that it can produce and sell to other countries at a price and in quantities that will result in a gain from trade to that country. The

basis for international specialization rooted in comparative advantage is founded on such an assumption. The third assumption pertains to self-regulating nature of competition. The assumption is that economic agents are more or less equal in bargaining power and no one individual (country) has the ability to control the outcome in the market. Competition among equals assures that exploitation of one unit by another will not take place.

Economists of course do not agree completely about the universal prevalence of the conditions embodied in the above assumptions in national or international economies. For example, the neoclassical school believes that, left to itself, the market will be self-correcting over time, and that interference by nonmarket forces will be more harmful (or less beneficial) than the unregulated market approach. According to Keynesian analysis appropriate fiscal and monetary policy measures by government can and should be used to achieve macro-economic stability. Such government policy measures thus help to reduce (or even eliminate) the harmful inequities resulting from unregulated markets. Marxists and neo-Marxists would argue that public policy focus should be on meeting human needs and not just on macroeconomic stability.

In any case, one could hardly argue that the above-mentioned three assumptions are satisfied to a significant degree in the operation of international markets. Economists of various persuasions have concluded that systemic variables contribute to the empirically observed dismal economic performance of very poor countries. These include: the so-called brain drain, the debt crisis, the armament race, private investment capital in poor countries, foreign aid distributed by developed countries and by international organizations and the global trading system.

The world trading system is not characterized by equal and mutually gainful access to markets. While it is true that comparative-advantage based international trade has helped countries like South Korea and Taiwan, among others, many other countries have struggled to compete in international markets. The world economy is dominated by wealthy countries. Although they repeatedly extol capitalism and free trade, these rich countries can, and do, change the rules governing trade and move capital around the world in a manner which has significant adverse effects on poor countries. The developing poor countries have basically only primary products to sell in international markets and they do not share significantly, if at all, in the returns to the later stages of processing (of primary products). The gains from foreign trade go predominantly to developed countries. Developing countries face formidable barriers to entry in developed economies which tend to protect their own producers. Prices for primary products are volatile because they respond to changes in supply and demand to a greater degree than do manufactured commodities. Contributing to the producers' inability to control either supply or price are such variables as the difficulty of storing agricultural products, the dependence on the vagaries of weather and the undifferentiated nature of primary products. The secularly declining terms of trade faced by predominantly primary product exporters

may or may not be a generally accepted hypothesis by scholars but they certainly impose a significant burden on the poor developing countries affected.

The brain drain is another impact of the market system on developing countries. Educated young men and women find their skills more in demand in the flourishing job markets of rich developed countries than in poor developing countries where they find themselves overeducated when they seek employment. The flow of specialized human resources from poor to rich countries is at the same time both a cause and an effect of the low living conditions of developing countries.

Private foreign investments flow in the direction where returns to those investments are highest. The poorest and neediest countries which have relatively weak infrastructures, relatively unskilled labor forces and relatively unstable political climates offer less than favorable conditions for such private investments. During the late 1940s and 1950s poor countries with unexplored and underexplored natural resources and relatively low-wage labor found multinational companies in search of resource extraction and exploitation willing to invest in their economies. In the late 1950s and 1960s, such companies sought out poor countries willing to develop industries like textiles, construction and steel. More recently, however, multinational corporations are more interested in high-tech, capital-intensive industries like electronics and chemicals, in which the population in developing countries can participate in a limited way because of low education and skill levels.

Foreign aid supplied by individual countries often comes tied to specific projects or to countries from which necessary imports have to be ordered even at high prices. It also has political strings attached. A significant component of foreign aid is military rather than economic assistance. Foreign aid often fails to reach the needy people in developing countries because wealthy powerful interests are often in charge of implementing projects in these developing countries.

Multilateral foreign aid was designed to avoid some of the limitations of foreign government-to-government aid. But in practice international agencies like the World Bank and the International Monetary Fund are controlled to a significant degree by rich countries. Developing poor countries have often found the policies of such institutions unresponsive to their needs. A case in point is the set of adjustment programs designed to bring about structural adjustments in the countries applying for assistance from the IMF which has required such programs as a condition for new loans beginning in the 1980s.

The total external debt of poor countries amounted to more than one trillion US dollars in the 1980s. Not all borrowing by the developing countries was prudent. However, many countries needed to borrow heavily to finance the purchase of necessary equipment and supplies on adverse terms of trade and with significantly higher prices of required oil imports.



Competition among lending bankers (from developed countries) who had large funds coming from invested earnings of OPEC members were only too eager to lend funds to developing countries without investigating thoroughly the ability to absorb (in the developing countries) the funds loaned and without worrying about the prospects for repayments. In several years during the 1980s and 1990s the flow of debt payments from the developing countries exceeded the flow of investments and aid into those countries.

## ECONOMIC JUSTICE

What constitutes economic justice in *the international* context? Several answers are possible. One approach may emphasize process or mechanics. An economic system is just, for example, if the countries comprising the system agree on the mechanics or the process by which the system should operate. It follows that such a just economic system delivers economic justice irrespective of the actual level of real income and/or of any distribution of such income. Another approach may stress individual (country) preferences. Thus, an economic system is just if it operates according to individual (country) preferences. Once again, such an economic system will deliver economic justice, by definition, irrespective of the aggregate level of real income or of the distribution of such income. A third approach may link justice and merit or ability. If an economic system results in a distribution of income and rewards according to merit or ability, that system may be called a just economic system irrespective of the level of real income generated by the system. Justice is thus correlated with merit. A fourth approach would link justice with social welfare or public interest or common good. An economic system thus is just if it maximizes such public interest. In this approach the real problem is how to formulate the social welfare function or how to define public interest or common good.

Let us then examine the value judgment underlying economic justice. A basic value judgment is the Rousseauvian one: all persons and all countries are by nature equal. We interpret equality to mean equality of opportunity. A just economic system therefore is one which will generate differences or inequalities in income and reward that can be justified legitimately. In this context, economists like to talk about an appropriate degree of inequality based on functional differences as legitimate. Two obvious questions arise: What specifically does equality of opportunity imply? And, how much functional inequality is consistent with a just economic system?

It is helpful to examine Rawls' views in seeking answers to these questions. According to Rawls a just system is one which individuals (countries) would choose if they did not know what relative position they would occupy in that system. No individual or country would want to be at the lower end of the distribution scale. It follows, for Rawls, that an individual or country would choose to be anyone or any country at random in a system in which the degree of inequality was acceptable, if the

person or country was at the low end. The Rawlsian principle of justice therefore might be stated thus: a just system is one which raises the level of the poorest people or poorest countries in the system. In other words, the individual or country would favor that system which maximizes the lowest incomes and rewards. This has come to be known as the maximin principle.

Rawls seems to assume that all individuals are risk-averse. (In our context, the assumption about risk-aversion would apply to countries.) His argument also runs into problems when we consider inter-generational equity. He recognizes that his maximin principle has limitations in micro-situations. Even in macro-situations, discussion of economic justice does not permit a clear-cut distinction between the level of real income and its structure or distribution.

The value of Rawlsian analysis in our context lies in the fact that it considerably clarifies two important aspects of economic justice. First, that the tenet of Rousseauvian equality implies a high positive correlation between justice and economic equality of incomes and rewards. One must therefore suspect the hypothesis that a significant degree of inequality is of benefit to the system unless there is strong or even definitive evidence to that effect. Secondly, an economically just system must have a certain minimum level of incomes and rewards for every country. The minimum level of income and reward would include what Rawls calls primary goods which include rights, liberties, opportunity, income, wealth and self-respect. However, Rawlsian analysis also demonstrates the difficulty of arriving at a complete specification of an economically just system from a universally acceptable set of philosophical axioms.

## ECONOMIC EFFICIENCY

Welfare implications of economic theory have been of interest to economists starting with Adam Smith. One of the most important conclusions of welfare economics is that the allocation of resources which would be decreed by the competitive market is the "best" allocation. That is, the optimum conditions of welfare derived from the general microeconomic models of an economy specify conditions of economic efficiency. These optimum conditions of economic welfare are static relative (rather than absolute) conditions. They are, in other words, conditions of maximization of output from given inputs, provided that wants of consuming agents or units can be taken as data and provided that the distribution of income is given. These static conditions are not the only possible welfare conditions. The maximization approach of price theory is not the only possible one. The early classical economists, from Adam Smith to John Stuart Mill, were also concerned with welfare, but their analyses were centered more on problems of capital accumulation and upon the dynamic process of economic expansion than on the problem of allocation of given inputs to maximize production of outputs.

An extension of the welfare implications of the classical theory to international economics was done by Ricardo. Under specified and somewhat restrictive assumptions, Ricardo concluded that total world production would be maximized if countries specialized along lines indicated by their comparative advantage. The source of comparative advantage was explored by Heckscher and Ohlin who concluded that relative differences in factor endowments were the source of comparative advantage. For Heckscher and Ohlin, differences in factor endowments were "given." Economists have conventionally classified factors of production into land, labor, capital and enterprise. It can be (indeed, it has been argued) that factor endowments measured in terms of these four factors are not static over time and, in fact, change with growth and with development. The extension or generalization of the infant industry argument for tariffs to developmental protection (or the infant country case) is based in large part on this premise. We need to remember the case for developmental protection as a valid exception to the case for free world trade particularly during these days characterized by confrontation between industrialized countries at GATT discussions and by the repetitive statements by economists and others in favor of unregulated economic activity both within national boundaries and between nations. New, more recent trade theories examine aspects like economies of scale, importance of imperfect competition and differences in dynamic changes in technology among countries as bases of international trade.

### INTERNATIONAL SOLIDARITY?

In the first section we presented the concept of solidarity as interpreted by Waters. His writings discuss solidarity in the context of a country, especially a country like the United States. In this concluding section we discuss the relevance of solidarity and community in the context of the world economy.

The world economy in the 1990s is characterized by the following five features:

It consists of about 200 countries which vary considerably in terms of (physical and demographic) size.

There is a very high degree of inequality in the distribution of incomes among (as well as within) these countries.

The distribution of wealth among these countries is also very uneven.

International trade among the countries results in persistent deficits for a large number of poor (i.e., low income) countries offset by large surpluses for a small number of wealthy (i.e., high income) countries. These trade imbalances have the consequence that the debt levels of the poor countries keep on increasing over time.

The international governing institutions are dominated by the few wealthy countries. The poor countries are members of a small number of governing bodies or committees which have no significant authority or power

In short, the world economy can be compared to a country with about 200 households ...

which vary considerably in terms of physical and demographic size,

amongst which there is a high degree of inequality of incomes,

the distribution of wealth among whom is also very uneven,

the poor amongst which face persistent deficits in their budgets and whose debt levels keep mounting, and

the wealthy amongst which dominate the governing structure.

How would we label such a society? Would we like to be a member of one of the households without knowing beforehand whether we would belong to one of the very few wealthy and powerful households or to one of the many poor and dominated households? Would we like to be one of the households in that society without knowing *a priori* what our income level or our wealth level would be?

From the economic point of view, one might wonder whether our global economy is an efficient one. This puzzlement could be interpreted to mean one of two things:

Could the global economy generate a higher level of aggregate real income with the level of inputs currently being used?

Could the global economy generate the current level of aggregate real income with a bundle of inputs that is smaller than the one currently used?

These two interpretations are summarized in the same word "efficiency" by us but they may or may not mean the same thing to a non-economist.

Secondly, one might wonder if our global economy is just or equitable or fair. This second puzzlement could also be interpreted to mean one of two things:

Is the distribution of real incomes or economic awards equitable?

Is the process by which such real incomes or awards being generated equitable?

These two interpretations mean different things to us but not necessarily to a non-economist.

One might wonder further if the issues pertaining to efficiency and those pertaining to equity can be separated and discussed in isolation and whether the two sets of issues have significant impact on one another.

A non-economist would probably be amazed that in a field of enquiry which we call welfare economics (which presumably deals with questions pertaining to the well-being of human beings and of groups of human beings), there is no place for justice, ethical norms, value judgments, because we wish to discuss questions of economic efficiency on a "scientific" basis! A solidarist must marvel at human ingenuity in that:

we have created a number of arbitrarily drawn nation- states between the peoples of which there are vast differences in standards of living;  
we have developed a field of study called welfare economics which has no apparent theoretical apparatus to facilitate a discussion about an international economic order other than in the context of efficiency.

From a solidarist perspective one must wonder why economists cannot see that discussion about value-laden efficiency and about value-laden equity within countries is relevant also in the context of discussion of differences between countries. A solidarist would probably tell us that we are smart in recognizing that economic efficiency is important but that we are not smart enough to recognize that efficiency is itself a value. He/she might want us to recognize further that there is another important (perhaps at least equally important) value called economic justice. And, he/she might want us to examine the possibility (in his/her view, a probability, if not a certainty) that economic justice would enhance economic efficiency at least in the long run. He/she might ask us to explain the difference between an efficient robot and an efficient human being, implying perhaps that robotic efficiency need not entail a dimension of justice but that human efficiency cannot be divorced from issues of justice.

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## SELF-INTEREST, ECONOMIC EFFICIENCY, AND THE GENERAL WELFARE

Elba K. Brown-Collier <sup>1</sup>

There is by now a long and fairly imposing line of economists from Adam Smith to the present who have sought to show that a decentralized economy motivated by self-interest and guided by price signals would be compatible with a coherent disposition of economic resources that could be regarded, in some well defined sense, as superior to a large class of possible alternative dispositions (Arrow 1971, p. vi).

The problem of conflict between the self-interested individual and the rest of society has engaged students of economics from its formal beginnings. Adam Smith asserted that the right of the individual to make choices in his own self-interest would lead to the best outcome for society and that a system organized in this manner would be morally acceptable or just. Smith, however, recognized that unbridled self-interest could be detrimental to the general welfare. Accordingly, he pleaded for some form of moral restraint to control self-interest.

Smith's "impartial spectator" provides the control, ensuring that the individual will temper his individual greed in his relationship with others.

There can be no proper motive for hurting our neighbour, there can be no incitement to do evil to another, which mankind will go along with, except just indignation for evil which that other has done to us. To disturb his happiness merely because it stands in the way of our own, to take from him what is of real use to him merely because it may be of equal or of more use to us, or to indulge, in this manner, at the expense of other people, the natural preference which every man has for his own happiness above that of other people, is what no impartial spectator can go along with.

...Though every man may, according to the proverb, be the whole world to himself, to the rest of mankind he is a most insignificant part of it. Though his own happiness may be of more importance to him than that of all the world besides, to every other person it is of no more consequence than that of any other man.

When he views himself in the light in which he is conscious that others will view him, he sees that to them he is but one of the multitude in no respect better than any

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<sup>1</sup> The author gratefully acknowledges the helpful comments of Edward O'Boyle. Any errors remaining are entirely the author's responsibility.



other in it. If he would act so as that the impartial spectator may enter into the principles of his conduct, which is what of all things he has the greatest desire to do, he must, upon this as upon all other occasions, humble the arrogance of his self-love, and bring it down to something which other men can go along with (Smith in Heilbroner 1986, pp. 93-4).

When there is no conflict between the interests of the individual and the interests of others in the group, when for example all trades and actions are mutually beneficial, behavior guided by self-interest is ethical. When there is conflict, however, it is in the individual's self-interest as guided by the impartial spectator, to behave as a member of the group, cognizant of the impact of his actions on others. It is assumed that the individual wishes to be thought well of by others and that this desire will override the desire for other things yielding him happiness.

Thus, Smith was able to argue that individuals should be granted the right to choose and that a capitalist market system was just because it results in the ideal outcome -- the good of the individual and the well-being of the group. While he did not specify the nature of that ideal outcome, *The Wealth of Nations* indicates that increased production and productive capacity certainly are desirable goals. Smith believed as did other natural law philosophers that there is a natural order to society which could be established and maintained by means of the self-interested individual as long as there is some control over unbridled greed.

Evensky claims, nonetheless, that Smith realized that the self-government necessary to bring about the ideal state or outcome was not likely to occur. Accordingly, Smith adopted the notion of "civic humanism" where "citizens are expected to share a common commitment to the well-being of the state (Evensky 1992, p. 72). The virtue of good citizenship would lead the statesman to help guide the state toward the ideal. "Smith had a change of heart. No longer seeing society as evolving toward an ethical foundation that would support the classical liberal ideal, he calls for the leadership of a statesman to provide a moral model and to rein in the unbridled self-interest of factions" (Evensky 1992, p. 73).

## THE NEOCLASSICAL STANCE

The neoclassical stance simply assumes that the interest of the individual is mutually consistent with the interest of the group as represented by the rest of the members of society. In this regard, there are two competing arguments. First, in neoclassical welfare theory the best allocation of output occurs when the allocation is Pareto optimal. Indeed, we describe this position as "economically efficient." The Pareto optimality condition is related to the concept of distributive justice referred to as utilitarian which is described below. Second, in matters of the distribution of the output, the notion that contributors in production should be rewarded in relation to their contribution is fundamental to

the neoclassical stance. This is related to the principle of commutative justice drawn from the right of private property, also described below.

In the ideal world of purely competitive markets, there is no need to choose between the two. The Pareto optimal point maximizes utility so that no one person can be made better off without someone else being made worse off *and* all factors are paid according to the value of their marginal product.

Conspicuously absent from the neoclassical paradigm is the notion of mutually inconsistent competitive behavior. It is simply assumed that all trades are beneficial or they would not take place and that a harmony underlies the market system which leads each of us to act in a way that is automatically beneficial to ourselves and to others. The conflict that troubled Smith is assumed away.

*Neoclassical Economics on Distributive Justice and Commutative Justice.* Distributive justice relates to the problem of the distribution of the goods and services produced among the members of society, a matter of considerable importance if the output is greater than the value of the inputs.<sup>1</sup>

The utilitarian rule -- which is endogenous as it derives from the preferences of the individuals in society -- is that a just distribution of production among the members of the group is one which maximizes total social utility or happiness (Silver 1989, p. 135). This is the foundation of neoclassical welfare economics. Although some argue that such a distribution requires a forced redistribution and "pays no attention to property rights", the essence of economic efficiency as used in neoclassical welfare economics is that such a position will be the automatic outcome of the purely competitive capitalist market system. At this point, one need only ask about the justness of the original distribution or endowment, since the relative position of all participants depends on the original distribution. There is no conflict between the interest of the individuals and the welfare of the group.

Nozick (1991), however, asserts that the utilitarian rule is unacceptable because it is an end-result principle as opposed to a historical principle. There is no procedure or rule for determining if the initial endowment of holdings is a just distribution. Accordingly, there is no reason to assume the end-result is just. Worland affirms that there is a "systemic kind of 'distributive exploitation,' which occurs when there is background injustice in the distribution of property and property incomes" (Worland 1981, p. 279).

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<sup>1</sup> The failure to recognize that this is possible leads to rather questionable conclusions from the "right of private property" notion of distributive justice.

The use of the utilitarian logic in neoclassical welfare theory has not been by itself the primary argument that the market capitalist system serves the ends of justice. Indeed, much of the argument depends on the assumption of purely competitive markets. Jacob Viner (1978) argues that commutative justice, which regulates the relationship between individuals, is provided in the exchanging and trading activities in a market capitalist system. Under conditions of pure competition, no individual will pay more for an item than the item is worth. This idea is extended to the labor market in the works of John Bates Clark and the marginal productivity theory. There is no violation of commutative justice in the wage bargain because labor will be paid exactly what labor is worth. Of course, this only occurs if markets are purely competitive and if there are no increasing returns to scale.

The relationship between labor and employer involves principles of both commutative justice and distributive justice. The assertion that the wage and, therefore, the distribution of the output are just relies completely on the assumption of purely competitive markets and on the belief that the initial endowment of property, abilities and opportunities is just.

When one allows that the requirements of pure competition no longer apply or that market failures exist, the argument that commutative justice is fulfilled with voluntary exchange no longer holds and the rule of maximizing total utility could imply the need to redistribute incomes arising from market activity. If an individual is forced to give up what is said to be his by some rule of property, the balancing of that person's outrage against another's increased pleasure becomes problematic. Do rights always outrank happiness? Silver contends strongly that they should.

It seems to me that once rights are introduced into what purports to be an ethical analysis the engineering aspect of economics becomes irrelevant: the intrinsic value, infinite or not, of a right provides sufficient reason for ignoring all instrumental values. Large gains in utility or whatever are incapable of transforming moral wrong into moral right (Silver 1989, p. 142).

Silver describes minimal liberalism as the requirement that "There are certain alternatives over which an individual ought to have a decisive say (a "right") irrespective of the preferences (in happiness terms) of others" (Silver 1989, p. 143). This leads to the conclusion that any distribution or redistribution of production which is not voluntarily conducted by each and every individual, by definition, must be unjust. This is particularly so when the individual's "right" is that of holding and transferring property along the lines described below. It may be inappropriate, however, to extend the notion of minimal liberalism to the "right of private property." The "rights" of minimal liberalism may be more correctly defined as those personal rights guaranteed to protect the minority from the majority in matters where such personal liberties do not infringe in any way on the liberties of the

majority. The right to hold and use property as one sees fit may not fit this definition. This is certainly the case when conflict arises, that is when activities are not mutually beneficial.

The "right of property" rule of distributive justice is also related to neoclassical welfare theory in that the just distribution of income in the purely competitive world not only maximizes total social welfare but also results in individuals receiving a portion of the output proportional to their contribution in producing the output. The property rights principle, which maintains that "Individuals ought to hold the objects they have produced; they ought not to be forcibly deprived of these objects," is the heart of the arguments for the marginal productivity theory of distribution. Silver asserts that this principle should be taken as "an ultimate value" (Silver 1989, p. 134).

Nozick states the rules of justice in holdings as follows:

a person who acquires a holding in accordance with the principle of justice in acquisition is entitled to that holding,  
a person who acquires a holding in accordance with the principle of justice in transfer, from someone else entitled to the holding, is entitled to the holding, and  
no one is entitled to a holding except by (repeated) applications of 1 and 2 (Nozick 1991, p. 225).

With this rule, Nozick argues that any forced transfer of holdings would by definition be unjust. While this is intuitively appealing, when pushed to its logical conclusion, such a position may be indefensible. If any forced transfer of income is considered unjust, how do we accept the reasonable expectation and legal requirement of child support? Few would deny that it is unjust to require a parent to care for and support his/her child. Indeed, some consider such support a moral obligation.

As with the utilitarian rule, the property rights rule also involves the question of the justness of the original endowment or the original acquisition. This is particularly troublesome when one looks at the distribution of abilities and opportunities with respect to labor as the source of property and/or income. Would we be willing to describe as economically unjust a system of forced transfer from those who had a superior initial endowment through no effort of their own to those who were less fortunate in the original distribution of abilities and/or opportunities also through no fault of their own? Perhaps, as Bloom (1991) suggests, the members of society may be more able to find agreement on what is an undesirable outcome with respect to economic justice than to find consensus on what is the best or most desired outcome.

## THE INADEQUACY OF DISTRIBUTIVE AND COMMUTATIVE JUSTICE

Social economists assert that, whatever difficulties inhere in the meaning and the application of distributive justice and commutative justice, these two principles alone are inadequate. Downie, for one, argues that the principle of utilitarianism has merit in that it "avoids the pitfalls of egoism and stresses that moral and political rules of social organization are mainly concerned with creating the best possible consequences for the majority in society" (Downie 1971, p. 35). He states, however, that this principle must be supplemented by the separate principles of equality, liberty and fraternity.

Liberty is defined as the freedom from interference of people to do what they wish to do - to allow them to pursue their own aims and fulfill their own aspirations. The principle of equality ensures that each person has an equal right to pursue his object of interest. The principle of utility is that the rules of society should allow for the maximization of happiness for the group. The relationship between equality, liberty and utility is very complex.

For example, it is obvious that if there is complete liberty in the pursuit of objects of interest then some people will be able to subdue others and to obtain much more for themselves. The principle of liberty must therefore be combined with that of equality, to produce the conclusion that each person has an equal right to pursue objects of interest. ... But the equal pursuit of objects of interest may still produce clashes and there is therefore a need for utilitarian rules of social harmony to minimize such clashes (Downie 1971, p. 42).

The debate between these three principles is reflected in the arguments made above regarding neoclassical economics and distributive justice and commutative justice. Downie, however, asserts that a fourth principle of social organization -- the principle of fraternity -- is necessary. This principle is the "emotional side to social morality" (Downie 1971, p. 43), providing moral restraints on the notion of liberty or self-interest.

There is a certain ambiguity in the concept of fraternity, but in its most important sense a principle of fraternity suggests a motive for action stemming from devotion to some community to which one belongs. In so far as people in a community really are imbued with a feeling of fraternity, they will not see restraints on liberty in the general interest as restraints - in fact they will not be such, but rather ways of bringing about what the individual wants most (Downie, 1971, p. 43).

Downie argues that if the principle of fraternity is not limited, it presupposes a respect for persons. However, if the principle is limited to a kinship extending only to a limited group, clan, or social class, "then it is not the same as respect, and may indeed be inimical to it" (Downie 1971, p. 88). This

principle is a unifying concept in social economics. The institutionalist view of social economics as presented by Hill includes Dewey's contention that "Moral actions are expressions of the human awareness of the ties that bind each person to all humankind" (Hill 1990, p. 164). Value judgments related to this awareness of mankind are used in the analysis of and proposals for solutions to social problems. Social economists following the views of Kant argue for the value of "human dignity" (See Lutz 1990, and Etzioni 1990). Perhaps the most detailed argument for a principle of fraternity is found in Catholic social thought.

Catholic social thought (CST) as summarized by Waters (1990) and O'Boyle (1990, 1991), involves a third principle of economic justice in addition to distributive justice and commutative justice as defined above. *Contributive justice*, called "social justice" by some students of CST, is "the obligation of the individual to the group, whether the group is private or public. Contributive justice asserts that insofar as the individual derives benefits from the group, he/she has an obligation to maintain and support the group" (O'Boyle 1991, p. 582). Dempsey states that "The principle of social justice demands that each human person contribute whatever is necessary for the common good" (Dempsey 1958, p. 243). Waters defines contributive justice as 'constructive justice' - "the obligation to reconstruct economic institutions so that they will reflect human dignity and produce effectively for the common good" (Waters 1990, p. 95).

Is this fraternity or obligation to the group described in CST limited in the sense described by Downie, or does this represent a sense of kinship with the whole human race? There is conflicting evidence. The notion of contributive justice is related to the concept of solidarity. The principle of solidarity, a commitment to one's group, in connection with the principle of subsidiarity leads to the conclusion that the social and spiritual development of the individual occurs within groups and these groups should be subsidiary in nature. The principle of subsidiarity is discussed by Dempsey.

All communities are subsidiary to, that is, designed to serve, the concrete human persons who compose them; all superior communities are subsidiary to, that is, designed to serve, the inferior communities of which they are composed, and through these to serve the concrete human persons who are members of the least highly organized communities (Dempsey 1958, p. 243).

This leads to the conclusion that the group to which the individual owes his contribution is defined as the group with which the individual has a common interest. O'Boyle calls attention to "Pesch's threefold solidarity [which] refers to the natural oneness among mankind in general, the oneness among citizens of the same nation, and the oneness among persons with the same production problems" (O'Boyle 1990, p. 136). He goes on to state that, following the principle of subsidiarity, group control over economic decision-making should be connected to the workplace.

Private-group control of decision-making directs the individual members of the group toward the common good through voluntary agreement on the responsibilities of the various members of the group itself. The individual members are functionally related to one another through some direct interest in the production of the same product or service. They form into a group in order to deal with workplace dysfunction that each one is unable to deal with alone.

Both the common good and individual responsibility are clarified and specified in terms of reducing, eliminating, or preventing specific dysfunctions in the workplace that affect the various members of the group. Cooperation means a willingness on the part of the individual to voluntarily moderate self-interest in order to deal with the dysfunctions that each one alone cannot deal with satisfactorily (O'Boyle 1990, p. 137).

Thus, it would appear that the concept of fraternity as embedded in the notion of solidarity or contributive justice is limited to the narrowly defined workplace or, with the principle of subsidiarity, with the immediate community. Yet, Pope John Paul II states "If there is no transcendent truth, in obedience to which man achieves his full identity, then there is no sure principle for guaranteeing just relations between people. Their self-interest as a class, group or nation would inevitably set them in opposition to one another" (John Paul II 1991, p. 17). Thus, it is unclear whether the notion of fraternity related to CST is limited to smaller groups or to the whole of mankind.

*Smith's Dilemma Revisited.* For both neoclassical economists and social economists the fundamental difficulty is in reconciling the principles of individual freedom or liberty with the concept of the common or social good. Both adhere to the principle that the individual has the right to choose and that the individual is best able to determine what is best for him. Indeed, this is reflected in Waters' discussion of the principle of subsidiarity. "... ideally society should be organized from the bottom up according to the principles of subsidiarity which implies a decentralized regulation of economic variables. Yet the principle of competition should be accepted to the extent that it does not lead to self destruction" (Waters 1990, p. 97) Similarly, Dempsey argues that man exercises free choice on the basis of his ability to determine what is good for him.

At the moment of acceptance I begin to know what is best for me here and now, i.e. that these reasons are my reasons. Such knowledge is desirous or causative knowledge, which is the internal act of free choice (Dempsey 1958, p. 270).



Social economists do not reject self-interest or the role for competition in promoting economic efficiency. They contend, however, that other values should also be reflected. The challenge is in determining just how individual values and interests get transformed into actions which are taken for the common good. Smith relied on the conscience of the individual or in the leadership of the statesman to cause individuals to restrain self-interest and act in accordance with the common good. Catholic Social Thought argues for a sense of community provided by religious teachings which is implemented through group decision-making at the lowest level of organization that is possible or necessary to solve the problems. Others argue for a secular sense of moral obligation related to the rights of human dignity implemented either through the state or some other social institution.

The crux of the problems is that the common good is something distinctly different from the good of the individual. As such, it may be impossible for individuals to become aware of the common good. The principle of liberty asserts that individual preferences and choices select the action the outcome of which affects all members of society. As Arrow points out, however, "The fundamental fact which causes the need for discussing public values at all is that every significant action involves the joint participation of many individuals" (Arrow 1983a, p. 63). Each individual may have little influence on the collective outcome and, more importantly, there may be no logical way to distinguish how the collective action does or should affect the individual.

We are face to face with an extremely difficult point. A standard liberal point of view in political philosophy, which also has dominated formal welfare economics, asserts that an individual's preferences are or ought to be (a distinction not usually made clear) concerned only with the effects of the social action on him. But there is no logical way to distinguish a particular class of consequences which pertain to a given individual. ... I am in effect arguing here that just as we cannot factor social actions so as to make each component pertain to a given individual, so we cannot factor the consequences of social actions in any meaningful way into separable consequences to individual members of the society (Arrow 1983a, p. 66).

If Arrow is correct, the mechanism of social choice and the definition of the common good become problematic.

The rules of social organization accepted by the members of society are themselves value judgments about what is "best" for society. In this view, the choice of a rule of "efficiency" defined as wealth maximization is simply the choice that the only measure of what is "good" for society is determined by individual preferences, weighted by disposable income (Medema 1993, p. 147). Similarly, arguing that social choice and institutions should reflect a concern for the dignity or fulfillment of the potential of mankind is another value judgment which must somehow be incorporated into the

thinking of individual decision-makers. If all decision-makers share the same values, conflicts would not arise. The difficulty is in choosing among different value sets and still preserving the notion that individual values and preferences count.

To repeat, neoclassical economics has sidestepped the entire issue by simply assuming that what is good for the individual is necessarily good for the community. There is no reason for conflict. Social harmony will result if the society is organized so as to allow individuals to maximize their position. Social economists and Pope John Paul II, however, assert that conflicts between the good of the individual and the good of the group can and do exist. Like Smith, they call for some restraint on "liberty." This includes limits on individual freedom of action, on the right of private property, and on the market itself.

Here we find a new limit on the market:

There are collective and qualitative needs which cannot be satisfied by market mechanisms. There are important human needs which escape its logic (John Paul II 1991, p. 16).

At the same time the church teaches that the possession of material goods is not an absolute right and that its limits are inscribed in its very nature as a human right (John Paul II 1991, p. 12).

Ownership of the means of production, whether in industry or agriculture, is just and legitimate if it serves useful work. It become illegitimate, however, when it is not utilized or when it serves to impede the work of others in an effort to gain a profit which is not the result of the overall expansion of work and the wealth of society, but rather is the result of curbing them or of illicit exploitation, speculation or the breaking of solidarity among working people (John Paul II 1991, p. 17).

The state must contribute to the achievement of these goals both directly and indirectly. .. Directly and according to the principle of solidarity, by defending the weakest by placing certain limits on the autonomy of the parties who determine working conditions and by ensuring in every case the necessary minimum support for the unemployed worker (John Paul II 1991, p. 8)

Social economists plead for some moral restraint in order to curb the excesses of unbridled self-interest. They see the result of unchecked individualistic behavior as detrimental to the well-being of at least some members of society. They seek institutional reform leading to recognition of these problems and in some form or another, rules or policies to alleviate the effects

on society. This, of course, necessitates a collective action or policy. If the members of society do not share these humanistic views, are such policies likely to be forthcoming? How are the values of the members of society formed?

*Formation of Values.* Samuels is instructive in the matter of values formation.

Another way of making the point is that whether one believes that values are made or discovered by man, man is involved in the serious business of articulating values. Choosing is not the same thing as making, but significant differences in understanding the functioning and performance of the social economy derive from, and in turn influence, the values that one articulates, and it is these understandings that form the basis of individual and collective action (Samuels 1990, p. 173).

Man's values are formed by the social structure in which he lives. If that structure reflects the values associated with unchecked individualism and a de-emphasized view of the community, those values will be reflected in the social actions taken and supported by the individuals in that society.

The rules and the institutions that embody them ... are not the result of deliberate rational negotiations, but are the product of historical, societal, and cultural evolution. Part and parcel of these evolutions are the sets of general and particular values, embodied in behavioral rules and in institutions (Etzioni 1990, p. 229).

These values can be changed, however. Values can be learned. In this respect, CST places emphasis on the family in teaching a sense of community. There is certainly a role and opportunity for statesmen and other political and community leaders as well as individuals in the mass media to influence the values adopted by individuals in the society. Both Smith and Pope John Paul II call for statesmen to articulate ideas related to the common or collective good. If individuals in the community lack a sense of community and concern for others, it is not likely that their economic decisions or the decisions and policies made by their representatives in the elected political body will share those concerns. In the age of mass media appeal to the electorate, it is doubtful that the "statesman" required by Smith and the "enlightened government" required by the Pope will become a reality.

*Community Versus Individual Interest.* It can be argued that in the post-war prosperity in the United States the success of the American corporation and the benefits to labor were for the most part directly related. While there were labor disputes with labor asking for higher wages, the increased profitability of the firm allowed for such increases. Because the corporation needed labor and labor needed the corporation, pursuing self-interest was mutually beneficial. When the rest of the world recovered, the United States began to experience declining productivity and falling real

wages. The response to global competition by profit-maximizing self-interest motivated corporations was to begin to compete for profits by decreasing labor costs. This, of course, translates as decreasing labor participation and decreasing incomes. Relaxing trade restrictions with respect to the flow of capital and intermediate and finished goods has facilitated this effect. To decrease costs, the U.S. corporation can import foreign made parts made by relatively cheaper production processes off-shore. With American incomes falling, decreased trade restrictions allow these same corporations to market the products elsewhere where incomes may be increasing relative to those in the United States. Now, there is obvious conflict between what is good for the corporation and what is good for labor.

This conflict may give rise to yet another conflict - between the employed worker and the unemployed worker. As Pope John Paul II points out, in modern economies, the ownership of know-how, technology and skill may be at least as important as the ownership of land or property (John Paul II 1991, p. 13). The move to downsize and move unskilled jobs offshore has left us with larger and larger numbers of technologically unemployed workers. While one may hold that the market system organized so as to maximize individual self-interest is "efficient" in utilizing resources, one must remember that competitive equilibrium requires "that for each individual there is at least one commodity he owns initially which is bound to have a positive value" (Arrow 1983b, p. 220).

However, a common social value that individuals are responsible for their own misfortune and, therefore, responsible for their own adjustment to such structural changes in the economy may lead to a public rejection of social actions aimed at providing necessary training and retraining enabling these workers to again provide for themselves and their families. The group conflict that may arise between the employed and the unemployed would not be resolved by group action at the workplace level. This conflict of group interests would be exacerbated by the declining real wages of those left working.

*Solidarity and Market Efficiency.* Can we argue that a new sense of community and cooperation is necessary in order for participants in production in the United States, labor and management, to produce "efficiently?" Can we begin to plead for social institutions promoting the interest of the group by arguing that it is actually in the self-interest of all participants to change the rules? Etzioni argues that there may be some distinction between the desire to "live up to one's moral obligation" as an item in the individual's utility function and those items yielding direct pleasure (Etzioni 1990, p. 223). We have also seen that assigning benefits from the common good to an individual may be impossible. Pragmatically, however, our best chance of achieving a change in values allowing for group interests may be to convince a majority of participants that their interests will be enhanced as well (see Wilber 1991).

U.S. corporations have made the decision to compete internationally on "the basis of low wages and lower living standards" (Faux 1992, p. 20). The "free trade" case for this behavior assumes that the advantages of such activity will automatically accrue to labor. All labor needs to do is take the responsibility of retraining so that their skills may be useful in the newly structured labor markets. The assumption of perfectly mobile resources is implicitly made.

The United States is currently in a position where it is in the best interest of the corporation to decrease labor participation and to lower labor costs. We have stated that this is essential in order to achieve economic efficiency.

One important consideration for us at EPI is that there isn't necessarily a tradeoff between economic efficiency and fairness. There's this notion that somehow you've got to make a hard choice: either the society can grow fast or it can be fair, but you can't have economic justice and economic growth at the same time. We think that if you look around in the world you find that that's just not true. This country, which has the low rates of growth ..., also, by almost any measure, is a most unfair society (Faux 1992, p. 20).

Yet our international competitors do not take the same attitude toward labor or the well being of the group. The prevailing view in the United States is that we cannot give "stake holders" other than management some input into decisions affecting the workplace. The principle of solidarity suggests group decision-making. Catholic Social Teaching calls for a renewed emphasis on charity and caring (O'Boyle 1990, pp. 128-9) A new emphasis on the group may be warranted. Indeed, the most successful of our global competitors appear to be more able to use groups or teams for decision-making and are, therefore, achieving significant success. The practice of including worker representatives in the decision-making of the plant is required in Germany.

I think there's a common notion that ... we must sacrifice. First of all, there's the question of who is "we". Policymakers and people with university tenure are fond of using this pronoun "we" in terms of sacrificing for the future. Of course it turns out that it's not "we." The sacrifices that are usually proposed are aimed at those people with least economic power. But I think the basic premise is wrong. In a modern economy you need the cooperation, the teamwork if you will, of all of the factors of production. I think that's the lesson in Japan. That's the lesson from the best practice in Europe (Faux 1992, p. 20).

The increased global competition and resulting falling incomes have also lead to a reduction in public expenditures on such important social investments as education, physical infrastructure and civilian technology (Faux, 1992, p. 18). If one accepts the premise that social investment promotes

economic growth, it is difficult to argue that the outcome of the market system under current conditions is economically efficient.

## CONCLUSION

The underlying issue for economics is whether there is "some essential harmony between private and public good" (Bloom 1991, p. 258). If there is no mutually beneficial outcome from individual actions, then the issue is how to choose between the two. Most of us would affirm that the rights of the individual are important. The Smithian dilemma, which is so clearly reflected in *Centesimus Annus* and in social economics generally, is how self-interest can be controlled so that we obtain the benefits and yet maintain a spirit of community necessary to guarantee to all members of that community the rights of economic participation and economic subsistence. The notion of economic efficiency as used in neoclassical economic theory simply assumes away the problem. It is assumed that what is good for the individual is good for the group. This emphasis on individual interest and lack of concern for the community may well now be detrimental to all or some members of our society.

In his criticism of Rawls theory of justice, Bloom points out that man's selfish and unsocial nature may dictate what civil society he chooses. "He (Rawls) is an individualist, but he does not wish to accept the harsh practical and theoretical consequences of that individualism." (Bloom 1991, p. 258) Bloom suggests that consensus about the lofty ideals of what is good for society may never be reached since each person defines what is good in light of his own self-interest. If a spirit of community is not a part of the cultural values of the society, whether from religious or secular teaching, the impact on the system when many are not allowed to participate may well destroy the allegiance to the system. Such consideration was expressed by Max Weber.

Where the fulfillment of the calling cannot be directly related to the highest spiritual and cultural values, or when, on the other hand, it need not be felt simply as economic compulsion, the individual generally abandons the attempt to justify it at all. In the field of its highest development, in the United States, the pursuit of wealth, stripped of its religious and ethical meaning, tends to become associated with purely mundane passions ... For at the last stage of this cultural development, it might well be truly said: 'Specialists without spirit, sensualists without heart' (in Williams 1993, p. 930).

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## ON REPAIRING THE DYSFUNCTION OF CAPITALIST ECONOMIES

Neoclassical economics focuses so much on decision-making individuals acting for what pays off in competition with each other that it ignores the fact that markets are only a *subsystem* of the economy. Neglected are the social and moral components that constrain and moderate competition; competition is conflict after all. Three kinds of interactions are needed to prevent market breakdowns: moral prohibitions, social bonds and government rules. The more we fail to recognize their roles and use the neoclassical as a guide for theory and policy the more the market economy is undermined. Markets depend on normative means and internalized values without which the transaction costs of maintaining the markets would simply be prohibitive; without them the system is pushed in an amoral, anarchic direction. The social bonds that integrate the economy are neglected in neoclassicism because the key element, cooperation, is missing. Cooperation, such as in voluntary associations, is a major protection against totalitarianism.

William R. Waters, "Review Essay: The Moral Dimension in Economics," *Review of Social Economy*, Spring 1990, pp. 64-5 (emphasis in the original).

The dialectical connection between the natural talent for entrepreneurial creativity and the man-made banking structure has a significant policy implication: a nation will prosper depending on the soundness and favorable ambience of its financial sector because there is not much that can be done to develop innovational talent.

William R. Waters, "A Review of the Troops: Social Economics in the Twentieth Century," *Review of Social Economy*, Fall 1993, p. 271.

## DOUBTS ABOUT COMPETITION

Mark A. Lutz

The work I have set before me is this: how to get rid of the evils of competition while retaining its advantages (Marshall, 1881).<sup>1</sup>

Bill Waters is well known as an eloquent advocate of a type of economic thought that cautions us not to embrace free competition as the sole regulatory principle in economic matters (Waters 1988). In taking this stance, he is, of course, marching in tune with Solidarism and figures such as Charles de Caux who regarded competition as "deleterious" and in need of being restrained in order to give a far greater weight to cooperation (Nitsch 1990, pp. 16, 72).

Some venting of doubt about the unalloyed goodness of competition, as expressed in the epigraph, has been rare among orthodox economists, especially among the contemporary generation, but at the same time, a suspicion of competition has for a long time been a key element of normative social economics.

In what follows, I shall start out by giving a short and rather rough historical sketch of the economists' examination of the process of competition. In so doing, we first shall try to point to the historical evolution of the viewpoints of prominent economists in the mainstream of the discipline, and then turn to the social economists of the human welfare school. The second part of the paper discusses the new dimensions brought about by various developments in our economy that are likely to strongly increase the kind of misgivings social economists have been having about competition as a tool of social control.

### HISTORICAL DOUBTS

*Qualified Doubts in the Mainstream.* Competition in society and economics is a phenomenon of a comparatively modern period, but ever since Adam Smith it has been a most central element in conventional economic thought. John Stuart Mill observed that English political economists had been accustomed to lay virtually exclusive stress upon the forces of competition. Whatever competition was said to do in theory it was also believed to accomplish in actual reality. Mill grants that this professional bias makes some sense once we realize "that only through the principle of competition has political economy any pretension to the character of a science" (Mill 1891, p. 306). Only to the extent that prices, rents, profits and wages are indeed determined by competition will

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<sup>1</sup> Farewell Address, Bristol, September 29, 1881 (quoted in Pigou, 1966, p. 16).

they conform to law, thereby permitting us to treat them as regulated by principles that are broadly general and scientifically precise. It was, of course, primarily David Ricardo who had been a real pioneer in leading early economics into this abstract way of thinking fully contingent on the unquestioned assumption of powerful competition.

But not all big names in the history of our discipline would have subscribed to the alleged scientific "fact" establishing competition as the sole force regulating production and distribution. To the degree that they were concerned with the real world, they had doubts about the full *scope* of competition; and correspondingly, the conclusions of the science were bound to be hypothetical. Similarly, in terms of a normative perspective, few 19th century economists were ready to endorse the force of competition in an unqualified manner. It's the latter issue that we will focus on, but we begin with some observations about scope.

There was a definite concern with custom traditional forces acting as "disturbances." Both J.S Mill and Alfred Marshall devote some space in their respective texts to this topic (Mill 1891, Book 2, chapter 4; Marshall 1907, pp. 465-6, 533, 604-5). Similarly, Edgeworth (1894 vol I, pp. 376-80) offers a brief discussion of competition and custom in a special entry of the Palgrave Dictionary

John Stuart Mill talks about custom as "a habitual regulator, modified from time to time by notions existing in the minds of purchasers and sellers, of some kind of equity and justice" (Mill 1891, p. 312). As a result there will be often multiple retail prices in markets, especially in different areas of Europe with no arbitrage making for equalization. He explains:

An enterprising competitor, with sufficient capital might force down the charges, and make his fortune in the process; but there are no enterprising competitors, those who have capital prefer to leave it where it is, or to make less profit in a more quiet way. (Mill 1891, p. 312).

At the same time, and in an implicitly more normative manner, Mill observes that custom has traditionally been "the most powerful protector of the weak against the strong." Even when the law of the strongest did decide, it was not "the interest nor in general the practice of the strongest to strain that law to the utmost, and every relaxation of it has a tendency to become a custom, and every custom to become a right" (Mill 1891, I, p. 307). It was generally felt that the forces of custom pertain more than anywhere else to the economics of land tenure and rent.

Alfred Marshall makes a very similar point. After acknowledging the importance of custom, particularly its cumulative impact on the economy, he declares it a "protective force" manifest in labor markets and tenant-landlord relationships. With respect to the tenant: "the moral sense of all

around him, high and low, protected against any attempt on the part of the landlord to make a sudden and violent change in the payments and dues, the tolls and fines which were recognized as usual" (Marshall 1907, p. 533). He claims that "everybody of custom that endures contains provisions that protect the weak from the most reckless forms of injury" (Marshall 1907, p. 604).

Edgeworth, too, points to custom as one of three rivals of competition, the other two being combinations and socialism. Competition in actual life is only a tendency in the absence of counteractive forces and he refers to Cliffe Leslie who "showed how much more important custom is than once thought" (Edgeworth 1894, p. 378). Still, he saw custom as a disappearing factor in the modern economy, and probably quite rightly so. Custom is hardly the rival it used to be.

Turning to the normative issue, it appears that the great economists of the past also had some misgivings of the adverse effects of competition. Adam Smith, for instance, qualifies his stress of market driven specialization of labor with a passage deploring division of labor making working life dull and thereby creating workers, "as stupid and ignorant as it is possible for a human creature to become" (Smith 1937, V, chapter 1, part 3: p. 2).

Similarly, John Stuart Mill, let his readers know that he was "not charmed with the ideal of life held out by those who think that the normal state of human beings is that of struggling to get on, [thereby] trampling, crushing, elbowing, and treading on each other's heels . . ." Neither was he impressed with the life where a "whole of one sex is devoted to dollar hunting, and of the other to breeding dollar hunters" (Mill 1891, II, p. 261).

Alfred Marshall, too, deplored that the abuse of competition "in many places degraded the race" and talks of a time "when free competition . . . was set loose to run like a huge untrained monster, its wayward course" (Marshall 1907, p. 9).

Even the American father of marginal productivity theory, John Bates Clark, in his first book (J.B. Clark 1885), realized that competition at its best is subject to serious criticism. Heavily influenced by the German School of economics, he saw no future for individual competition since it is "incapable of working justice." Instead, we need to regulate socio-economic interaction by moral force. At that time, even for an economist of the caliber of J. B. Clark, competition without moral restraint resembled a "monster" (J.B. Clark 1886, pp. 148-51).

Similarly, Henry Carter Adams, one of the first presidents of the American Economic Association, had, in 1887, much to say about the demoralizing and corrupting force of unrestrained competition. Witness the following: "The free play of individual interests tends to force the moral sentiment pervading any trade down to the level of that which characterizes the worst man who can maintain

himself in it, it is the character of the worst men and not of the best men that gives color to business society" (Adams, 1969, p. 89).<sup>1</sup>

Edgeworth, too, recognized that the preferability of competition can be debated on both utilitarian and transcendental grounds. To him, success in competition may not only be due to cleverness in attracting business, but also to "a lower standard of comfort." And he adds: That a degraded standard may result from unrestricted competition is evidenced by Booth's *Life and Labour in East London* (1892, London: Macmillan). In unregulated competition, "men injure themselves by over-exertion, infantile mortality, and other evils ascribed to the unrestricted employment of mothers" (Edgeworth 1894, p. 379). He also mentions other costs of competition, the wastefulness of advertising and the public good aspect of many arrangements which are in the "interest of all combined to adopt, but of each acting in competition to violate." As examples of the latter he offers Sunday rest and the early closing of shops" (Edgeworth 1894, p. 379). Edgeworth concludes his discussion, by endorsing the position of Professor Sidgwick: "It does not appear to me that the answer . . . in concrete cases can be decided by any broad formula, but rather that any case must be dealt with on its own merits, after carefully weighing the advantages and drawbacks of intervention" (Edgeworth 1894, p. 380).

All in all, the leading British economists of the 19th century did seem to pay some tribute to the limitations of the principle of competition. This is something we are not likely to encounter in the contemporary texts. In Samuelson's 9th edition, there is no longer any mention of elements of custom "protecting the weak." Whatever is said about costs of competition gets treated under the special rubric of externalities where he grants that "sound economics would suggest some limitation on individual freedom in the interest of all" (Samuelson 1973, p. 475). In his 12th edition, co-authored with William Nordhaus, we can find in its index the entry "competition: ambivalence about" only to be directed to the following paragraph:

Business heads and workers at the same time like and dislike competition. We all like it when it enables us to expand our market. But we label it as "chiseling," "unfair," or ruinous when our competitors cut our profits. Workers whose livelihood depends on how the market place prices their labor may be the first to howl when foreign competition threatens to depress domestic wages. (Samuelson & Nordhaus 1985, p. 48)

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<sup>1</sup> In another passage worth quoting, he deplores the competitive pressures to keep prices to the lowest possible level and observes: "If this cheapness, the essential requisite of business success, be the result of harsh and inhuman measures, or if they lead to misrepresentation and dishonesty on the part of the salesmen or manufacturers, the inevitable result must be that harshness and inhumanity will become the essential conditions of success, and business men will be obliged to live a dual existence" (Adams 1969, p. 91).

Obviously not much of a philosophical ambivalence here. In fact, it seems that when we turn to the contemporary mainstream textbooks, their authors do not seem to exhibit much doubt at all: competition can do virtually no wrong. It's a socio-economic regulator with essentially no opportunity cost. As a result, we may have today a much wider gulf between Solidarism and individualistic liberal economics than would have been the case a century ago. But Solidarism finds itself by no means in "splendid isolation"; the history of social economics in its secular humanistic version is marked by persistent doubts. Let us now briefly "review the troops" of this school of thought, first in its history and then with some more contemporary social economic insights.

*Doubts in the Humanistic Tradition.* Humanistic economics starts with J.C.L. Simonde de Sismondi, some 180 years ago. He was the first economist to reveal the strongest of doubts concerning the invisible hand and the doctrine of *laissez-faire*. Political economy based on individual self-interest and the principle of competition leads, in his view, to social misery. With this conviction he wrote and published the first edition of his *New Principles of Political Economy* in 1819. It was meant to contradict "one of the axioms on which political economy has above all insisted: that only the freest competition determines the most advantageous course of industry" (Sismondi 1826, p. 305). Among the legislative measures he demands are limits on competition, "such that it assures to each worker a certain property right in his work" (Sismondi 1826, p. 324). This is not the place to consider its arguments attacking the 'old principles' but we honor him by quoting its concluding paragraph:

Only one nation [England] finds itself today in such straitened circumstances; only one nation sees at all times its apparent wealth contrasted with the frightful misery of a tenth of its population, reduced to live on public charity. But that nation, so deserving of imitation in some respects, so dazzling even in its faults, has seduced by its example all the statesmen of the Continent. And, if these thoughts can be of no use to it, at least I will consider to have served humanity and my countrymen by pointing to the dangers of the course it follows, and establishing by its very experience that basing all political economy on the principle of unfettered competition means to sanction every person's actions against society, and to sacrifice the interests of humanity to the simultaneous action of everyone's individual greed. (Sismondi 1826, p. 586)

Sismondi died in 1842 but his aversion to competition survived in Thomas Carlyle who helped bring his message to the attention of the British. For Carlyle competition is a mechanism dissolving social bonds, a "social gangrene," a "virulent disease destroying the life essence of society" (quoted in Sherburne 1972, p. 81). Similarly with his student John Ruskin, the great moral critic of Victorian England, to whom competition meant nothing other than the "law of death" and the decomposition of society.



Ruskin had many followers in various disciplines, but it was John Hobson who carried his torch in the field of economic thought. In 1914 he deplored the "dehumanising and derationalising influence" due to the stress "which the operations of modern industry lay on competition between trade and trade, business and business, worker and worker"; and observes: "No graver injury has been inflicted on the mind of man, in the name of science, than the prepotence which the early science of Political Economy assigned to the competitive and combative aspects of industrial life." Hobson sounds like a Solidarist when he further asserts that "by laying the stress upon the competitive aspect of industry, this teaching stifled the growth of intellectual and moral sympathy between the various human centres of the industrial system, and impaired the sense of solidarity which, apart from its spiritual value, is the mainspring of efficient economic organisation" (Hobson 1914, p. 251).

The next great economist of the human welfare school was the American John Maurice Clark, who seems to have been infected by his father's earlier doubts about competition. He strongly criticized orthodox, or "Euclidean," economists in their embrace of abstract and static competition to the neglect of actual and dynamic competition. He stressed the cumulative effects causing the business cycle, the dysfunctional competition in industries burdened with large overhead costs, and the coercion exerted by a single competitor whose standard is more unscrupulous (J.M. Clark 1936, p. 65). In a nutshell, Clark's contribution was to make a distinction between the relative innocence of competition as depicted in the economist's textbook, and the real perils of actual competition which is essentially dynamic in nature.

No survey of social economists' ambivalent relationship to the principle of competition would be complete without mentioning the great book *Social Limits to Growth* published in 1976 by the late Fred Hirsch. The villain which sets limits to growth is competition for positional goods like leadership jobs, vacation houses on quiet lakes, homes in suburbia not too far from the city, and the like. These goods, although absolutely scarce, are more and more wanted. Competition for them is zero-sum, even of a negative-sum variety: "In the positional sector, individuals chase each other's tails. The race gets longer for the same price" (Hirsch 1976, p. 67). He paints an impressive and comprehensive picture how increasingly important "positional competition" manifested in more time necessary to get an appropriate education and ever increasing commutes to work lead to a mounting scarcity of time. This in turn leads to an erosion of sociability -- an "economics of bad neighbors" -- and with it an erosion of the moral fabric. Competitors not only play by the rules but increasingly try to gain advantage by manipulating or bending the rules. In such an economy the "good guys finish last" syndrome becomes more and more real. What is needed, according to Hirsch, is a "moral reentry" where participants in the economy see it as their obligation to cooperate, to respect unwritten laws grounded in traditional social ties, religious belief or a civic duty to uphold justice. Market competition needs a moral foundation, yet "as the foundation weakens, the structure

risers ever higher," threatening in a self-destructive name the functioning of a liberal economic system (Hirsch 1976, pp. 12, 124).

The general theme of competition leading to social degeneration has been a central one throughout the history of social economics. In fact, this concern may be one of its primary constituent characteristics and acts as the justification or underpinning to the call for an ethical economics; a social economy based on the unit of the moral person and the kind of socio-political institutions and business organizations that this would imply. Meanwhile, doubts about competition are bound to continue; in fact, there have been new forces and insights at work that most probably will lead to even greater doubts about the goodness of competition.

### GROWING DOUBTS IN TODAY'S ECONOMY

In this part of the paper an attempt is made to first address some recent insights about the need to make some distinctions when we assess the general merits of competition as a regulator of society. We will then illustrate the problem by taking a look at the new competitive global marketplace that is taking shape under the auspices of GATT. As the repercussions of this new development will progressively manifest, it may very well become the kind of "wake-up call" needed to compel economists to reconsider their long-held faith.

*Corporate Competition.* The problem arises with the modern phenomenon of "corporate competition," as contrasted with the more traditional business competition. To begin with, large investor-owned corporations dominate today's economy; in fact, they account for almost 90 percent of all sales in our economy. Furthermore, they have been increasingly oriented towards the bottom line.

In this context, it is worth pointing out that earlier in our history, corporations had been chartered by state legislators on the condition that they operate in the common interest, meaning to benefit the community as a whole. Their charters had to be periodically renewed, a process contingent on socially responsible behavior. This was not to last.

Due to novel imputations of the Court, or "judge made law," corporations ended up evolving to something quite different in the last one hundred years. In separate decisions, the Supreme Court ruled that the "common good" meant nothing other than maximum production or profits and that the corporation was a legal person sheltered by the Bill of Rights and the 14th Amendment (Sklar 1988). Moreover, the increasingly multinational character of the big corporation means that they are no longer citizens of any particular country and therefore can be expected to be loyal only to their economic interests. Empowered by all these developments, corporations lack social responsibility, or in more popular jargon, they have "no soul." Responsibility implies moral agency; yet in our

public corporations it is the individual shareholder who owns the firm. This phenomenon implies an absentee ownership controlled by the impersonal force of stockholders, especially managers of pension funds and mutual funds, seeking a financial return for their investment. It matters little whether they have their eyes on short-run profits or long-run profits. In either case, the corporation is ultimately controlled and driven to maximize profits to the exclusion of moral and social consideration.

Granted, to the extent that there still remains a so-called divorce of ownership and control, the executive officers of a corporation can, as moral persons, exert agency and trade off profits against what they perceive to be the common good. This has been to some extent the situation prevailing up to more recent times; but the growing importance of institutional investors, the new phenomena of threatening hostile take-overs, together with increasing international pressure to engage in cost competition has brought us to a point where the corporate leadership has little choice but to follow the dictates of investors' financial interests and maximum profits. Ironically, modern corporations are now structured in a way that are bound to operate like moral morons, even if all their officers and many of their stockholders were fully concerned persons generally inclined to exercise their moral agency. Here there is a very significant difference in kind to the traditional competitors: proprietors, partnerships, cooperatives, and privately held corporations. All these traditional forms of business enterprise are able to forego profits for other considerations if they deem it desirable. In stark contrast, the publicly owned firms cannot; like insensitive monsters they suffer from a built-in tendency to go trampling all over the country, even the world, tearing up the remaining threads of the human, social and environmental fabric in the process.

John Culbertson, in a little book titled *Competition: Constructive and Destructive* (Culbertson 1985), reminds us that competition must be seen as a relation among people, not a particular action. What matters is not the degree of competition but the type of activity in which people compete. In other words, we must see competition not as a beneficent guiding force but a blind whip. What is needed is a steering wheel that is sensitive to the interests and goals of society. Such guidance is secured through regulatory rules. In obeying these rules, competition is constructive, otherwise it turns destructive.

A corporation's own interest cannot be expected to be automatically constructive. Even if it was aware of the social good, it could not pursue it. It follows that in a world of "free" or unregulated competition we must brace ourselves to the unleashing of competitive forces that are predominantly destructive in nature -- the stronger the competition, the greater the destruction. Culbertson paints a world of price wars, financial speculation raising havoc in the banking industry, exploitation of vulnerable people and the undercutting of standards including standards protecting health and safety as well as the environment. In short, an economy dominated by large corporations must be subjected

first and foremost to social regulation, only then can we entrust ourselves to the benefits of corporate competition. Yet, as we shall now see, in heeding the advice of expert economists, and yielding to the demands of the corporate elite, we have been jumping head over heels into the rough waters of destructive competition.

*International Competition.* For a contemporary illustration of menacing corporate competition we now turn to the sphere of "free" international trade, particularly the recent developments brought about by the conclusion of the Uruguay Round trade talks under GATT.

Within the United States we have long witnessed the competition among states to attract business firms and jobs (e.g., Schellhardt 1983). In the process, companies are offered subsidies, tax privileges and other give-aways. From the point of view of the nation, such competition is at best zero-sum. Similarly, this variety of competition conducted on the international level, is highly problematic. According to Culbertson, it "misdirects governmental units from their constructive function making laws and rules that elevate the nations' quality of life to eliminating or downgrading rules in order to outbid nations to win firms and jobs for their people" (Culbertson 1989, p. 97). He sees it as "perverse competition" fueled by the incompatibilities of rules, regulations, and the customary standards of countries (Culbertson 1989, p. 98). More recently, Culbertson describes the dominant pattern of world trade as:

Shift production to the countries with low wages, low labor standards, low environmental protection standards -- and then sell the output in the countries that have high standards, high costs, and a high-income-based market that can absorb large quantities of advanced and expensive goods. (Culbertson 1994, p. 2)

In other words, the kind of international competition engaged in by the transnational corporations must be an inherently downward-leveling, degenerative variety of trade which is debasing people and threatening to destroy the environment. "Free" international trade falls considerably short of being competition within a framework of one set of rules. The simple fact that different nations, as it were, impose on their firms different rule books, will make it degenerative. Therefore, "unregulated foreign trade is unreasonable in a world in which intra-nation economic activities are constructively regulated and guided -- because 'free trade' will confer on foreign produced goods an exemption from the rules, guideposts, and constraints to which home produced goods are subject" (Culbertson 1994, p. 8). Since international competition is not playing by the (same) rules, it is "unregulated" -- better "unruly" -- and must be seen as pregnant with destructive forces for humanity, society and nature.

With Culbertson's analysis of destructive competition and its application to international social economics, doubt and reservations about competition may have reached a historical high.

Interestingly enough, the basic logic of international trade generating socially dysfunctional outcomes is even admitted by some of its most stout defenders. Witness the former editor of the *New Republic* when he writes, "if you believe in capitalism at all, you have to believe . . . that the result from the turmoil of competition is more than outweighed by the efficiency of competition in keeping all the competitors on their toes" (Kinsley 1987). In other words, loyalty to corporate capitalism (i.e., ideology) is a way to shield the believers from serious doubts about unregulated international competition.

Commitment to corporate capitalism may be one reason for concern, but there is another: unquestioned loyalty to the doctrine of comparative advantage -- a position quite equivalent to ideology -- also acts as a sedative by forcefully dispelling possible doubts. In a recent paper on correctly teaching trade to economic undergraduates, Paul Krugman remarks: "One of the most popular, enduring misconceptions of practical men is that countries are in competition with each other in the same way that companies in the same business are in competition. Ricardo already knew better in 1817" (Krugman 1993, p. 24). He admonishes us to teach "that international trade is not about competition, [but] about mutually beneficial exchange" (Krugman 1993, p. 24). The pep talk concludes with the following exhortations:

We need to teach [students] that trade deficits are self-correcting and that the benefits of trade do not depend on a country having an absolute advantage over its rivals. If we can teach undergrads to wince when they hear someone talk about 'competitiveness', we will have done our nation a great service. Amen. (Krugman 1993, p. 26)

Quite obviously little doubt concerning competition is evident here. The key to confidence is the time-honored notion of comparative advantage, a doctrine that simply rules out any factors creating *absolute* advantage--whether due to climate, relative factor endowments or government standards. Similarly, to worry about destructive competition based on different rules, or an 'uneven playing field', can only raise doubts about the doubter's credentials as an economist. Yet, for an increasing number of social economists, doubt about international competition continues to grow. It seems to be building on the realization that the modern commercial world is inhabited by amoral transnational corporations which account for roughly half of global trade. With this realization, the old assumption propping up comparative advantage doctrine -- *no* capital mobility between nations -- also gets knocked down. We are thereby led to the penetrating insight that there is no more difference in kind between the principles of domestic and international trade; both operate according to the principle of *absolute* advantage.<sup>1</sup>

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<sup>1</sup> Elsewhere I have elaborated a little more on the radical implications of this fact (Lutz 1993, pp. 465-469).

For all these reasons, it should come as no surprise that many of us do worry about the environmental destructiveness of trade and the loss of sovereignty implied by the latest GATT agreement. It gives consideration to the goal of maximum trade clear priority over ecological values, even international agreements, such as the Montreal Protocol (addressing the stratospheric ozone problem) or the CITES Convention (trying to preserve endangered species). GATT, or the proposed World Trade Organization in Geneva, seems predisposed to regard national provisions banning certain exports (such as logs from trees from tropical rainforests) or banning certain imports (such as live birds, "dolphin unsafe" tuna, or trade sanctions against the sale of products by nations that are not signatories to multilateral agreements such as nontariff trade barriers) as fair game to be challenged and removed.<sup>1</sup>

Even top GATT defender Jagdish Bhagwati, when discussing the environment, has to admit that environmentalists have "cause for concern," but he adds: "Not all concerns are legitimate, and not all solutions to legitimate concerns are sensible" (Bhagwati 1993, p. 44). To him, legitimate concerns relate primarily to transnational ecological problems. Illegitimate concerns, on the other hand, tend to prevail in conflicts between the environment and trade that are "intrinsically domestic." Here he strongly criticizes the idea, expressed by Al Gore and others, that lax environmental standards might create a "pollution haven" that would generate an unfair competitive advantage to be corrected by some countervailing tariff. In response, Herman Daly makes the observation that such tariffs would be fully warranted on grounds of economic efficiency requiring that "each country should set the rules of cost internalization in its own market." He further explains that in doing so, "no standards are being imposed through 'environmental imperialism'; [but that] paying the costs of a nation's environmental standards is merely the price of admission to its market" (Daly 1993, p. 52). Here we seem to have a reassuring example that good economics and sound common sense can indeed go hand-in-hand.

Environmental standards protecting our habitat are important, but there are other values and other standards that get equally eroded through unruly international competition. Many of us worry about the absolute advantages created by low standards of living and low wages in low income countries. It is such social standards pertaining to work and the workplace that have always been close to the heart of social economists. Yet when it comes to labor standards, GATT only prohibits the employment of prison labor. Nothing is said about slave labor, bonded labor, sweat-shop labor or the employment of children.

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<sup>1</sup> For a more or less complete list of GATT's impact on the environment, the reader may want to consult Lang and Hines, chapter 6. In this context, it ought to be emphasized that NAFTA is a much "greener" agreement than GATT; see the recent paper by EPA's chief NAFTA negotiator Daniel Esty (1994). For a discussion of NAFTA's environmental implication, see Kaufman et al. (1993).



The problem is quite simple; when faced with low wage competition from abroad, what can we expect a socially responsible employer to do? There are only three potential answers: (a) go out of business, (b) move the plant abroad, or (c) attempt to drastically reduce labor costs either by increasing the productivity of workers or by cutting labor compensation.

Let us take a brief look at the third alternative. It is often embraced as a promising and hopeful strategy to alleviate doubts about international wage competition. Along these lines there are social economists who seem to believe that lower wages abroad merely reflect labor productivity differentials and therefore would not signal lower labor costs. In other words, today's structure of labor cost is believed to be more or less in equilibrium (Finn 1994, p. 23).<sup>1</sup> Theoretically, such a faith rests on highly questionable grounds as pointed out by Culbertson (1994, pp. 14-9). The fallacy is rooted in a misunderstanding of what economists mean by "labor productivity." It assumes the average and marginal productivity of labor to be unrelated to net imports. But this is simply not the case. Consider American shoe workers: the more we import from China, the more the price of shoes will drop and with it the marginal (and average) value productivity of our shoe workers. In other words, one of the ways to raise productivity is by bringing Chinese or Malaysian imports more into balance with exports. For the same reasons, additional job training and education will prove difficult in an economy embedded in a world where labor productivity is heavily dependent on foreign trade policies, the rate of population growth and international migration. The argument for training also seems to overlook the possibility that low income economies can adopt similar measures and perhaps with a greater effect. Let us be aware that educational standards and achievements are easily underestimated when it comes to China and perhaps even India. When these two giants enter the ring of international competition, when they start attracting cutting edge technology from the developed nations, the outlook of successfully defending our industries by means of training seems less than reassuring.

Moreover, there are empirical studies that show that a middle income country such as Mexico is able to operate its new automobile and computer plants with a labor productivity that parallels contemporary U.S. or Canadian experience (Shaiken, 1990 & 1994). At the same time, wages are a mere fraction of what they are in the United States -- no wonder there have been stories about a surge of new auto plants set up in Mexico (Templin 1994). Also, and more generally, it is misleading to cite average national labor productivity figures in a low income country as the relevant factor determining labor costs. What is needed is the prospective labor productivity for a specific firm contemplating a brand new plant in such a country. If the latter figure is relatively high, a U.S. or

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<sup>1</sup> Depressingly enough, the assumption of unit labor costs being the same here and abroad also underlies many of the computer simulations, the so-called "computable general equilibrium models," when grinding out their optimistic predictions about job impact of new trade agreements such as NAFTA (Stanford, 1993).



Japanese firm will be attracted regardless of the prevailing productivity levels elsewhere in that economy.

Enough has been said to indicate that unregulated international competition appears quite destructive and potentially threatening to our social economy. "Good guys finish last" is a very real scenario in a world pregnant with standards-leveling competition, mobile capital and billions of low wage workers eager to get in on the action. We will soon be standing on our toes, wondering what to do next.

## CONCLUSION

It is no exaggeration to assert that the logic of individualistic economics together with a continuing faith in Adam Smith's benevolent "invisible hand" implies a very high level of confidence in competition and the doctrine of *laissez-faire*. Doubts about competition arise when we approach economics from a social point of view, and when we talk about real rather than textbook rivalry. Doubts also arise when we recognize the prevalence of externalities and other market failures. Internalization of externalities through embedding economic activity in a corrective web of rules and regulations has always been one of the primary concerns of thinkers preoccupied with social values. That's how social economics developed, and it is a continuing concern with issues of this nature that have been setting us apart from mainstream economic thinking. As a group we realize, as did once J. B. Clark, that competition even at its best is incapable of working justice. Something more than mere market institutions are needed. The alternatives range from private associations to government regulations.

As the American economy has been evolving in an increasingly global direction, we have now reached a new type of competition, where coercive force and sanctions will be used *not* to prevent but to enforce a *laissez-faire* economy that knows no boundaries. It's going to be a world where economic material interests will rule the globe, and where social and human values will be relegated to the sidelines and protest demonstrations. In my view, there cannot be any stronger challenge to social economics. And, if we as a school of thought want to survive, we have to become even more assertive in communicating our position on competition, denying to ourselves that intellectual sedative which we call comparative advantage doctrine and the wishful thinking that American workers have nothing to fear if they become a little more educated, trained and thereby also a little more productive.

We are at an historical hour and to the extent that we can meet the challenge, and constructively point in radically new directions, we will be reaffirming what social economists have tried to do over the last two centuries, and at the same time also follow Sismondi in the context of our own times: to serve humanity by pointing out the dangers of *laissez-faire* thinking and to demonstrate that abiding

by the principle of unregulated international competition "means to sanction every corporation's actions against society." Nature and humanity will be far better served if we reign in such competition and also pay tribute to Solidarism and the principle of cooperation long advocated in the work of social economists under the gentle guidance of Bill Waters. Is there any more sensible way to get rid of the evils of competition while retaining its obvious advantages?

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## ETHICAL CONFLICTS IN MANAGING THE S&L INSURANCE MESS

Edward J. Kane

With the benefit of hindsight, most observers agree that taxpayer losses in the S&L insurance mess exceed \$150 billion and resulted from a pattern of industry losses, expedient policy mistakes, and taxpayer ignorance and unconcern about the size and significance of losses and mistakes alike. Assessing blame for this mess reduces to a pair of tasks: to identify damaging mistakes and to assign responsibility for them.

The first task is a straightforward investigative chore: finding out what actually happened and determining the extent of the damages. Assigning blame is more complex. It entails analysis that turns on whether to benchmark right conduct by means of a relative or an absolute ethical standard.

Even though it accords situational managerial ethics informal standing, common law employs an absolute standard for assigning responsibility for the S&L insurance mess. This massive body of centuries-old case law presumes accountability for actions that harm others and treats conduct as morally wrong whenever it is violative of *duties* of loyalty and care legitimately owed to others. Because the duties a manager owes to different parties must regularly be traded off against each other, this standard is difficult to apply in practice. Thus, accountability for damages done to various stakeholders must be thrashed out case by case in the courts.

A relative standard is endorsed by Jackall who documents that operative principles of managerial and professional ethics often conflict with the ideals of academic and churchly moral codes. He defines managerial ethics disarmingly as rules that "managers construct to guide their behavior at work" (Jackall 1988, p. 4). The morality of these rules, he says, "does not emerge from some set of internally held convictions or principles, but rather from ongoing albeit changing relationships with some person, some coterie, some social network, some clique that matters to a person" (Jackall 1988, p. 101). In large organizations, "independent morally evaluative judgments get subordinated to the social intricacies of the bureaucratic workplace" (Jackall 1988, p. 105). An avowed goal of these intricacies is to "nurture the trust required to maintain a kind of corporate non-accountability for expedient actions" (Jackall 1988, p. 118).

Whenever they are accused of policy mistakes, government officials lean on their Jackallian ethical code to spin to a series of well-worn, but contradictory defenses:

The policy actions in question cannot be characterized fairly as importantly damaging anyone.

The alleged mistakes served a far-higher goal, for whose achievement officials should be celebrated, not chastised.

Nobody knows who made the mistakes nor perhaps even when or why they were made.

Nobody can prove who made the mistakes or why they made them.

One member of the team is ultimately responsible and deserves to be sanctioned.

Sovereign immunity means never having to say you are sorry.

Although all of the first five excuses were sounded by various officials at different times during the course of the S&L mess, this essay argues that the sixth defense -- that no one was meant to be accountable for the expedient policies that compounded taxpayer losses -- is the only persuasive one. The ethical analysis presented here relies upon the legal ethical standard.

### INCENTIVE CONFLICT IN GOVERNMENT SERVICE

In the S&L insurance mess, the fundamental step in assigning blame is to distinguish the causes of *S&L losses* from the causes of *taxpayer losses* (Kane 1989). The causes of losses at individual S&Ls can be personified as gangs of miscreants that informed witnesses need in each instance to identify from a lineup of the "usual suspects" that competent investigators would round up to lay blame for the failure of any regulated enterprise. These suspects are: bad economic luck, bad (meaning either poor or dishonest) managers, bad (meaning perversely unrealistic) theories of regulation, bad accounting for losses in deposit institutions, and bad faith by public officials.

On the theory offered here, the loss-intensifying role played by the last factor is critical to harm passing through to taxpayers. We allege that expedient behavior by public officials helped to provoke -- and served to compound -- the damage initiated by the usual suspects. We see the root problem that caused *extensive* taxpayer losses as a breakdown in ethics of delegation: an insufficient ability to *monitor* and *police* incentive conflicts between taxpayer "principals" and their government-employee "agents."

In a representative democracy, taxpayers delegate tasks to elected and appointed government officials. As in any other delegation, important *conflicts of interest* stand between taxpayers and their agent government officials. An ideal principal-agent relationship exists when an agent intends to offer its principal a selfless application of time, energy, expertise, and information. These ideals are stated in academic and churchly moral codes, but belittled in the accountability-resistant codes of Jackallian managerial ethics.

Economics tells us that costs from principal-agent conflict ("agency costs") are minimized when society's institutions weave a web of so-called "optimal contracts" that align the incentives of the agent with interests of the principal or whenever ethical constraints to which agents voluntarily and scrupulously subscribe inadvertently happen to minimize the costs of principal-agent conflict. Conflicts between government managers' opportunities for personal enrichment and advancement and the simpler joy of doing a task honestly and proficiently explain the two key features of the S&L mess: (1) why *so many* S&Ls and banks were allowed to become *so severely* wrecked and (2) why the bill for repairing the damage ended up on *taxpayers'* tab.

For managerial markets to work well, enough information must flow to permit accurate external evaluation of a manager's job performance. This essay speculates about whether violations of informational reporting and other duties owed to taxpayers by government officials might -- in the absence of sovereign immunity -- be provable in court. It asks readers to decide for themselves whether flows of disinformation about policy-making mistakes resulted predominantly from innocent errors or were the fruit of deliberate violations of express or implicit truth-telling obligations that responsible officials owed to taxpayers and that taxpayers ought to concern themselves with enforcing in the future.

In government service, only limited opportunities exist for outsiders and markets to challenge self-assessments of the quality of bureaucratic enterprise and worker performance. Inside whistle-blowing from individuals who may be distressed about what they perceive to be serious deviations from the social mission of their agencies is discouraged by the threats of career and reputational reprisal. For this reason, watchdog agencies such as the General Accounting Office, Civil Service Commission, and the General Services Administration are charged with monitoring and enforcing merit systems of performance measurement and contracting. In turn, these oversight agencies are themselves answerable to high elected officials, academia, and the press. Finally, elected officials are accountable to the electorate.

In a representative democracy, this web of rules, enforcement, and accountability sets minimum responsibilities for all parties. Once these minimal standards have been clearly defined, derelictions of duties can be measured quasi-objectively as departures from them.

This essay concerns itself with violations of standards for truth-telling and faithful service that common law suggests ought to have been applicable to the high officials that were charged closely with managing or overseeing the operations of the Federal Savings and Loan Insurance Corporation (FSLIC). It maintains that decades of covering up bad news worsened the true economic condition of FSLIC and the S&L industry. This long-lasting accounting cover-up greatly compounded the



damage suffered by taxpayers. It did this by allowing losses in S&L enterprises to accumulate beyond the value of private ownership stakes, so that red ink slowly and surreptitiously spilled onto the books of FSLIC and through FSLIC onto the tab of ordinary taxpayers.

The behavior of high officials during the S&L mess recalls Christ's Parable of the Unjust Steward. Historically, a steward was an official in the household of a king or other noble who was responsible for managing the servants, household income and expenditures, and inventories of household provisions. He transacted all legal and financial business for his lord, who (as a noble) shunned commercial activity.

There was a rich man that had a steward, and a report came to him that this steward had wasted his goods. Whereupon he sent for him, and said to him, What is this I hear of thee? Give an account of thy stewardship, for thou canst not be my steward any longer. At this, the steward said to himself, What am I to do, now that my master is taking my stewardship away from me? I have no strength to dig; I would be ashamed to beg for alms. [Aha!] I see what I must do, so as to be welcomed into men's houses when I am dismissed from my stewardship. Then he summoned his master's debtors one by one; and he said to the first, How much is it that thou owest my master? A hundred firkins of oil, he said; and he told him, Here is thy bill; quick, sit down and write it as fifty. Then he said to a second, And thou, how much dost thou owe? A hundred quarters of wheat, he said; and he told him, Here is thy bill, write it as eighty. *And this knavish steward was commended by his master for his prudence in what he had done*; for indeed, the children of this world are more prudent after their own fashion than the children of the light ... No servant can be in the employment of two masters at once; either he will hate the one and love the other, or he will devote himself to the one and despise the other. You must serve God [your principal] or money [Mammon: i.e., your own narrow welfare]; you cannot serve both (*Gospel According to Luke*, Chapter 16, Verses 1-8, 13).

The parable frankly acknowledges every agent's natural tendency to be more sensitive to its rights than to its duties. It treats the loss suffered by the landowner as just punishment for his lack of diligence in monitoring the behavior of a steward whose incentives he had severely distorted by giving notice of imminent dismissal. That the landowner recognized his negligence is shown by his admiration for the steward's ingenuity in transferring wealth from the landowner during the steward's eventful final day of service.

Just as the landowner, U.S. citizens have failed to demand from their managers the information they need to protect themselves from unjust stewardship. U.S. taxpayers have been willing to settle for a

flow of half-truths that lack the power to *shame* poor performers when bad faith is uncovered. Too many citizens apathetically accept *corruption* and *moral cowardice* in public officials as nuisances that must be accepted, rather than as evils for which society ought to design reliable procedures to discourage and punish.

## HYPOTHETICAL INDICTMENT PROCEEDINGS

Throughout this section, I ask readers to pretend that I am a prosecutor and that they are members of a grand jury. Our joint task is to use common and statutory law to conduct an inquiry into the ethics of a series of linked corporate, bureaucratic, political, and taxpayer behaviors in the S&L industry.

This inquiry is merely hypothetical because courts might conclude that elected and appointed officials charged with supervising and managing the affairs of FSLIC enjoy sovereign immunity for their actions. Such immunity is rooted in the ethically questionable proposition that a monarch or high official in a sovereign state should have absolute freedom in making and enforcing the laws of the land. To protect officials from being compelled to spend much of their lives in court, wielders of sovereign power are exempt from conventional burdens and civil liability for most of the actions they take.

But let us pretend that another tribunal has authorized us to weigh indictments for three separate *breaches* of the duties of trust and public stewardship that elected and appointed officials owe to taxpayers: fraud, influence peddling, and gambling imprudently with taxpayer money.

## FRAUD

Five cumulative common-law tests must be met to bring a fraud indictment (Bear and Maldonado-Bear, 1994):

a conscious *misrepresentation or concealment* of the truth,

an *intent to benefit* by causing another party to rely on the untruth to his or her detriment,

the misrepresentation was *material* (i.e., directly related to the harm caused),

an *intent* to cause the other party to *rely* on the misrepresentation to his or her detriment, and

evidence exists that the other party did *believe, rely, and suffer* provable harm.

I am going to ask readers to consider the applicability each of these five tests to members of Congressional Banking Committees, to presidents, and to members of the regulatory brain trust of the FSLIC who held office during 1975-1988. In voting, readers must remember that, to bring an indictment, the standard of guilt is "probable cause." This standard requires only that the possibility of guilt constitutes a reasonable inference based on "credible evidence." It does not require us to ascertain "guilt beyond a reasonable doubt." This tougher standard would take extensive investigative work and weeks of trial to establish.

*First Test.* Did misrepresentation occur in the ways in which top officials accounted for FSLIC's loss exposure in the decades prior to its demise in 1989? Were accounting smoke and mirrors used to cover up loss exposures officials *knew or should have known* FSLIC was accruing?

Tables I and II present figures to show that authorities knew or should have known of FSLIC's longstanding weakness. For top regulators, the force of these figures is confirmed in part by testimony from economist Lawrence White who knew as a member of the Federal Home Loan Bank Board (FHLBB) that by 1986 FSLIC was already grievously damaged (White 1991, p. 141).

Straightforward and conservative opportunity-cost accounting of information collected in the S&L regulatory reporting system could have readily revealed the magnitude of FSLIC's downward slide to higher elected officials. This is shown by straightforward calculations made from these data summarized in Kane (1985, 1989) and more sophisticated analysis presented in Kane and Yu (1995). It is also shown by working papers prepared in the early and middle 1980s by FHLBB staff economists such as James Barth and H. Dan Brumbaugh. Their research sketched alarming patterns of cumulative decline in FSLIC's net reserves and was meant to alert higher-ups to the severity of the problem facing them.

Using accounting flexibility to delay recognition of most of FSLIC's opportunity-cost losses and loss exposures allowed official measurements of the fund's net reserve position to cover up plainly relevant evidence of poor regulatory performance by the FHLBB and FSLIC.

Readers are invited to decide now whether they believe this de facto cover-up was inadvertent or self-interested and to record their judgment on the first line of the Synthetic Grand Jury Ballot at the end of this essay.

*Second Test.* Did government officials seek to benefit personally or politically from misrepresenting FSLIC's condition? Some officials have claimed they understated FSLIC's problems only to achieve a greater good. They argue that releasing accurate official measurements of FSLIC's condition would have panicked S&L depositors and provoked a deposit run that would have ruined the S&L industry and importantly disrupted the real economy.

This argument presupposes that few S&L depositors were aware that FSLIC was short of explicit economic reserves or understood that elected politicians faced strong political pressures to bail out FSLIC if and when a depositor run were to ensue. But, in the early 1980s, both of these propositions were strongly held by experts in banking and finance (Carron 1982; Kane 1985). In 1981, even the head of the FHLBB acknowledged in several public speeches that FSLIC was about \$100 billion underwater. Responding to Congressional concerns which were almost certainly influenced by pressure from S&L lobbyists, he continued to sign annual reports that proclaimed FSLIC to be solvent. Not long thereafter, he moved through the revolving door of public service into a high-paying job in the mortgage-finance industry. Would that job have been available had he insisted that Congress resolve FSLIC's insolvency?

Would incumbent members of Congressional Banking Committees have had a harder time running for re-election in 1982 if FSLIC's weakness had been plainly stated and addressed? In March 1982, prior to running for re-election, these incumbents voted to pass Joint Congressional Resolution 290 which sought to assure depositors that the full faith and credit of the U.S. Treasury stood behind FSLIC and FDIC guarantees. Assuring worried depositors without explicitly funding FSLIC's capital shortage supported lenient regulatory treatment for insolvent 'zombie' S&Ls. This lenient treatment earned the gratitude of zombie managers by preventing the funding costs market participants imposed on their living-dead firms from rising fatally. Is it likely that elected and appointed officials truly did not care that acts of leniency and procrastination enhanced their professional reputations, re-election potential, and/or post-government career opportunities?

Readers are invited to contemplate these issues and to mark their conclusions on the second line of the synthetic ballot.

*Third Test.* Did continued misrepresentations of FSLIC's condition ever prove material? Did putting misleading information into the FHLBB's annual reports keep FSLIC's losses from influencing campaign politics? Much as the lapse in watchfulness shown by the landowner in the parable, did taxpayer ignorance permit taxpayer harm to escalate?

Would taxpayers have forced a different pattern of regulation had the facts been clearer to them? Evidence that politicians thought so may be inferred from the absence of taxpayer losses from FSLIC as an issue in the 1984 and 1988 election campaigns. It is widely alleged that the bipartisan nature of contributions to the FSLIC mess led to backroom agreements between Democrat and Republican presidential candidates to remain silent about FSLIC's shaky condition and accumulating losses.

Readers are invited to ponder these questions and to enter their judgment on the third line of the ballot.

*Fourth Test.* Did officials intend for taxpayers and voters to rely on these misrepresentations? When officials offer a pursuit-of-greater-good defense against the charge that they acted for personal benefit, they concede their intention to keep the bulk of society blissfully unaware of FSLIC's weakness. It is hard to understand why Democrat challengers in 1984 and 1988 would have left FSLIC out of presidential campaign politics unless they feared that blowing the whistle on FSLIC mismanagement would adversely affect the Congressional wing of their party, the economy, and/or their own professional futures.

Just prior to FSLIC's death throes, official underestimates of FSLIC's reserve shortage in 1987 were used to downsize the amount of funds appropriated for resolving insolvent S&Ls. Debate over how much borrowing authority to create for FSLIC in the Competitive Equality Banking Act of 1987 turned on the extent of FSLIC's immediate need for funds. It was alleged that establishing authority for FSLIC to borrow \$10.8 billion would be enough to clean up industry insolvencies, even though calculations of the type summarized in Tables I and II could show that FSLIC needed an injection of ten times that amount.

It can also be documented that professional staff and academic economists were advising officials that leaving insolvent S&Ls in play distorted managerial incentives at these firms. This distortion disposed S&L managers toward looting (Akerlof and Romer 1993, pp. 1-60) and go-for-broke behavior (Barth 1991; Brumbaugh 1993) that imposed expected losses on FSLIC and taxpayers.

Again, readers are encouraged to think through this issue and to mark their conclusion on line four of the ballot.

*Fifth Test.* Did taxpayers believe the false assurances? If taxpayers hadn't believed, the press would not have had to apologize so hard in 1989 for having missed the unfolding story of FSLIC's losses (Skidmore 1992, pp.100-1). Nor would influential members of the Banking Committees have been condemned so roundly by challengers when they ran for re-nomination and re-election in 1990, 1992, and 1994.

Did taxpayers in fact suffer harm? As detailed in the footnote to Table II, Congress has so far set aside \$159 billion for use in resolving FSLIC's insolvency. The cost to taxpayers would have been far lower had regulatory authorities routinely carved out a risk-balancing warrant position for taxpayers in every insolvent S&L they allowed to operate in an insolvent condition. Doing this would have rebalanced incentives for risk-taking at zombie institutions. Equally importantly, it would have allowed taxpayers to reap capital gains in return for the dividend-free implicit equity

capital FSLIC provided to crippled thrifts that managed to regain their solvency. These gains would have been available to offset some of the \$159 billion in losses taxpayers were accruing in the S&Ls that proved unable to sustain a recovery.

Readers are urged to decide these questions and to record their decision on the fifth line of the synthetic ballot.

*Lesser Charge of Negligent Misrepresentation.* Although a grand jury is entitled to guess at motivations and missing facts, some readers may be uncomfortable with inferring the required elements of regulatory intent. Any reader who could vote aye on the third and fifth charges can consider indicting officials on the lesser charge of negligent misrepresentation. Common-law fraud entails intentionally unethical behavior. Bear and Maldonado-Bear (1994) clarify that one can also be held accountable at law for 'misrepresentation or concealment' that results from stupidity or negligence, without a deliberate intent to deceive, and thereby profit from, another. Although sometimes loosely characterized as a variety of fraud, the proper name for this behavior is *negligent misrepresentation*. For acts of negligent misrepresentation, a defendant is responsible at law if, in the course of his/her business or profession, the defendant supplies misinformation for the guidance of others in their business transactions that they rely on to their detriment. The defendant is responsible if she/he "fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting."

Most of the major S&L accounting firms have settled negligent-misrepresentation charges out of court. For having these charges dismissed without admitting guilt, five members of the nation's Big Six accounting firms have paid a total of \$984 million. FDIC et al. (1994) clarifies that allegations of accounting malpractice include such negligent acts and procedures as:

Improper work paper and document retention practices, including violations of Generally Accepted Accounting Standards (GAAS) and regulation, that impacted on regulators' ability to review accounting policies and practices of former clients and failed thrifts.

Failure to mark trading accounts to market in accordance with Generally Accepted Accounting Practices (GAAP).

Misapplication of GAAP requirements relating to accounting for acquisitions of savings and loan associations.

Improper accounting for profits on sales of real estate and exchanges of assets.

Failure to audit allowances for loan losses in accordance with GAAS.

Both at auditing firms and some Federal Home Loan Banks, evidence exists that underlings feared reprisals for blowing the whistle on efforts to overstate capital at crippled, but well-connected S&Ls. Readers must ask themselves whether it is plausible that competent and diligent S&L examiners and their regional and national supervisors would not have uncovered at least some of the particular weaknesses in reporting practices that embarrassed the accounting firms into paying compensation.

### INFLUENCE-PEDDLING IN EXCHANGE FOR PRIVATE BENEFITS

Our second charge alleges a conscious betrayal of the public interest in exchange for explicit or implicit compensation. Because such exchanges take place out of public view, it is hard to assemble convincing evidence without a back-up team of skilled investigators.

Such investigators did assemble persuasive cases of influence peddling against former House Speaker James Wright and former House Majority Whip Anthony Coelho, both of whom resigned their seats in Congress as a result. Suggestive circumstances exist in many other cases, most notably for the Keating Five Senators and for the regulatory forbearances accorded the politically well-connected Silverado and Whitewater S&Ls.

Two points are clear. First, both at the state and federal level, S&L regulators routinely engaged in policies of leniency and indulgence in enforcing FSLIC and taxpayer interests in supervising insolvent S&Ls. Second, private benefits came to both politicians and top regulators from pursuing these policies. Lenient treatment of a zombie S&L almost always pleased one or more incumbent politicians holding office in the particular state in which the unresolved zombie was headquartered. It protected top regulators' reputations against knee-jerk industry criticism of regulatory demands for recapitalization as merciless and unwise. It also spared their agencies the nuisance of having to defend themselves against stockholder and management lawsuits.

It is important to understand that, without federal deposit insurance, it would not have been possible for uncured shortages of equity capital at zombie S&L enterprises to persist. In the absence of federal guarantees, depositors and other creditors would have strong incentives to insist that a zombie enterprise raise more capital. If a voluntary recapitalization was not forthcoming, it would pay creditors to resolve the insolvency by taking over from pre-existing owners all or most of the ownership position in the firm. Takeover need not mean *closure*. If the S&L had solid going-concern values, creditors would accept warrants or other equity stakes in the operations of the S&L until either their claim was paid or they managed to find a willing buyer for the firm.



Shutting down an insolvent S&L that is truly needed by its community is seldom sensible. Any politician or regulator who claims that closure was the only viable alternative to leaving such a firm in business with dividend-free taxpayer support is speaking either from ignorance or with a forked tongue. Other corporate-finance options for extinguishing or diluting the claims of existing owners were available that could have served taxpayers better than closure. Offering poorly framed excuses for not having acted in timely fashion to resolve widespread S&L insolvencies serves to circulate disinformation. Readers are entitled to infer that resort to disinformation evidences an unwillingness to identify the true reasons for granting leniency.

It may be hard for readers to vote to indict politicians and regulators for influence peddling purely from observing suspicious patterns of activity and other forms of hard-to-explain circumstantial evidence. But at a minimum, mulling the gaps in the evidence available ought to convince readers of the need to insist on improved campaign-finance laws and to impose stricter ethical and disclosure obligations on high-ranking public servants so that such gaps will be narrower in the future.

Activity that is consistent with influence peddling can be observed in the heavy flow of campaign contributions that was supplied to banking-committee members in both houses by political action committees (PACs) sponsored by S&L, construction, and real-estate trade associations and corporations (Kane 1989, pp. 52-53). It is understood that campaign giving buys "access" to committee members for industry lobbyists. The importance of such access transforms Congressional committee assignments into licenses to milk the PACs of firms and industries whose business lies within each committee's jurisdiction.

The buying and selling of access and influence is often described euphemistically as "participating in the political process." But the undisguised ethical character of influence peddling can be clarified by contrasting some plain-spoken remarks with the carefully crafted defenses offered by defendants in influence-peddling scandals. The unguarded comments were captured by police on tape in Arizona during a sting operation, called AZSCAM. This operation videotaped negotiations in a candid-camera setting as a police agent sought to buy votes from individual members of the Arizona legislature to pass a bill that would legalize casino gambling in the state. The sentiments that a corruptible legislator was willing to express in bargaining for a better fee underscore the hypocrisy that customarily disguises the activities of buying and selling legislative votes in a representative democracy. These cynical views may be contrasted instructively with the defenses offered by the Keating Five senators. I suspect that the Senate Ethics Committee would have treated the Five far more harshly if any of their negotiations with Keating (either before or after pressuring FHLBB officials to go easy on Keating's Lincoln S&L) had been taped.

In AZSCAM, legislators all but shouted the following comments into microphones:

"I want to die rich." (Many elected official do die rich, bravely overcoming low salaries and high expenses they face in public service).

"We all have our price." (The purpose of this remark was to stress that someone who is uncomfortable with receiving payments in cash can still be open to a more subtly structured "deal.")

"There isn't an issue in the world I give a shit about. I do deals." (This official went on to emphasize that his main interest in a deal was "what's in it for me.")

"This time I sold my vote too cheaply." (When the previous official later discovered that another legislator had managed to sell his vote for \$20,000 more than the candid deal-doer had received, he chalked it up as a learning experience.)

"I have done nothing improper." (This is what all parties claimed when they were arrested.)

That they had done nothing improper was also the claim that emanated from every member of the Keating Five: Alan Cranston, Donald Riegle, John Glenn, Dennis DeConcini, and John McCain. These senators did not deny that they had exerted influence on FHLBB members to derail the efforts of the Federal Home Loan Bank of San Francisco to close Keating's deeply insolvent \$5.5 billion Lincoln Savings and Loan. Nor did they deny that each had received campaign funds and other benefits from Charles Keating and his associates. These points had been documented clearly (U.S. Senate, Select Committee on Ethics, 1991). Their defense was to deny that the pressure they exerted was connected to the substantial donations or other favors they had received from Mr. Keating.

Alan Cranston had a particularly hard time sustaining the plausibility of this claim. Not only had he solicited \$850,000 from Keating interests for three organizations he founded or controlled, but the funds were received well after the April 1987 meeting at which the five senators energetically intervened with the FHLBB. The defense he mounted on January 16, 1991 damns his colleagues, Congressional ethics, and the system for overseeing federal regulation: "Every senator has done it."

A grand jury is free to disbelieve the senators' claims that their intervention was unconnected to the favors they had received. It can do so on the grounds that these assertions defy common sense and are contradicted by Keating's own conception of what he thought himself to be getting in return for the contributions he made. At a press conference held after his S&L was finally closed in April 1989, Keating was asked whether he believed that his generous support of politicians had helped him to handle regulators in the past. He replied: "I want to say in the most forceful way that I possibly can:

I certainly hope so.” The chutzpah of this clever riposte made him an ideal target for subsequent federal prosecution. Nobody loves a wise-ass, particularly when the wit he exhibits intensifies pressure being felt by other members of the accountability-resistant Jackallian social network whose code of silence had protected him in the past.

## REGULATORY GAMBLING WITH TAXPAYER MONEY

I now invite readers to levy a third charge against the defendants: gambling at grossly unfair odds with taxpayer money. This accusation presumes the sort of guilty knowledge that is featured in our first charge. However, compared to the charge of influence peddling, the behavior alleged either assigns a less shameful motivation or stands as an additional and compounding breach of faith.

Kane (1989) emphasizes that incentives facing high government officials supported a two-part managerial strategy of: (1) covering up layered shortages of explicit capital at FSLIC and many insured S&Ls and (2) letting these shortages ride. The motivation for the letting-it-ride half of this analysis is summarized in a parable describing members of Congress who have stopped for dinner at an expensive Washington restaurant:

As political celebrities patronizing a D.C. restaurant, they soon find themselves seated at a prominent table. The prominence of their table tempts them to order the most expensive food and wine on the menu, on the gamble that a lobbyist at some other table will notice them and pick up their check. They confidently expect the restaurant manager to fill even the most lavish orders. He does not worry about how much cash or what credit cards individual members of the dinner party may have brought with them. He is confident that one way or another someone will pay these customers' bill in full. With the same confidence, the members of the dinner party end up staying at their table for an uncomfortably long time and even order an unwanted round or two of after-dinner drinks to give potential volunteers more time to grab their growing check (Kane 1989, p. 3).

Year after year, rather than submitting the bill for S&L losses to taxpayers for immediate payment, officials hoped that if they waited a little longer insured institutions' imbedded losses would be cured by extraordinarily lucky movements in bond, real estate, farm, and energy prices. Kane and Yu (1994) explain how FSLIC lost on average about \$8 billion a year while officials sipped their after-dinner drinks, waiting for the luck of crippled S&Ls to change. The flaw in the policy of passive supervision lies in the failure to negotiate for taxpayers an enforceable and balanced claim on the upside profits that a crippled S&L might earn down the line. Such a claim was needed because deposit-insurance guarantees already assigned the downside of any zombie's future earnings completely to FSLIC.

Making badly structured contributions of taxpayer capital to zombie thrifts would be indefensible in private corporate transactions. The problem of when and how to distribute losses in an insolvent firm is well-researched in corporate finance. As the capital stake put up by a firm's stockholders declines, creditors have an incentive to step up to demand that stockholders recapitalize the firm or else. The "or else" involves greatly diluting or wiping out the stakes of existing stockholders and either bringing in new equity or assigning to creditors a properly balanced equity claim on the future upside of these firms.

Recapitalization by no means requires closure, but it does require that accrued losses be distributed across prior stakeholders in the firm. By not distributing past losses, supervisory leniency distorted managerial incentives. It disposed zombie managers toward hell-for-leather funding and investment strategies that spread zombie-ness rather than controlled it (Kaufman, 1987, pp. 84-91).

The Report of the National Commission on Financial Institution Reform, Recovery, and Enforcement (1993) tells a simpler story. It characterizes S&L regulators, high administration officials, and Congress as being "asleep at the switch." But it blames parties in the S&L, homebuilding, and realty industries for compounding FSLIC's losses by perverting the oversight process.

The Commission's story ignores the force of public-service incentives. It suggests that the oversight process was okay until FSLIC became insolvent. But the oversight process was perverted *ab initio*. For the most part, in the S&L mess private lobbyists responded to longstanding incentives in ways that Jackallian managerial and professional ethics openly bless. To clarify this point, it is necessary to investigate the role of the one player who became the biggest loser in the game: the federal taxpayer.

The Commission portrays taxpayers as completely innocent victims. This is mistaken in that official behavior inimical to taxpayer interests ought to have been foreseen and guarded against. The failure of government officials to man their "switches" adequately is not an aberration of the S&L mess. It is a general problem that our system of government must resolve. Even children sense that, in a game of repeated victimization, a compliant victim's lack of resistance may be blameworthy in itself.

Conflicts in interest facing government servants in the FSLIC mess were aggravated by the conviction that taxpayers and the press were not concerned with monitoring them. Few outsiders can meaningfully assess the tradeoffs government officials make. Politicians and top regulators received immediate benefits from delivering leniency to constituents at zombie thrifts, but enjoyed a delayed and confused accounting for the costs and risk exposures this leniency passed through implicitly to taxpayers. Knowing that industry gratitude was assured while taxpayer criticism was uncertain

tempted officials to gamble that they could bend to industry pressures and escape through the revolving door with their reputations intact.

When taxpayer burdens did finally surface, responsible officials shifted their activity into blame-shifting. Far from proposing policies that would resolve the conflicts of interest that persuaded some officials to feather their nests at taxpayer expense government spokespersons refused to acknowledge the relevance of incentive conflict. Instead, government officials framed the policy debate around incomplete theories of the mess. These partial theories fixed the blame for the mess wholly or largely outside of the government and distracted taxpayers from addressing the desperate need for genuine reforms in regulatory performance measurement, governmental ethics, and campaign funding.

The success of governmental efforts to furnish scapegoats for taxpayers to condemn supports the hypothesis that the taxpaying public deserves some of the victimization it gets. Taxpayers are inherently more interested in the gossipy task of pinning the blame for the policy debacle on a few sharp S&L operators and a few allegedly sleepy officials than it is in working to uncover and solve the incentive problems that underlie this or any other public-policy scandal. Public preference for gossip over intellectual analysis is underscored by the great attention paid to Michael Jackson's alleged sexual deviancy, Woody Allen's romance with his step-daughter, and Zsa Zsa Gabor's run-in with an LA policeman. These personal-interest stories and the trial of O.J. Simpson each received more and better press than the \$150 billion-plus deposit-insurance mess ever garnered. Twists and turns in the juiciest stories are followed closely by an attentive audience of tens of millions, while issues in deposit-institution regulation are followed closely by an audience numbered in the tens of thousands.

The National Commission (1993) charged with officially analyzing the FSLIC debacle framed its analysis around a distinction between factors that precipitated the damage and factors that merely intensified damage already done. The Commission's *Report* uses this distinction to put the cart before the horse. It classifies "systematic breakdown in the political system" that "prevented corrective actions" (National Commission, 1993, p. 7) as an intensifying factor, while labeling the relaxation of regulatory and supervisory standards that was pulled by this incentive breakdown as a precipitating force.

The conceptual disengagement of mistaken supervisory policies from the incentives that led to their selection leaves the Commission's work half-done. In an "Additional View" appended to the Commission report, Commission member Eliot H. Levitas makes much the same point. He states plainly that guardians of taxpayer interests in FSLIC (government officials and the press) "failed miserably in their jobs" and "deserve to be held accountable" (National Commission 1993, p. 86).

To establish accountability is precisely what we are asking readers to undertake here. What are now seen to be "miserable" governmental policies persisted over two decades. Is it reasonable to believe that these policies could have endured in the face of guilty knowledge about their damaging effects on taxpayers unless this pattern of loss shifting was systematically *preferred* to other alternatives by the succession of officials who were in charge of managing and overseeing FSLIC?

Readers are invited to decide for themselves whether this revealed preference constitutes a breach of faith with taxpayers.

### NO EASY ANSWERS

The root issue in the S&L debacle has nothing to do with the nature of the S&L business. It doesn't matter to taxpayers how individual S&Ls actually lost money. The questions that matter are *why taxpayers suffered losses* and *why taxpayers could not see these losses* when they were developing.

To frame an adequate program of public-service incentive reform, one needs a complete theory of taxpayer losses. Complete theories of the mess must focus on the behavior of government agents under conditions of asymmetric information.

Taxpayer losses resulted from their agents' ability to take expedient actions to delay loss distribution and to hide both the true reasons and effects of these actions behind a smokescreen of disinformation. The cover-up of specific actions and reasons continues to this day.

In this respect, the National Commission's 1993 *Report* may be read as another brick in a wall which obstructs taxpayers' view of who did what, when, and why? Authorities' hiding of FSLIC losses is little different from efforts to cover up any unsavory actions officials take. Ironically, the *Report* treats governmental lying over the size of the budget deficit as routine, but offers policy recommendations that presume that truth-telling can easily be "required" of financial regulators.

The problem is to overcome authorities' propensity to rescue troubled industries and to cover up the costs of making that rescue. Vague disclosure requirements cannot easily overcome accounting legerdemain to make rescue costs *transparent*. Authorities find it all too easy and all too useful to block the flow of unflattering information. Accountability for regulatory performance begins with assuring the timeliness and accuracy of information supplied by managers of insured institutions and ends with assuring that managers of deposit insurance funds make fully informative reports to politicians and the press.

One way to reduce the scope for covering up bad performance is to require that self-reporting of regulatory performance be based on opportunity-cost accounting principles of measurement that

measure period-by-period changes in taxpayer loss exposure in insured institutions. This would entail at least three specific actions by Congress:

Defining what information supervisory authorities are to disclose in an operational manner free of obvious loopholes,

Specifying criminal and civil penalties for officials that sign off on willful inaccuracies and nondisclosures, and

Establishing a credible enforcement mechanism.

Such accounting and enforcement reforms seek to create incentives for regularly measuring and reporting the capitalized cost to taxpayers of caving in to pressure to allow troubled deposit institutions to operate insolvently. In the event of a future taxpayer bailout, such measurements would assist the press and voters to assign blame. Officials' opportunities to claim ignorance of the long-term consequences of forbearance policies ought to prove more constrained than they were in the FSLIC mess.

One way to reduce the scope for influence peddling and regulatory gambling is to enact information-contingent action-forcing rules. These rules should spell out measurable performance standards and identify quality-assurance issues. Incentives ought to be established to define and penalize dereliction of duty at all levels of oversight. Duties to be mandated should include:

requiring deposit-insurance managers to recapitalize their insurance funds according to a relatively speedy timetable when and as they suffer opportunity-cost losses.

requiring losses that exceed deposit-insurance reserves to pass through the federal budget as they accrue.

requiring members of Congress and the Administration to:

set explicit and enforceable limits on their ability to intervene ethically into the process of closing individual institutions,

report all interventions on behalf of individual institutions to Congressional banking and ethics committees for explicit review, and

subject committee reviews to regular evaluation by "disinterested" outside experts.



A complementary third way to improve incentives for deposit-institution regulators would be to privatize a first tier of accountholder deposit-insurance coverages. While government funds could continue to underwrite catastrophic risk, a privately insurable first layer of deposit-insurance coverage could be assigned to private bonding companies. These companies would have cleaner incentives to manage site examination and capital requirements for insured deposit institutions. The purpose would be to make government monitoring and supervision more transparent by pushing it back a step. Instead of examining thousands of deposit-institutions, officials would accept the simpler task of overseeing the condition and risk-management policies of a handful of private deposit insurers. Taxpayers' ability to monitor regulators' performance of this oversight task would be assisted by observable market signals that competing insurers would receive from the financial and insurance markets in which they operate.

The difficulty of enacting any of this trio of reforms is a measure of the depth and stubbornness of the mess. Whether such reforms will ever seem desirable to elected officials will depend on the electorate's willingness to face up to its monitoring responsibilities. One can only hope that voters penalize and shame incumbents for emergent government failures during future elections as strongly as firmly as they did in 1994.

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**TABLE I**  
**COMPARISON OF OFFICIAL AND**  
**OPPORTUNITY-COST ESTIMATES OF FSLIC**  
**FINANCIAL HEALTH, 1975-1989**

	Official Estimates of FSLIC Insurance Reserves (in \$ billion)	Official Reserves as a Percent of Insured Deposits (in percent)	Assets at FSLIC-Insured Institutions (in \$ billion)	Opportunity-Cost Value of FSLIC's Net Accumulated Losses As a Percentage of Assets at Insured S&Ls (in percent)
1975	4.1	1.5	329	-7.8
1980	6.5	1.3	615	-12.8
1985	4.6	0.5	949	-5.5 b
1986	-6.3	-0.7	1,164	-6.5 b
1987	-13.7	-1.5	1,251	-9.6 b
1988	a	a	1,350	-10.1 b
1989	a	a	1,301 b	-8.7 b

Source: Official figures for 1980-1987 FSLIC Reserves come from the Federal Home Loan Bank Board's *1987 Annual Report*, p.8. Figures for 1975 come from the Board's 1980 Annual Report. 1975-1988 Assets for FSLIC-insured institutions from various *Federal Reserve Bulletins*. The last column combines 1975 and 1980 information from Kane (1989, p. 75) with later information from Kane and Yu (1995).

a. The missing information was not released to the public until after FSLIC ceased to exist.

b. September 30th figures calculated by Kane and Yu (1995).

**TABLE II**  
**ECONOMIC CONDITION OF FSLIC AND RTC, 1985-1990**

Date	Net Worth		Economic Income
	Opportunity Cost Value	Official Yearend Value	
9/30/85	-\$86 Bil.	+ \$4.6 Bil.	...
9/30/86	-\$122 Bil.	- \$6.3 Bil.	-\$45 Bil.
9/30/87	-\$107 Bil.	- \$13.7 Bil.	+\$7 Bil.
9/30/88	-\$161 Bil.	...	-\$63 Bil.
9/30/89	-\$161 Bil.	...	-\$7 Bil.
12/31/89	...	- \$99.9 Bil.*	...
12/31/90	...	- \$100.3 Bil.*	...

\* Accumulated Deficit reported by the Resolution Trust Corporation (RTC). RTC was asked to absorb FSLIC's losses in all S&Ls for which a conservator or receiver was appointed between January 1, 1989 and August 8, 1992. RTC's life and loss acceptance has been extended twice. Through December 31, 1993, RTC had received \$123 billion in appropriations. Its latest legislated end date is scheduled for July 1, 1995. The cynically named Savings Association Insurance Fund (SAIF) is standing by to take over future loss exposures in S&Ls when RTC closes shop.

Insurance losses on FSLIC's books prior to 1989 did not go to the RTC. These losses were assigned to a separate FSLIC Resolution Fund that totaled \$14.4 billion in December 1989 and for which \$22 billion more was appropriated in 1991.

Pulling appropriations to these two funds together, by December 31, 1993, \$159 billion in taxpayer funds had been designated as filler for the hole in FSLIC's negative net worth.

SYNTHETIC GRAND JURY BALLOT ON THE  
APPLICABILITY OF FIVE COMMON-LAW TESTS FOR FRAUD:

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- a conscious *misrepresentation or concealment* of the truth
- an *intent to benefit* by causing another party to rely on the untruth to his or her detriment
- the misrepresentation was *material* (i.e., directly related to the harm caused)
- there was an *intent* to cause the other party *to rely* on the misrepresentation to his or her detriment
- that the other party did *believe, rely, and suffer* provable harm.

## **THE CIVIL WORLD OF BUSINESS: EVOLVING SYSTEMS OF SOCIAL ACCOUNTABILITY**

Severyn T. Bruyn

The collapse of socialist states has sent a message to the world that socialism has lost and capitalism has won the battle of this century. It appears that capitalism is the wave of the future for all nations. But students of capitalism and people who are hurt by it say that the system is seriously flawed and its future is in doubt. There is not only a downside to capitalism but a self-destructive side as well. It produces major social problems with no alternatives within the system for correcting them. Governments continue to grow in an attempt to solve these problems through regulatory agencies and monitoring systems. In the process, governments become command bureaucracies, oppressive in themselves. There is no social vision that could turn capitalism into a system of self-regulation and social justice.

The poor today are getting poorer and the rich are getting richer. From 1977 to 1990, the pre-tax earnings of the poorest one-fifth of Americans fell by five percent and the earnings of the richest one fifth rose by nine percent. Drugs and crime grow on city streets as community life is destroyed. The number of homeless people and the number of people in prisons keep growing. Environmental damage is mounting. Nuclear power plants continue to produce dangerous and intractable wastes. Global corporations can make the world an even more dangerous place to live in this age of nuclear and chemical weapons (Reich 1991).

Business scholars look for ways in which markets can be more responsibly organized, but they say it requires a local-to-global vision. People who have been disenfranchised argue that it is time to create a system in which they are real participants. Political leaders argue that business associations must help set standards in the national interest. Leaders in developing nations call for a system that can operate more justly and fairly on their behalf. Economists argue that a system must be created that works in the public interest and eventually for the common good.

My question is: How are people creating systems of accountability which help solve problems of dominance and exploitation in business? We shall see that systems are evolving at local to global levels but problems must be resolved to make them work more effectively in the public interest.

### **A THEORETICAL ORIENTATION**

I assume that the market is based in social as well as economic exchange. This means analytically that we live in a social economy, by which is meant that capitalism operates in a human domain and the basic problems of business are studied best in the context of society. The full meaning as to how

this social factor works cannot be discussed here but it is important to note that social and economic factors are intricately intertwined in the evolving formations of business today.

Business is grounded on systems of social governance and defined by principles of self-governance, mutual governance, and command governance. Self-governance is the capacity of business at all levels to operate with minimum outside interference and controls. Mutual governance is the capacity of people at all levels to manage their affairs together. Command governance is the capacity of people to work in a formal hierarchy of offices under an agreement to obey orders from above. There are many varieties within these generalized types of governance and all three forms of social governance co-exist in the business system.

This conceptual framework assumes that business has a capacity for social development, that people cultivate human as well as economic resources within the system. Systems of accountability are a subtype of mutual governance and their augmentation is part of social development which takes place by building modes of mutual governance which augment the capacity of people to be self governing.

Systems of social accountability develop in the private sector when competing parties (1) create electoral systems of governance at work and (2) establish judiciaries which resolve problems based on principles of equity. Accountability is created when opposing parties organize democratic systems in private business and provide a procedural access to justice by due process.

Accountability systems have been evolving in business for over a century in the United States but today they are becoming noteworthy for their capacity to reduce the need for government control over the economy. My assumption is that when people create electoral and judiciary systems in the private sector to advance the values of equity and freedom, they operate in the public interest. Such systems alter the more oppressive types of command governance in business and can advance the self-governing powers of the participants.

There is a difference between social responsibility and social accountability in the private sector. Social responsibility refers to the conscientious efforts to take account of those who are adversely affected by corporate policies. Business people see norms of justice that are important to advance in doing business. Social accountability, on the other hand, refers to formal structures that require people to act responsibly toward one another on the basis of social norms. It refers to a structure that makes certain that those who exploit are answerable to the exploited. All parties participating in a specific system of socioeconomic exchange are obligated to act with common norms of fairness and justice.



Accountability systems are complex but key variables include types of joint participation in governing work, electoral processes, social norms, judiciary structures, due process, informal/formal organization, and collective attitudes.

My proposition is that the development of social accountability in business advances the self-regulatory power of the economy. This is a type of social development in accord with the original dreams of Adam Smith and Karl Marx. Smith had a vision of a self-regulatory market system operating apart from state controls and in the public interest. Marx dreamed of the "withering away of the state" and envisioned a self-governing economy, with very little government administration. Both Smith and Marx wrote about an economic order managed by people (not the state) in society.

The development of social accountability in the economy invokes oxymorons in today's business culture. As we shall see, new concepts like "public economy" and "cooperative competition" become part of the development of accountability. Accountability systems introduce a concept of a "public order" in the private sector and require modes of cooperation in an otherwise competitive system. They are part of the changing world of business in a civil society where the public is not represented adequately by the state. We also see how competition is shaped by some form of cooperation in the economy. The growth of accountability systems in the private sector requires that cooperation take place among competitors in the public interest, without state involvement.

I am assuming that the public interest is served by a business system that integrates social and economic principles, a system that is non-bureaucratic, productive, efficient, responsible, decentralized, community-oriented, and humanly focused. In sum, accountability systems produce a publicly-oriented, social market, within the private sector. Systems of accountability show the ways in which the dream of Smith and Marx evolves, although there is a world of difference between the ideal and reality. This is why studies of these systems are important today.

Accountability systems show promise of operating in the public interest as part of a mode of business development but the cases which follow are all flawed in some measure, requiring much study. National studies are needed to determine the extent to which corporate self-studies and legislation may be needed to make them operate in the public interest. Let us look at these cases to see how they have potential to reduce government controls and operate in the public interest.

#### EXPERIMENTAL MODELS: EVOLVING SYSTEMS OF SOCIAL ACCOUNTABILITY

I summarize systems emerging in the firm's relation to (1) its employees, (2) its locality, (3) the public, (4) its competitors, and (5) host societies in the global market. These five areas are critical to a business system which is becoming socially self-regulatory.

## THE CORPORATION: ACCOUNTABILITY TO EMPLOYEES

New systems of accountability are emerging within firms which organize employee participation and ownership. As command-based firms develop significant degrees of worker participation and ownership, the management system changes. New attitudes, electoral systems, and judiciary processes change the character of the former mode of command.

Two major changes have taken place in the last forty years. The first change is toward *worker participation in management* through the establishment of autonomous work groups, quality circles, labor-management committees, matrix systems, co-determination, tribunals, grievance committees, and disclosure agreements. The second change is toward *worker ownership*. Over 11,000 firms now have some form of employee ownership.

Firms engaging in co-management or co-ownership often are called "self-managed" or "socially owned and self-managed." Self-management specialists argue that if these two practices continue to evolve, a point of convergence will be reached where the internal system of the corporation is characterized as fully self-accountable. As firms become more self-governing, labor needs fewer state agencies and laws to protect it. Such firms operate to a greater degree in the public interest and contribute to the self-regulatory power of the economic order.

The firms with a high degree of self governance help save jobs, maintain local flows of capital, promote community development, keep high levels of productivity and efficiency, reduce absenteeism and labor turnover, curb tardiness and malingering among employees, reduce pilferage inside the firm, eliminate middle-management bureaucracy, and finally provide employees with a sense of purpose and meaning in their work. Ultimately they pay off for everyone because the government does not have to create agencies and laws to protect workers from corporate abuses.<sup>1</sup>

Corporations are becoming relatively self-managed together in different countries. Their systems of accountability reveal considerable diversity. Three models are presented below.

*Model 1. Mutual Stock Ownership* Among major Japanese corporations, the bulk of corporate stock is held institutionally rather than individually, reducing the power of the individual and increasing the power of the group. Japan practices a form of mutual stock holding among competing

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<sup>1</sup> Self-managed firms do not leave the country because labor costs are lower in foreign nations, thereby compounding the high rate of unemployment and subsequent welfare costs. These firms help maintain stability in neighborhoods which have become disorganized and drug-ridden and reduce the need for police and drug squads. They help keep capital in the locality because incomes circulate locally without interruption. They tend to be more responsible to the environment and reduce the need for environmental protection agencies. Scientists today are finding that space for self-management on the job is critical to personal health (Karasek and Theorell 1990).

firms, making them relatively free from outside takeovers because of the power balance in mutual ownership and the practice of cooperation among enterprise groups. Firms work together to advance their common interest and each aids the other in times of crisis but corporate management in each firm still has full autonomy over the direction of the firm.

Board members include senior supervisors of the firm and are subordinate to the president. The corporate board generally does not monitor the conduct of the president. Board's chair is usually an elderly former president of the firm, a symbolic figure, but significant. A stockholder's meeting is held ritually and institutional owners (other firms) send in proxy votes to management. If the president grossly mismanages the firm, he may resign under pressure from management.

This model involves a different internal organization than is typical of U.S. firms. The after-tax salary of the president is about six times as large as the lowest starting salary of a new worker as opposed to 16 times in the United States. There are internal unions which work with management on a greater trust basis than is the case with U.S. unions. Management shares proprietary information with unions, offers guaranteed life-time employment, talks over company R&D policies and their potential impact on employees. The union contract is general and implicit as opposed to U.S. labor contracts which are specific and explicit. The normative culture of the firm is cooperative. In Japan, a pension reserve is maintained as part of the firm's own assets in contrast to the United States, where employer/employee contributions to retirement benefits are in diversified portfolios external to the firm.<sup>1</sup>

*Model 2. Co-Determination.* In the 1970s, West German and Scandinavian countries adopted a system of labor-management co-determination. In West Germany, the law of 1976 required a board of supervisors (above the board of directors) whose membership represented equally both stockholders and labor. The task of the supervisors was to oversee the broad range of company affairs, from the performance of senior managers to personnel policy and the financial condition of the firm. The supervisors were empowered to dismiss all executives except the president of the company, and the board of directors was obliged to comply with supervisors' decisions. In case of a deadlock, the chair of the board of supervisors, who represented the stockholder-owners, would cast the tie-breaker. In this way, the ultimate control of the board was preserved as capitalist, but the new organization changed the orientation of the firm in a social direction. Labor representatives were in a position to learn about inside information and felt responsible for the common good of the firm. A new system of mutual accountability was created.

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<sup>1</sup>During recessions, top salaries are cut first. Work hours are reduced in order to rotate work. Surplus employees who might be fired in one department are shifted readily into other departments. Holistic and generalist thinking is encouraged among employees in the firm. New managers are selected by both their superiors and their subordinates (Ozaki 1991).

Co-determination systems in Sweden and Norway are different than in Germany and these, in turn, differ from the U.S. experience where firms generally have no elected worker councils or legal system which requires adjudication of disputes and monitorable health and safety standards in the workplace.

*Model 3. Worker Cooperative.* The system of cooperatives around the village of Mondragon in the Basque region of Spain may be the clearest example of a fully self-governed system. In terms of normative design and economic success, it represents an authentic model anticipating the development of a social economy.

The corporate board is elected at the annual meeting of all employees. Employees own and manage their own firms on the basis of one vote per person, with social councils operating at middle-management levels. A system of internal capital accounts operates in each firm and each worker's share of the net annual product, positive or negative, is credited to his or her account. Ten percent of the profits is allocated to community development, thirty percent to the firm's internal development, and sixty percent to the employee accounts which accumulate with interest until retirement.

While it may be in the interest of an individual worker to receive a yearly share of the whole profit, it is not in the long-term interest of the firm. If the whole profit is divided among the member workers, any financing necessary for expansion must come from external sources, putting the firm at the mercy of banks and other lenders.

Typically U.S. co-ops fail to retain sufficient capital due to annual distribution of the whole profit, do not attract and retain skilled managers, and are vulnerable to buyout by outsiders if they become successful. These self-destructive tendencies are overcome in the Mondragon system which has established a system-wide coordination of firms in banking, retail trade, farming, housing, social security, and education. This system is designed to work together cooperatively in the interest of the whole community.

*Flaws.* These relatively self-managed firms are proving to be highly productive and profitable but they are all flawed in certain respects, requiring social economic research. Employee accountability is not simply established by organizing systems for workers to elect a board of directors. Systems of accountability are evolving at every major level of the firm. This is why both trends -- employee ownership and participation -- are vital to the development of a fully self-managing firm.

One flaw is bigness and bureaucracy. There are problems for a democratic company that grows too large, even when workers elect a corporate board. The command system can become oppressive

because middle managers ignore the rights of workers, competitors and customers. Most self-management consultants recommend decentralizing big firms into smaller companies through self-managing systems of accountable organization. England's John Lewis Partnership, a large democratically-oriented firm of 25,000 employees, maintains an internal set of competitive newspapers to help workers have a public voice. These newspapers allow any employee to complain anonymously about a department policy or floor rule. The appropriate supervisor must respond in the company newspaper. This practice keeps the corporate hierarchy accountable to the needs of people at the bottom.

German companies with more than 40,000 employees require tiers of worker councils at local and regional levels. Local councils elect higher councils between regions in a self governance system. Very large corporations also must maintain ombudsmen at the floor level. Effective systems of accountability begin at the bottom levels of a corporate hierarchy and continue all the way to the corporate board.

Systems of accountability in worker ownership in the United States have serious problems. Joseph Blasi argues that the current legislation on Employee Stock Ownership Plans blocks the development of self-managed firms and he wants to see (1) more equity for employees with the least savings and access to credit, (2) the limit on the amount of stock distributable to an employee substantially increased, and (3) stock allocated on a more equitable basis than salary. The practice of excluding workers from stock equity because of age should be eliminated, he says, and worker-owners should be able to protect their rights through their own involvement in corporate governance, instead of depending on the complexities of government regulation that encourage court cases (Blasi 1988, pp. 239ff).

The Japanese model of employee accountability is significant because it expresses so much group pressure and social responsibility within the firm that individuality is lost. Japanese patterns of employee responsibility are evident in quality circles, equitable pay, sharing of information, permanent jobs, avoidance of outside takeovers, and systems of accountability created through union contracts. But the Japanese model of community operates without judicial recourse for employees to top boards. There are collective patterns of paternalism, sexism, and inhibitions against whistle-blowing. In other words, when the sense of community breaks down in a Japanese firm, there is no judiciary to hear complaints of dissident employees and no voting rights for employees to make a board of directors accountable. The Mondragon system, on the other hand, offers the same desirable norms and values but also guarantees accountability for employees from the bottom to the top of the corporate hierarchy.

Students of self-management argue that the attributes of a fully self-managed firm are: (1) employee ownership with equitable voting rights for work groups and boards of directors; (2) employee participation in decision-making at key levels of internal management; (3) profit-sharing among employees; (4) full information sharing; (5) an internal representative judiciary; (6) employee attitudes grounded on principles of respect, fairness and democracy; (7) continuous training and educational programs; and (8) support from trade or sectoral associations.<sup>1</sup>

These three models show the importance of the difference between social responsibility and accountability within management systems. The Japanese example reveals a powerful social responsibility to the firm. The German model reveals legal steps to assure accountability to workers by elections and due process. The Mondragon model reveals both social responsibility and formal systems of accountability.

But studies show that all three systems are flawed in some way. Germany and Japan show problems of neo-corporatism, that is, maintaining centralized hierarchies of government-management-labor collaboration to the disadvantage of people at the bottom. In Germany, labor itself is highly bureaucratized and economic growth is slowed by centralized capital. In Japan, corporate life is closely controlled by the national government for the purpose of further penetrating global markets. Japanese women are kept from participating at top levels of business and the corporations represented in this case do not represent the periphery of smaller businesses remaining under their hegemonic power. In Mondragon, one study showed how a male patriarchy persists within its formal systems of accountability.<sup>2</sup>

#### THE COMMUNITY CORPORATION: ACCOUNTABILITY TO THE LOCALITY

Several models have developed in the United States during the last few decades especially through the efforts of local people oppressed by business practices. Oppressed by sudden mass lay-offs and prejudicial action, it is often women, Afro-Americans, and other minorities who establish corporations to maximize accountability to the whole community.

*Model 1. Community Development Corporation.* CDCs maximize profits in the interest of the whole community. Their boards of directors are accountable to local citizens who elect them. Local people elect board members who hire a professional staff to manage the corporation. Since the

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<sup>1</sup> For a comparative study of cases of worker-owned-and-managed companies based on such criteria, see Bernstein (1980). For a systematic review of a model with applied cases, see Gunn (1984) and Oakshott (1978). For a broader philosophical discussion of these attributes, see Dahl (1985) and Mason (1982).

<sup>2</sup> A field study of the Mondragon system reveals that male-oriented norms persist within its democratic structures of accountability. Nevertheless, the accountability system is allowing women to fight the old norms (Clamp 1985).

1970s, CDCs have created housing for the poor and many local businesses, including shopping centers, factories, and professional services. Their presence reduces the need for governments to intervene in the private market to protect local citizens from the failures of conventional firms to be accountable to local citizens. But they need public support to advance their formation across the country.

*Model 2. Community Land Trust.* CLTs are nonprofit corporations, controlled by local citizens. CLT boards of directors are elected by local citizens who own the land in common. They rent parcels of land out to private businesses who, in turn, become represented on their local board. CLT boards are structured to balance the representation of leaseholder members with non-leaseholder residents.

The CLT is a democratic company which honors free enterprise and eliminates poverty. If a corporation wants to operate in the locality, it must write a contract with the CLT. It can have a representative on the local board to argue its case when contract problems arise. The board sets standards for the environment and sees that proper rent is paid to people in the local community.

A National Association of Community Development Loan funds makes loans to new members. From inner-city areas to small towns, today's housing crisis has spurred the development of CLTs as vehicles for providing homeownership opportunities for low-income people without racial/ethnic discrimination while preserving the affordability of housing for future residents.

*Model 3. Community Development Finance Corporation.* CDFCs are customer-owned local banks with boards that are elected by their customers. CDFCs invest in local businesses and real estate projects in disadvantaged communities and have a close relationship with CDCs. They invest in minority enterprises as with BHM, a Boston organization which began in 1987 to provide outpatient mental health programs and forensic residential services, and La Alianza Hispana which provides a wide range of social services to Spanish-speaking residents of Roxbury and North Dorchester. CDFCs offer their members educational programs on financial issues.

The CDFC movement began as a protest against redlining by banks. Minorities protested in what they called a "green line" movement to change conditions, and with the aid of federal legislation, the customer-owned bank was created. CDFCs exist in poor neighborhoods today across the nation but they constantly face a hostile capitalist environment. They need supportive legislation to advance their position and cause in a socially accountable economy.

There are other models of community corporations accountable to local citizens. Public utilities, for example, have organized local customers on their boards and have encouraged their customers to buy stock as a strategy to win their favor. For example, the main electric utility serving the Cleveland area offered customers a chance to buy stock in the company. In two months, 17,000 customers



responded by buying 729,000 shares for \$13.7 million, at \$800 per customer. Such utilities are transitional models in a vision of accountable systems that work for the common good.<sup>1</sup>

*Flaws.* There is a literature which criticizes community corporations especially in terms of participatory democracies versus representative democracies. For example, Ram Cnaan utilizes a typology with ten criteria to determine whether community organizations are democratic. He uses measures of accountability, including the degree to which elections are open and members are participating and informed about activities. Cnaan finds that community corporations have a difficult time finding people willing to hold office, participation generally is minimal, communication systems often are inadequate, and due process frequently is not utilized (Cnaan 1991, pp. 614-34; see also Twelvetrees 1989).

### THE PUBLIC CORPORATIONS: ACCOUNTABILITY TO SOCIETY

The idea of chartering large corporations at the federal rather than the state level was proposed by James Madison during the Constitutional Convention in 1787. Madison's idea would have created charters based on principles of accountability to the general public, but when states began to compete for corporate charters, the public purpose of corporations was lost. There is reason to argue that federal charters in select cases such as large firms would not curtail their freedom in the market. They would be nongovernmental corporations operating in the public interest (Nader and others 1976).

The problem is that government control too often operates in the interest of its own bureaucracy rather than the interest of everyone. Accountability to the public-at-large is not easy to establish in cases of government monopoly over a market. In the public market of the mass media, for example, professional journalists must be free of government interference to investigate matters of social concern to everyone. The mass media should not be restricted from reporting news that offends government officials.

The same problems of accountability apply to the field of public education. The production and transmission of knowledge cannot be territorially circumscribed by a political institution; the purposes of education extend beyond the aegis of the state. In times of crisis, teachers should not be required to take an oath of allegiance or be prohibited from teaching courses which are not approved by the state but should be expected to meet public standards, in this case, professional and academic standards of their own societies. How then is private education to be held accountable? The answer is by civil associations in society.

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<sup>1</sup> These innovations are a step in the right direction but not the basis for establishing true equity and accountability which require respecting the power of each citizen regardless of ability to buy stock (*Business and Society Review*, 1984, p. 68).

*Model 1. Higher Education.* Public accountability in the field of higher education is not administered by the federal government. Instead, associations represent and coordinate the work of four thousand institutions of higher learning, lobby for various forms of federal aid to higher education, and define national educational issues and priorities through conferences, publications, and special projects (Diner 1993, p. 21). Few faculty members know much about the activities of the American Council on Education, the National Association of State Universities and Land Grant Colleges, the American Association of State and College Universities, or the Association of American Colleges, let alone the differences among them. Even so, presidents and deans relate to these associations just as scholars relate to the American Sociological Association, the American Historical Association, or the Modern Language Association.

The members of these private associations operate in the private sector and are civil institutions rather than individuals. The founders of these organizations were committed to a philosophy of associationalism which justified the multiplicity of power centers in society. Education, the founders argued, needed systems of accountability to prevent fraud, proliferation, and corruption by special interest. These associations became self-governing private associations, standardizing and regulating higher education in America without formal control by the national government and without incurring government costs.

Today institutions of higher education are licensed or chartered by a state, after which they are eligible for accreditation by regional and specialized accrediting bodies. To receive federal financial support, an institution must be accredited by a private association itself accredited by the secretary of education. Thus, the private system is interdependent with the federal government but not directly regulated by it.

*Model 2. National Television.* In Germany, a private-sector television company is accountable to society rather than the government. Public television began in the early 1950s when an association of radio stations created the First Channel Television. This Channel remains today as a decentralized system of social management.

The Second Channel Television in Germany was organized in 1961 with a television board to represent society. The board includes eight representatives from various political parties who are appointed according to their electoral proportions in the government. The remaining representatives are drawn from the main organizations of society (Conrad, no date).

Apart from the First and Second Channel television, the broadcasting firms have a trade association that produces third channels alongside regional programs. The dominant topics are education, public information and the arts. Thus, the media's trade association has broadened the basis for firms to act in the public interest even though it is designed primarily to serve the media industry.

## TRADE ASSOCIATIONS: ACCOUNTABILITY TO COMPETITORS

Competing firms cooperate to achieve certain goals in common, raising a question as to whether their cooperation is in the public interest and not a collusion which advances the self-interest of the allied firms. Transitional models that encourage cooperation in the public interest are being created in nations around the world.

Trade associations can work for the public interest or against it, depending upon how they are organized. In some cases, the associations set public standards and in other cases the government encourages them to establish standards to protect the environment, health, safety, and the civil rights of people in the public interest. This public policy reduces the need for government agencies to monitor business because these associations work for the public interest as well as for their member companies. These private associations have flaws in their democratic organization but it is important to see how they develop systems of mutual governance and accountability.

*Model 1. Japanese Enterprise Groups.* Major Japanese companies affiliate informally today in enterprise groups. An association may consist of a city bank, a trading company, and a manufacturing firm as the central core, and several manufacturing firms with different product lines related to pyramids of affiliated smaller subcontracting firms all of which maintain a contributing relationship to the core. There is no formal charter spelling out rights or obligations. Each group has a presidents club that meets periodically for information exchange. The club is said to make no group wide managerial decisions. The goal is to reduce transaction costs and enhance joint productivity. Credit is extended in full knowledge of internal conditions. Enterprise groups exist in all major industries even when their member firms stand in competition with one another. It is said that these groups provide the dynamic behind Japan's success in the world market.

Affiliated firms agree to offer mutual assistance in difficult times during a recession or when a firm member begins to fail. Rescue for a failing firm may come from the affiliated firms in the form of credit and expertise. Nissan's 1990 takeover of Fuji Heavy Industries, maker of Subaru, is an example. A new president was appointed, a bank advanced credit, and production in the firm was reduced. There was no change in stock and no purge of executives as often happens in the United States in such failings. A sense of mutual interest and common purpose prevails in these groups.

*Model 2. U.S. Trade Association.* The American Standards Association is a peak association serving the public interest. It is a clearinghouse for creating technical standards in the interest of society and its members. It does not develop standards itself but provides educational materials and recommends procedures for those who are interested in standardization. It is a federation of over 100 trade associations, technical societies, professional groups, and consumer organizations, and over 25,000 member firms. Its organization has developed almost 1,600 standards dealing with almost

every facet of the economy. Associations have made it possible to manufacture a light bulb in New York that will fit a socket in Los Angeles, for a size 5 shoe made in Boston to fit a wearer in New Orleans, and for a doctor's prescription written Pittsburgh to be filled safely in Denver.

At the very time that the Federal Trade Commission was established in 1917, two trade associations of paint and varnish manufacturers adopted an iron-clad anti-rebate agreement as a condition of membership. They jointly agreed not to pay any gratuities, commissions, rebates, or loans to employees of business concerns to whom they sold their product and not to approve reimbursement of their sales personnel for any expense other than legitimate business expenses. The two associations set up their own unfair competition bureau, which solved these problems by investigating complaints and settling issues through consultation with the parties involved. They were able to avoid having the FTC spend time and money monitoring their activities.

Many of these self-monitoring systems operate in the public interest as well as the interests of the competitors. For example, years ago the Southern Pine Lumber Company set standards for other like-minded associations. They agreed on a private grading system for prioritizing lumber quality. This process operates in the interest of construction companies who need to know the quality of the lumber they are buying and in the public interest as well.

There are literally thousands of accountability systems evolving in trade associations. Such systems are taken for granted today. New ones never make the headlines. Hundreds of private tribunal systems are maintained by associations to handle their own internal problems in ways that reduce the need for government controls over business.

Trade associations are developing administrative, judiciary, and legislative systems of private governance. Each system is undergoing constant self-correction by member firms who see problems and by those who cannot seek justice and litigate through government courts. For example, associations have problems on the extent to which their members have equal voting rights in decision-making when their association draws its income from members' dues in a manner which can express a power differential affecting the reality of a voting structure. Some members are more wealthy and influential than other members. Also, the judges in private tribunal systems sometimes have been personal friends of offenders, violating due process. Federal courts have demanded more objective standards to insure standards of justice administered through these associations.

Associational practices are vital to the creation of a civil society. Government agencies cannot monitor health and safety practices in millions of firms competing across the country. It already has failed to organize accountability systems on this front. For example, the Occupational Health and Safety Act of 1970 was written to protect every working man and woman in the nation, but today the

National Safety Council shows that thousands of workers are killed and millions are injured each year in job accidents. A federal agency cannot monitor firms without the aid of accountability systems of private trade associations.

The same problem exists in other areas of environmental protection and housing. In what follows, two cases of private accountability systems in Sweden -- housing and health and safety in the workplace -- are presented.

*Model 3. Swedish Industry/Housing Council.* Sweden has not needed an OSHA because the problem of health and safety in the workplace has been solved through labor-management cooperation. Trade associations and unions have designed and co-participate in a self-monitoring system. Firms save money by working with unions to establish common health and safety standards. The standards have been enforced equitably and fairly under this arrangement, reducing the need for a government agency and its costs to the public (Kelman 1981).

In housing, private landlords, co-operative housing, and municipal housing companies each have their own negotiating association for bargaining with tenants who, in turn, are organized in the National Federation of Tenants' Associations. Private landlords usually belong to the Swedish Federation of Rental Property Owners, while municipal housing companies belong to the Swedish Association of Municipal Housing Companies. Negotiations between municipal housing authorities and the local and regional branches of the National Federation of Tenants' Associations set the norm for annual rent increases. Regional rent courts together with the national rent court provide a system of institutionalized arbitration and sanction. These are bi-partite bodies, with an equal number of members chosen from the landlords' and renters' organizations, with a neutral legal counsel as chair (Pestoff 1991).<sup>1</sup>

Thus, trade associations set standards for their market area and monitor the conduct of competing members. When an offending firm breaches an ethical code, it is subject to judiciary action within the framework of the association. Trade associations thus reduce the need for government agencies to settle their problems by outside judicial and regulatory action. Associations serve as a form of democratic self-government that reduces the need for state and federal government staff to monitor competing firms.

*Flaws.* Trade and professional associations can monitor the behavior of their own member-competitors effectively except when they commit offenses against outsiders. For example, physicians and lawyers do not perform well in protecting patients and clients from the misconduct of

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<sup>1</sup> The Swedish Employers' Confederation is currently seeking to decentralize these sectoral systems and therefore they must be seen as models in transition.

their colleagues through their tribunal systems. In such cases, associations must have a judicial system that includes the outsiders, in this case, their respective patients and clients.

Similarly, producers cannot monitor actions effectively when they involve distributors and retailers. In these cases, distributors and retailers must be represented in tribunal systems. To illustrate, General Motors and the National Association of Automobile Dealers have established a private court to settle conflicts that arise between producer and customer.<sup>1</sup> Inter-organizational standards and tribunals for the settlement of disagreements between oppositional groups are being established in the market system to reduce the need for government intervention but they need further extensive study so that they operate in the public interest.

### THE GLOBAL MARKET: ACCOUNTABILITY TO HOST SOCIETIES

Business researchers have shown how global firms help host nations by creating jobs, offering training in management skills, and supplying capital for developing societies but critics have also shown how these firms exploit people in host nations. They can extract profits unfairly and collude with government elites to dominate the host economy because there is no formal system of accountability.

The question is whether global firms can be organized to work in the public interest of the nation they represent and for the common good of humanity and still work in their own interest. As foreign financiers increase their investments and global corporations buy more land in the United States, this questions become even more critical.

We have mentioned how community corporations operate at the local level to protect U.S. citizens and residents. They can operate similarly in the economies of small developing countries. The community land trust, for example, rents portions of domestic land to foreigners, giving host people the right to control what is done to their land and at the same time to share in the economic return on investments made by foreign investors. Foreign investors, in turn, are given the right to participate on the corporate board of the host country's land trust and to make their needed profits.

I offer two models that illustrate how host nations have approached the problem of the multinational firm.

*Model 1. Puerto Rican Copper Mining.* When Kennecott and Amax Corporations were exploring the advantages of copper mining in Puerto Rico, local citizens fought against them because their exploratory excavations were damaging the environment. The Council of Churches asked university

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<sup>1</sup> The tribunal was organized in 1938 to protect local dealers against unjust cancellations of contracts by middle management. This was first reported by Drucker (1946) and later by Vollmer (1960) and Scott (1965).

researchers to investigate the problem, asking: How can a multinational firm operate fairly in a host country without exploiting the environment? Council members said that any multinational firm would need to contract within the private sector through a socially-accountable company because the government represented an elite group already colluding with these foreign firms.

An alternative structure was devised in Puerto Rico in which an island-wide nonprofit corporation was established with all citizens having the opportunity, by paying \$5.00 membership, to vote for the board of directors. This public corporation is established in the private sector to negotiate a contract with a global firm to develop a copper mining system. A corporate contract would require the organization of community development corporations within each village where mining takes place. The global firm would have the right to mine the copper under their control for five years. During this time, CDCs would be organized with the joint aid of the island government and the municipalities. CDCs would gradually be given the authority to oversee the remaining development of copper in the future.

The profits from the mining operations would return to three parties: the local CDC, the island government, and the multinational company. A fair and proportionate distribution would be determined by negotiations with competing world copper companies. The distribution of profits to the local democratic structure reverses the tendency for profits to be retained by the host government which often fails to decentralize its financial benefits.

The model calls for a public review board composed of university science faculty to monitor the mining process and its impact on air, sea, earth, and rivers. This eliminates the possibility of government collusion with multinational companies to overlook local environmental damages. A judiciary board, composed of employees of the local firm and village representatives, receives complaints made by anyone who feels injured or unjustly treated. Such a system avoids the secrecy that often attends the activities of multinational companies and allows citizens to blow a whistle on any corporate action that injures people or the environment.

*Model 2. Multinational Co-operative.* Multinational co-operatives do not operate as conventional global corporations because they are organized to be profitable through a democratic rather than a command system of governance. They are proving that it is possible to be fair and just and also make money. These types of co-operative global firms have been studied in Canada and, while they differ in organization, there are similarities in the board's relationship to subsidiaries.

A number of sub-models are developing based on socio-economics, synthesizing justice with profit-making. First, the subsidiary firms in host nations may appoint representatives to the board of directors of the global firm. Second, the host firms can be employee-owned/community-owned (CDCs or CLTs) or customer-owned. They contract with the global firm for production or retail



purposes. Third, a co-operative multinational may itself be owned by its host constituencies who are employees or customers. Finally, other systems of accountability are developing whereby social audits are conducted along with financial audits.

*Flaws.* Studies of multinational cooperatives indicate that they are superior to conventional global enterprises. Nevertheless, there are problems in finding a more effective co-ordination of all stages of their organization from resource extraction to manufacturing and marketing and in hiring and training effective leadership among the different divisions of the corporation (Craig 1976).

The United Nations seeks an economic system that works for the common good through its agencies, including the Economic and Social Council, Center for the Study of Transnational Corporations, the Food and Agricultural Organization, the International Labour Organization, and other agencies that concern themselves with shaping global markets. But the U.N. is still weakly organized in the face of a growing world market system capable of becoming seriously unstable. Future problems of accountability arise, for instance, from unmonitored world stock markets, from the creation of new technologies, and from global banking systems lacking the kind of self-regulation which would force participants to operate in the common good.

#### PRIVATIZATION: CREATING SYSTEMS OF NONSTATIST ACCOUNTABILITY

Privatization refers to the removal of state agencies from immediate government control and endowing them with the freedom to operate in the private sector. Privatization, however, is a mixed blessing: it may lead to even greater levels of wealth and income inequality, increasing the ranks of the poor especially in Eastern Europe and Latin America.

Yet something different is also happening. With the privatization of government agencies in the United Kingdom, 400,000 workers bought shares in their companies on very favorable terms. During the flotation of British Telecom stock, 96 percent of the Telecom workers bought shares. Also, at the time of the sale of the National Freight Consortium, about 10,000 workers bought shares, and today more than 27,000 employees (almost the entire workforce) are stockholders and share price is 47 times greater than at issuance. By 1988 there were more shareholders than union members.

The U.S. General Accounting Office has an interest in spinning off federal agency programs to its employees. Under a 1986 program known as "Fed Co-op", federal services that could be commercialized, such as government maintenance functions, information programs, or testing laboratories, would be transferred to new employee-owned private companies which, in turn, would contract with the government to provide required services (GAO, no date).

Government agencies can be privatized so that they are accountable to their stakeholders. This happens when (1) government factories become employee-owned, (2) government utilities become customer-owned, (3) government land becomes community-owned, and (4) government agencies become public (not state-owned) in the private sector. The transfer of ownership and control of government agencies to stakeholders and broadly organized sectors of the market requires an accountability system which does not exist in conventional capitalism.

Certain social advantages logically follow. Employee self-management should reduce the need for labor departments in federal and state governments because firms become accountable to their workers. Customer-owned utilities reduce the need for agencies such as the FTC to protect consumers, since these companies are designed to be accountable to their customers. As a result of creating socially-accountable enterprises, taxes should be reduced and capital can then remain productively employed within the economy.

*Flaws.* In England, employees of British Telecom and the National Freight Consortium have voting rights *per share* and do not have systems of protection whereby workers are guaranteed voting rights *per person*. This means that personal control is determined by wealth and the shares likely will be sold eventually to the most wealthy. In Eastern Europe and Russia, the former *nomenclatura* and *aparatchiki* have the inside track in getting ownership and have purchased vouchers from workers and retired people. Workers have not been supplied the proper systems of accountability to protect the person.

But even under the best conditions in the examples given above, problems of accountability arise in larger society. For example, privatizing government factories by providing employees with full voting rights per person and with proper internal systems of accountability would still not supply accountability to communities and customers. Employee self-managed firms could compete against other firms and exploit outsiders in their own self interest.

To function within a larger system of accountability means that self-managed firms must work cooperatively with competitors to establish public standards and contract with community corporations to avoid negative impact on localities. This is why studies are needed of the whole system of accountability and the relationship between firms, including their wholesale and distributing outlets.

In sum, Adam Smith and Karl Marx had a common vision of a self-governing, civil economy which operates in the public interest. It is time for that vision to be given more serious attention. Social-accountability systems are evolving to make their vision feasible but there is a long way to go before they operate fully and reliably in the public interest. There is a major role ahead for

researchers in social economy to study this phenomenon and for the government to encourage this type of social self-regulation and social development.

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## ON THE TRANSITION FROM COMMAND ECONOMIES

... Nitsch refers to the traditional position that the [Catholic] church has no models - that is does not favor a specific kind of economic system or economics, just philosophical principles. Apparently Nitsch accepts this, but I have a problem with it. the principles *dictate* a structure or preferred model, negatively if not positively. For example, market liberalism or *laissez-faire*, which assumes automaticity, is excluded by the principles; so is centrally planned socialism - subsidiarity does not allow it. By the time logic expunges most economic systems, one is left with an economy of group decision making, a solidarist one.

William R. Waters, "A Comment on Social Economics and the New World Order: A Roman Catholic Perspective," *Forum for Social Economics*, Fall 1993, p. 34.

How can the economy be reorganized to achieve a full measure of self governance, with a diminution of state intervention on the one hand, and without unfettered markets and market liberalism's impersonal forces of supply and demand on the other? By four organizational changes: (a) social instead of (typically American) hierarchical work place management; (b) social as well as and along with financial criteria for investment; (c) markets founded both on conflict resolution and cooperation, not on competition alone, that is, social governance of markets; and (d) competitive markets organized to promote public interest, not self-interest alone - that is, a social economy.

William R. Waters, "A Solidarist Social Economy: The Bruyn Perspective," *Review of Social Economy*, Spring 1994, p. 112.

## CATHOLIC SOCIAL DOCTRINE AND THE NEW WORLD ORDER: DOES THE CHURCH HAVE MODELS? <sup>1</sup>

Thomas O. Nitsch

In the prospectus for a contribution submitted to the editor of this collection, the writer noted several "intersections and ironies" regarding "Bill Waters' and my paths ... in the ASE-related literature [of] the last thirty years," viz.: (1) my 1964 "Comment" on his 1961 article in the *Review of Social Economy*; (2) the respects paid to me in his contribution to Lutz's *Social Economics* (1990); and, (3) my recent article and his "Comment" thereon in the *Forum for Social Economics*.<sup>2</sup>

As a Marxian Catholic Social Economist, it is true that I have striven (Waters 1990, p. 104) to accommodate (if not "integrate") that corpus of thought and "doctrine" generically referred to as "Social Catholicism" with what I here designate "Classical/Social Marxism."<sup>3</sup> More particularly, this effort has been to identify the areas of agreement and oneness between Marx and the Church, in order to isolate and further probe the nature and significance of the real *differentia specifica*. This recognizes that in any such "integration" irreconcilable nonessentials are simply jettisoned.

In the course of the present writer's research and reflection in this connection over the past thirty-one years (beginning with Nitsch 1963), an issue which has come up over and over again, implicitly if not explicitly, if it is not indeed the all-embracing issue, is that of the "models" proffered, i.e. the Church's vs. or *vis-à-vis* Marx's. And, hazy, abstract, unspecific as he was and might have been over that two-score span of 1843-83 regarding future society(ies), no one can doubt -- nor did Marx ever disclaim -- that he was about formulating, predicting and prescribing the truly human social economy and truly social human economy of the future -- including, with the help of Engels' *Anti-Dühring* (1878-94), what, in phases, was to happen to property and its derivatives, the Classes and the State. We now turn to our subject, the Church's stand or claim in this matter.

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<sup>1</sup> "Catholic is used here in the *specific* sense of *Roman-Catholic*; and, some might want to specify further "Papal" to recognize other teachers/"doctors" in/of "the Church."

<sup>2</sup> One of the ironies involved here is that in his 1990 piece, Bill proceeded on the "premise that the development of social economics in the United States can be examined by investigating the research of the membership of the Association for Social Economics and its publications in the *Review of Social Economy*" (p. 91). Yet, when it came to my credit as one "who has written for years to show commonalities and differences of solidarism and Marx" (p. 104), it is only my article in the Fall 1987 issue of the *Forum for Social Economics* which is cited (p. 116). I regard that RSE "Comment" twenty-three years earlier as my first ASE essay in this on-going effort.

<sup>3</sup> "Classical Marxism" centers on Marx (1843-83), but includes Hegel (1803/4-1821) and Engels (usually with Marx, 1843-95). "Social Marxism" seeks to exclude the nonissue of Marx's "atheism"; Marx did *social* analysis (sociology and economics), *not* a theology.



## CATHOLIC SOCIAL DOCTRINE AND THE GOOD SOCIAL ECONOMY

In Volume III of his celebrated *Lehrbuch* (1926, p. 547), Heinrich Pesch, the reputed "Commentator on *Rerum Novarum* ... and source book of *Quadragesimo Anno*" and sire of the Roman-Catholic doctrine of "Solidarism" (Mulcahy 1952; 1967), avowed that "Catholicism gives to the world no economic system; it is bound to no definit(iv)e economic constitution, and is committed to no definit(iv)e economic system."<sup>1</sup> Echoing this position two-thirds of a century (including a great depression, second world war, rise and fall of the Soviet Union) later, John Paul II, in his encyclical letter commemorating 100 years of official Catholic Social Doctrine, disclaimed as follows (CA, §43):

The Church has no models to present; models that are real and truly effective can only arise within the framework of different historical situations, through the efforts of all those who responsibly confront concrete problems in all their social, economic, political and cultural aspects, as they interact with one another.

Now, the question is, do these assertions/disclaimers hold water, stand up under close scrutiny?

*Nitsch on Waters (1964/1961).* In commenting on Bill's ('Schumpeter and Catholicism') article in the September 1961 issue of the *RSE*, I criticized "Professor Waters, the Holy Fathers of the social encyclicals, ... Heinrich Pesch, et al.," for appearing to take a neutral stance between the two vying theoretical models of *laissez-faire* capitalism and central-planning/state-socialism, while actually coming down more on the side of the former. In Bill's case, this was in the course of articulating a model (Peschian "voluntary associationalism," I called it), where in his version the Schumpeterian lone-entrepreneur would be replaced by a (Peschian) 'intermediate body' performing essentially the same innovation function. Having presented my understanding of "the artist's conception proffered by [Professor Waters]," my critique on this point concluded (Nitsch 1964, p. 105):

Since I cannot conceive of capitalism without the market system as we know it, *as well as* the institution of private property, so I cannot conceive of any socio-economic system that maintains both [and given the possible modifications noted] as being less than two-thirds capitalism and more than one-third whatever else.

Accordingly, while Bill was clearly advancing a new economic model consistent with Christian/Roman-Catholic principles, I faulted "the Church" et al. for "plump[ing] for voluntary

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<sup>1</sup> "Der Katholizismus gibt der Welt kein Wirtschaftssystem, er ist an keine bestimmte Wirtschaftsverfassung gebunden und bindet an kein bestimmtes Wirtschaftssystem." The key term here is *bestimmte*, which can mean *definitive* as well as merely *definite* (special, etc.). Cp. the rendering of Mulcahy (1952, p. 6).

associationalism," and upholding the (properly policed) market mechanism and (properly qualified) private property in the means of production (land and capital), while proclaiming that it was maintaining neutrality in the matter of system preference.

Now, as the author of a mere "Comment" and Ph.D.-holder-yet-to-be at the time, the present writer might have played a bit fast-and-loose with the official position of the Church *re* (especially) the matter of the marketplace vs. the central-planning mechanism. The latter, of course, was not in effect at the time of *Rerum Novarum* (Leo XIII 1891) and, even at the time of *Quadragesimo Anno* (Pius XI 1931), was in its infancy in the Soviet Union. Only by the time of *Mater et Magistra* (John XXIII 1961) had it become thoroughly established and stood the test of some thirty-three years in the USSR. True, the excesses of unbridled competition and survival-of-the-fittest in the market place were roundly condemned, *along with* the notions of inevitable class warfare whence state ownership of the means of production and domination of economic life (cf. *M&M*, §23). But, the marketplace *per se* was never ruled out as inherently inimical to the common good; while, at the same time, central planning as such was not explicitly addressed. What we did have at that earlier (1961-63) juncture, for instance, was Mulcahy's presentation (1952, pp. 172-8) of *Pesch's* critique and denunciation of the planned economy ("die *Planwirtschaft*") and nationalization. Essentially, the former would violate what became the principle of subsidiarity (*QA:RSO*, §79-80), while the latter, the ultimate form of state economic control, was only to be used as a last resort.<sup>1</sup> The official nod, implicit though it may have been, was for the (properly regulated) market and against central planning.

The model the present writer proposed (*RSE*, 1964) as consistent with Christian principles of justice, stewardship, etc. was characterized as democratic/central-planning state socialism.

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<sup>1</sup> Mulcahy (1952, p. 176) cites the *Lehrbuch*, Volume I (1924, p. 100) and Volume IV (1922, p. 539) in the former (central planning) connection. Essentially both of *Pesch's* arguments thus involve practical, efficiency propositions, viz: (1) the inability of a central control (*Leitung*) to master the complex relations as managed by "numerous, self-interested entrepreneurs" ("zahlreiche, selbinteressierte Unternehmer"); and (2) the loss in productivity (*Leistungsfähigkeit*) resulting from the "sucking out and absorption of the independence (*Aus- und Aufsaugung der Selbständigkeit*) of the entrepreneurs [in] the 'planned economy' ('*Planwirtschaft*')." The first of these, as the present writer noted earlier (1964, pp. 108-9), is essentially a technological problem, solvable with the appropriate "digital computery." the second, surely a matter of efficiency, also contains (more directly) moral matter; viz., as noted by Professor Gaburro (*infra*), the stifling of the initiative of the workers and separation of mental and manual labor, thus striking at the question of the dignity of the human person. The issue of nationalization (government-ownership) of industry is more nuanced, but also involves the essentially pragmatic, efficiency/subsidiarity criterion of which form of ownership and control, public or private, best serves the national economic interest and the common good. Opposing across-the-board nationalization as a matter of principle, *Pesch* concludes that nationalization ("*Sozialisierung*," *Veröffentlichung*) should only be resorted to "when the vocational-group or state regulation (*berufsständische oder staatliche Regelung*) does not suffice to eliminate the private-economic abuses." Speaking for *Pesch*, Mulcahy notes that "those industries able to be directed more schematically and bureaucratically [generally, mass production industries] may be even more productive under public control than in private hands." (Mulcahy 1952, pp. 176-78; *Pesch*, I, 1924, pp. 198-99, and IV, 1922, p. 212).

*Waters on Nitsch (1973).* Four years after my finding "[Professor Waters'] synthesis of Schumpeterian socioeconomics and Catholic ethics ... ably performed" (*RSE* 1964, p. 104), he indicated he found my arguments in that "Comment" essentially well taken (valid).<sup>1</sup> Now, just recently, as noted, Bill returned that earlier "favor" by commenting on my paper in the Fall 1993 issue of the *Forum*. There he noted (p. 34), *inter alia*, that I "apparently [accept] the traditional position that the Church has no models -- that it does not favor a specific kind of system or economics, just philosophical principles." And, I must confess, up front, that I did present the Peschian/John-Pauline disclaimer in perhaps a purposely uncritical fashion, viz. to leave the door morally open when it comes to the economic system of choice. That this echoed that sigh of relief, breathed thirty years earlier (Nitsch 1963, p. 33), that in his *M&M* John XXIII had recognized the economic system as a *human* creation subject to human alteration, versus a sacrosanct (naturally/supernaturally posited) fixture, there is little doubt. Yet, this does bring out the ambiguity, at least, leading to the question which Bill Waters raises and, again, which I in effect posited in that earlier "Comment" (1964), viz.: Does the Church *not* have a model? Do Pesch and, most recently, John Paul II protest (read *disclaim*) too much? Let us re-examine the latest evidence.

*Nitsch on the Question: 1994.* In his "Objectives" statement in the program of the VII World Congress of Social Economics, Professor Giuseppe Gaburro (1994b) wrote as follows:

The fall of communism confirms century-old libertarian claims that equity and justice cannot be imposed by force, that central planning stifles workers' creative potentials. Clearly, enterprises whose inputs and outputs have been determined by a central planning procedure exclude workers and consumers from decision making, separate conceptual and manual tasks, and offer unequal consumption and work opportunities. For the Central and Eastern European countries to reject these injustices is encouraging. Markets not only allocate resources and distribute income; they also shape our culture, foster or thwart desirable forms of human development and support a well defined structure of power. Markets are as much political and cultural institutions as they are economic. For this reason the standard efficiency analysis is insufficient to tell us when and where markets should allocate goods and services and when [instead it is preferable to give way to the contribution of the other expressions of civil society or the public institutions].<sup>2</sup>

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<sup>1</sup> This was at the CEA/ASSA meetings in Chicago, December 1968.

<sup>2</sup> The "Objectives" statement in the English language program is a considerable truncation of the Italian version; and, no doubt inadvertently, omits the bracketed completion of the last sentence here.

Responding to this "editorial comment" of Professor Gaburro at the opening session of the Congress, the present writer indicated he was not ready to "toss in the sponge on central planning," doubting whether the Soviet model, e.g., really represented the democratic variety (esp. *a la* Nitsch 1964).

Professor Gaburro is a faithful and leading exponent of Catholic social doctrine in Italy. His remarks, therefore, must be taken seriously. In the (unabridged) Italian version (1994a) he readily recognizes the abuses, the permissivism, corruption and social injustices which marked the history of *laissez-faire* capitalism; continuing, "to which the communist utopia has sought to respond in an unacceptable manner." Thus, Gaburro's (as the full Italian text would further bear out) is a very qualified and nuanced, as well as clear, endorsement of the marketplace over the central planning board.

But, he is not the Pope, nor does he purport to speak for him. Where does the reigning Pontiff stand? Does *he* "have" / endorse / adhere to a model? As I have recently noted,<sup>1</sup> while John Paul II does affirm (CA, §43) that "real and truly effective models," as matters of human praxis ("social, economic, political and cultural"<sup>2</sup>), can only emerge in concrete situations; yet, in giving the nod (however qualified and nuanced in CA, *passim*), to the private-enterprise/market system over "real socialism" *he is proposing* that model in the current real-world context. Further, when, in continuation of that same "Church has no models" paragraph (CA, §43), the Pope goes on to explain in what the "indispensable and ideal orientation" proffered by "the Church [in] her social teaching" consists, one is hard put to hold that the same (the Church/J.P.II) is 'offering' any less of a system than did Adam Smith, G.W.F. Hegel, Karl Marx and Friedrich Engels (Nitsch, esp. 1994). That is, when one compares the contents -- the nature and number of elements -- in (1) Smith's positive-normative model, "civilized and commercial society" as *sublated into* "the obvious system of natural liberty" (WN, Book IV and Book V, Chapter I), (2) Hegel's "bürgerliche Gesellschaft" *cum* "politische Staat" (1821 = 1952/1967) and (3) Marx-Engels' Kapitalistische System *sublated (aufgehoben)* into Communism Alpha whence Beta (1844-94) *with* (4) the normative-systemic specifications / preferences / "profferences" of the Pope(s) *qua* the Church, one has either four models or no models.

The *specific* differences here, I would say, especially as between Smith, Marx-Engels and the Church, are as follows: (1) Smith's future society, his normative model, is a somewhat static, antisocial, inhuman omega point; (2) Marx-Engels' future society (Communism Beta) which, apart from the freely associated workers determining their own *Arbeitsproccess*/mode-of-production "in accordance with a settled plan (unter deren bewusster planmässiger Kontrolle)," is more the absence

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<sup>1</sup> Nitsch 1993, pp. 18-19; and 1994a/b, pp. 108-9ff./6-12.

<sup>2</sup> In the unabridged (Italian) version of his "Objectives," Professor Gaburro emphasizes this point by specifying that, "Markets originally [i.e., in their inception] are as much political and cultural as they are economic institutions" (1994a).

than the presence of specific forms (viz., the classes and the state as such; or, as we know them);<sup>1</sup> and, (3) the Church/Pope unambiguously coming down in favor of a rather definite (and much more fleshed-out than Marx-Engels') praxeological formulation for the present time and plannable future. Having said that, it must be recognized that, while this is a *definite* model (the first connotation of Pesch's "bestimmte") it is *not* a *definitive* one. Smith's system of the future was probably more definitive than definite, and Marx's (though certainly a happier state of affairs) was decidedly so. The Church's/Pope's at the present time and -- the present writer would peradventure -- at future junctures is and will be just the other way 'round; i.e., much more definite than definitive.

## CONCLUSION

The plan-able future includes the New World Order now emerging. In the second-to-last paragraph of his "Objectives," Professor Gaburro (1994a) posed "the fundamental question confronting both the eastern-European countries in the difficult phase of the transition to the market and the industrialized countries facing the crisis of the social state" as follows:

How to devise a new relationship between the market, civil society and the public institutions so as to pursue simultaneously the objectives of economic efficiency, democracy, social justice and human dignity.

I don't think the Pope would put it much differently, if any better. Definitely, the market (as circumscribed and supplemented), along with private property (likewise), is (still) *in*.<sup>2</sup> My model of democratic/central-planning/state socialism proffered thirty years ago seems to remain as futuristic and, in Professor Gaburro's terms, utopian now as then; though, I would still hold it perfectly in accord with the Christian *principles* of justice, stewardship, human dignity, and (obviously) democracy.

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<sup>1</sup> Marx 1954, p. 84; and 1883, p. 49. Earlier (1844 = 1975, p. 296 = 1968, p. 536), Marx wrote of the "sublation" or *Aufhebung* of, first, private property (hence the classes), whence, the state. In this regard, Engels (1878-94 = 1966, pp. 306-7 = 1948, pp. 347-48) writes of the proletariat seizing state-power, and transforming the means of production initially into state-property; whence, the state itself is not "abolished (*abgeschafft*)," but merely "withers away" ("*stirbt ab*" = literally, "dies off"). Without going into a lengthy Hegelian-Marxian linguistic analysis here, we may safely state that what Marx and Engels are saying is that, once it has done its "job" on private property and the classes, the state *as we know it* will fade away or be sublated into something qualitatively new.

<sup>2</sup> This glosses over much of the systematic detail to be found in CA, esp. re the (more specific) economic functions of the State (cf. e.g., J.P.II 1991 §34, 35, 36, 40, 43, 48); and, while there is no special appeal for a Peschian "social system of labor," the right of workers among themselves and with employers to form voluntary associations is reaffirmed, while in that "no models" paragraph (§43) a favorable nod is given in the direction of the participatory economy or workers' self-management system.

Today, as a Roman-Catholic social economist, Professor Gaburro seeks a new accommodation -- a reorientation between the market, civil society and the public sector -- in pursuit of the several objectives noted, significantly reflecting/restating the latest papal pronouncements, the Church's *magisterium*. Seventy-five years ago, Heinrich Pesch sought, in several respects, "a middle Way/Position (eine vermittelnde Stellung)" in his "solidaristic Labor-system"; i.e., his "new Sozialökonomie," alias "'Christian Solidarism'" (IV, 1924, p. 212; II, 1920, pp. 194-213ff.): (1) as between the doctrines of "Individualism" and "Socialism"; (2) in terms of supra-family/infra-national economic collectivities, the "vocational groups" or 'voluntary associations' (Mulcahy 1952, pp. 178-88; Nitsch 1964, pp. 104f.); and, (3) between private and public ownership and control of the production-enterprises. Along these very Peschian lines, Pius XI (1931) called for a reorganization of the social economy ("la restaurazione dell'ordine sociale") to negate and transcend the evils and dangers of the two opposed "isms."<sup>1</sup> Pesch's/Pius XI's dream/model did not come true. Will that New World Order called for contemporarily by Catholic Social Doctrine and its exponents?

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## ETHICAL POLICY MAKING IN THE TRANSITION ECONOMIES

Christine Rider

Since 1985 when Mikhail Gorbachev first made it possible to consider serious alternatives to the Communist-dominated, bureaucratically planned economies in Eastern Europe, countless reams of paper and gallons of ink have been expended in analysis and advice. The outpouring speeded up after 1989 when the Berlin Wall came down. But, remarkably, there has been very little attempt to visualize what these "re-made" societies could achieve in terms of creating an environment humans could take pride in. Most of the advice and recommendations seem to be assuming that these "socialist economies in transition" are in transition to something already existing, i.e., to become like western market economies. Often, the goal is merely expressed in terms of becoming so-called free market democracies. Few writers explicitly talk about achieving a civil society or a pluralist mixed economy, perhaps because as economists, they are unwilling to move too far away from the nice orderly framework of acceptable mainstream economic analysis into the untidy world of socio-economic analysis.

Perhaps considerations of this nature do not influence more work on the transition economies, because maintenance of social cohesiveness is incompatible with the movement towards a free market economy, and many economists are uncomfortable dealing with these implications. However, a carefully thought out specification of what the components of a humane, civil society are would give a sense of direction to the policy recommendations. This is an area where social economists have distinct advantages because of their ability to move beyond the self-regulating market economy paradigm. It is only when one recognizes the complex interconnections in a modern society, especially its ethical connections, that it is possible to start making meaningful policy recommendations. The problem with using the mainstream paradigm and incorporating regulatory action designed to "protect the social interest" or to remedy market failures, is that the recommendations will always be less preferred because they can be demonstrated to be less efficient<sup>1</sup>. But to wish to achieve "free markets" is as unrealistic as it is socially undesirable.

If one instead goes back to the original tradition of economics, and begins with a view of it as a moral science, seeing the economic system as part of a broader social reality, then it is possible to offer suggestions that can help inform decision making. This is particularly relevant for the Eastern European societies which have been given a rare opportunity to remake themselves. It is important, therefore, that such an opportunity not be wasted in an attempt to reach some ideologically-inspired

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<sup>1</sup> "Less efficient" in the sense that if a purely private economy is considered the most desirable, then *any* intervention is, *per se*, undesirable, mainly because resources will be diverted by government to reach its goals. Furthermore, giving a role to government may also add new wastes or political problems.

but theoretically impossible state, which may be a "state of bliss" on paper, but which will fall far short in reality.

I propose to make a start in this direction here, beginning with a brief survey of the main problems being faced by these economies in transition. Knowing the starting point is important: policy cannot be made in a vacuum or as if one were sketching on a blank piece of paper, because what is already in existence, even if it is to be removed, will exert an influence on what is added. Then I shall discuss the goal, focusing on the need to produce a civil society in which pluralistic institutions reinforce both the functioning of the economy and the desire for democracy. Many social economists have written extensively in this area, however, I shall borrow some relevant ideas from John Maynard Keynes, whose ideas on the role of the state deserve wider attention. Knowing both the starting point and the goals makes it easier to outline the policy needs, which here will be grouped into four broad, overlapping categories: institutional, macroeconomic, microeconomic and behavioral. These suggestions, to repeat, are attempts to look at social relationships as a whole. In particular, because they are suggestions for societies existing in real historic time, they will also be structured to encourage adaptability to change, and to produce, as far as possible, an environment where all have the opportunities to reach full human potential. No society stands still, so there is no point in basing policy recommendations on the conditions needed to achieve equilibrium in a static economy; in such a situation, no policy recommendations are needed, because events simply repeat themselves and no development is possible (see Dobb 1969, pp. 121-3).

## BACKGROUND TO THE TRANSITION

After the Soviet Union extended its influence over the countries of Eastern Europe in the 1940s, the Soviet system of centralized administered planning was imposed to manage these economies. This system, originally intended to speed up industrialization in the backward Soviet Union, became highly bureaucratized under Stalin, beginning in the late 1930s. When applied to the Eastern European economies, many identical problems began to crop up over time, in spite of the fact that economic conditions were not the same throughout the area. So, for example, Albania and Romania were most like the Soviet Union just after the First World War, predominantly agricultural and semi-feudal; Czechoslovakia and the former German Democratic Republic possessed modern industrial sectors; while Czechoslovakia, Hungary, Poland and the GDR had a modest heritage of at least some private entrepreneurial activity. No matter: what became important was to produce a modern industrial economy as quickly as possible in order to show the superiority, material and moral, of planned socialism over the decadent western economies.

Priority was therefore given to building up heavy industry at the expense of consumer goods, agriculture and infrastructure. Output targets and the allocation of resources were specified in material terms, not in financial ones. Planning was taut, and there was little slack available. Paired

with the socialist commitment to full employment, the absence of slack implied that these economies would find it difficult to adapt to changing circumstances. In sum, these economies were resource constrained economies, pursuing an extensive growth path.

That is, rapid industrialization and growth in general using existing techniques was possible as long as resources were available. But the limits of this approach soon emerged, and shortages and bottlenecks appeared. The emphasis on heavy industry and the lack of resources to devote to light manufacturing showed up as extensive shortages of consumer goods (see, for example, United Nations, 1989 and 1990). When capacity is short relative to demand, the usual response is to add capacity, but in these economies, the attempt to do so worsened the situation by adding to excess demand that could not be met. The results were high rates of investment which, given the resource constraints, produced bottlenecks or projects that remained half finished because inputs were unavailable or not available in sufficient quantities. The emphasis on output at all costs is also likely to have contributed to the disregard for environmental quality that is one of the more shameful legacies of this period.

If these societies had been structured differently, one would have expected an increase in innovative activity to overcome these problems, and a switch to an intensive growth path, but this did not happen. Although there were pockets of advanced technology -- space exploration and some medical research come to mind -- inflexibility generally prevailed. This was due to the lack of incentives for innovation and to the politicization of enterprise decisions. Because of the material balance approach to planning, enterprise managers had little incentive to economize on inputs for fear that output targets would be revised upwards. And because managers were often appointed and promoted as a result of their Party connections, rather than their technical or executive expertise, they did not have to demonstrate an ability to adapt to a changing *economic* environment.

By the 1960s, it became more difficult to hide the problems of falling growth rates, shortages of consumer goods (which were also often of low quality) and innovative stagnation. There were occasional efforts to reform the planning mechanism, some as early as the 1950s; but increasingly, the reformers had to acknowledge that marginal adjustments of the planning mechanism were inadequate. The problems did not seem amenable to such a partial approach, but some attempts were nevertheless made to give enterprise managers more freedom to make decisions. These attempts at decentralization were usually followed by a period of recentralization; there was little real change.

By the mid 1980s, it was clear that this type of approach was no longer effective. Possibly also because of growing political unrest, policy makers favored a complete change of direction. It is as if having decided that the problems were intrinsic to social ownership of productive resources and central planning, the only option was to adopt the diametrically opposite approach. Thus the

preferred approach has been to privatize state-owned property, liberalize prices and introduce markets. In the first few years, this three-pronged approach was to be adopted as quickly as possible (Lipton and Sachs, 1990). The idea behind this so-called shock therapy was that if the state were removed from interfering in the economy, the inherent abilities of the population would be unleashed and all the virtues of a private enterprise economy would rapidly ripple throughout the affected societies.

So state subsidies were removed; enterprises set free to make their own decisions in response to market signals; prices were freed from planners' control; enterprises would be permitted to make, and keep, their own profits if they guessed right, and go bankrupt if they didn't; they could hire and fire workers at will -- with the emphasis being mainly on firing, in the interests of corporate efficiency and cost cutting; and the process of privatization was begun. The groundwork for the adoption of these restructuring policies was laid with a period of so-called stabilization. Stabilization was intended to equate aggregate demand to aggregate supply, mainly by severely limiting central government's ability to keep inefficient enterprises afloat. However, another way in which demand was reduced occurred as a result of the rapid inflation that followed price liberalization; this inflation effectively wiped out the value of any monetary assets held by the population in some of these societies, Poland and Russia most notably, dramatically destroying purchasing power.

Unfortunately, the result was near collapse. Industrial production declined, unemployment soared, inflation rose, many of the features of the socialist state that had previously provided a security cushion disappeared. While many luxury imports -- such as western cars or designer clothing -- became available, this was not much comfort to those on fixed incomes who had lost access to subsidized food, housing or health care, or to those who lost their jobs and were forced to sell what few possessions they had to buy food. These stabilization policies, when added to the inherited problems, undoubtedly helped produce such undesirable results that contributed to the recent appeal of reactionary parties in Russia, Poland, Hungary and elsewhere.

The inherited problems are hardly amenable to a "free market" *laissez-faire* solution, which in fact would worsen them and make the economic situation even more difficult to correct. Four related problems in particular need positive action. First, the planners' preference for building up heavy industry left these economies severely unbalanced. Light manufacturing, agriculture and infrastructural development were underdeveloped. Although many newly-created small scale, private enterprises have recently been started, especially in the provision of services and retail stores, it is difficult to see how a *laissez-faire* approach can re-balance the economy. How can new enterprise be expected to jump in and see profit potential in the areas of the economy, industrial areas, suffering the severest declines? One would expect that some significant encouragement and direction would be more appropriate; but the issues associated with external economies and

economies of scale in general have long been recognized only by development economists. In addition, attempts to turn over state-owned assets to private owners has run into problems in the attempt to sell *large* units. Ignoring for the moment the problems connected with valuing assets and the actual procedure to be used, these units are not attractive to potential owners without state subsidies -- which of course defeats the point of the exercise.

A second problem relates to the politicization of the economy, and the privileged position of the *nomenklatura*. These individuals achieved their privileged position not necessarily as a result of technical or executive expertise, but because of their Party connections. The point of restructuring is to remove elements holding back change, which again requires an active, not a passive, approach. If positive, future-oriented action is not taken -- as, for example, in carefully establishing the framework that must be in place before privatization can occur -- then some opportunistic individuals can simply take advantage of an unclear situation, and take over ownership of enterprises. This has in fact happened throughout the region. The problem then is that, after having enriched themselves under the old regime, they are now able to repeat the process in the new, while access to opportunity remains blocked for most of the population.

Both the problems of imbalance and of entrenched interest groups are related to the problem of monopoly. Monopolized industrial structures are the outcome of the planners' desire to capture economies of scale and their preference for dealing with a small number of enterprises. The result was vertically integrated units, which were often the sole suppliers of particular commodities in the smaller economies. Unfortunately, if they did capture economies of scale, it is now difficult to break them up into smaller components. And without a deliberate anti-monopoly policy in place, privatizing them as-is (assuming they are viable operations) simply substitutes a private monopoly for a publicly-owned one with all the potential for abuse that entails.

Finally, the fourth problem concerns the lack of innovation in these economies, as shown by their inflexibility and inability to adapt to changing circumstances. This feature is partly the result of practical adaptation to the system of planning. Output targets were set in physical terms and inputs were also allocated to enterprises in physical terms. Planners originally set output prices so as to achieve approximate balance at the macro level, but also to generate revenues for government purposes. That is, the proceeds of the turnover tax, which was simply the difference between (accounting) costs of production and selling price, were used to finance the provision of various state-provided services and to subsidize inefficient enterprises whose costs could not be covered. The essentially arbitrary nature of the turnover tax, and the ability of the center to determine prices, contributed to the lack of incentives to innovate. Any improvement in operations would only be captured by the center. In such an environment, it is hardly surprising that managers focused more on developing close links with planners and politicians; this would pay off for them in the long run much better than attention to technological progress.

Nor is it surprising that the first few steps of restructuring, influenced by the western mainstream strand of economic thinking, had so many negative outcomes. It is possible to make a case for the three-pronged approach of price liberalization, marketization and privatization, but only in an economy where all the necessary institutions are already in place. It cannot be made if neither these institutions exist nor the "general environment" accepts them. Some of the absences are being taken care of -- the steady flow of western advisers to Eastern Europe helping set up securities exchanges or commercial banking systems or advising on change in constitutional law, for example, is considerable. However, even establishing these misses the point that it took the functioning western mixed market economies generations to mature to the point they have today. It is unrealistic to expect the Eastern European economies to reach the same levels of performance in a matter of years. Also unfortunately, the political changes and the general desire for democratic openness have raised unrealistic expectations in the population -- fed by the reformers -- that prosperity would be just around the corner if only the "free market" reforms were given a chance. The failure of most to share in the limited successes so far could lead to a more generalized lack of faith in the reformers. Signs are already emerging that this is happening. It will continue to be encouraged by the failure of the implicit belief that "the market" will just fall into place. That the (correct) actions of all involved make market societies work has not yet been a thoroughly absorbed lesson. (For some readings on the transition, critical and otherwise, see, for example, Clague and Rausser 1992; Keren and Ofer 1992; and Knell and Rider 1992.)

### KEYNES' THEORY OF THE STATE

A new goal and a new direction should be predicated on the realization that a just society cannot be based on the assumption that individuals will behave morally only if it pays, the assumption of restructuring based on the neoclassical paradigm. The goal of introducing a market economy is bound to fail, even if all the necessary institutions and new behavior patterns necessary to make the price system work are in place, because this model assumes independent rational decision making by atomistic individuals, hardly an appropriate description of modern societies. Even if a sop is thrown in the direction of reality, and efforts made to deal with the consequences of market failure or with those decisions that are inherently collective in nature, the outcome will be less than ideal if "ideal" is defined only in terms of maximizing output or minimizing costs.

The alternative social economics view looks at society as a whole, and, an important consideration for the East European countries, includes political-democratic considerations with a view towards nurturing positive freedom. Economically, this means moving away from a view of a self regulating economy where, magically, private and social interests coincide, so the role of government can be minimized and non-economic elements largely ignored. In its place, the Aristotelian tradition of



seeing an economic system as the totality by which material needs are met is suggested. This puts a focus on material need, permitting the analysis of various institutional and non-economic factors, not as second best or inferior elements, but as an integral part of the effort to maximize well being. If instead, the necessary constitutional, infrastructural and institutional arrangements that make western societies work are taken for granted, any set of recommendations designed to permit free price setting by independent private enterprises motivated by self interest will only produce more problems. And by also not developing those institutions with the ability to control individual actions, it becomes more difficult to remedy or correct the problems. This seems to be the case in Eastern Europe. While some outcomes have improved, the legal and constitutional gaps have permitted the appearance of an unbalanced economy; crime, and other examples of social dysfunction, have risen; the standard of living of large segments of the population has fallen, although a small number have managed to take advantage of market opportunities to enrich themselves. Russia, which seems to be the worst off in this respect, even has the dubious distinction of being the first industrial country to experience a rise in the death rate and a fall in population.

Clearly this, and similar outcomes, were hardly intended by the reformers. Their mistake was to focus on the anti-government bias of western neoclassical economists, combine it with many of the government-related problems of the planned economies, and conclude that an important component of the entire restructuring process is to minimize the government's role. By doing this, however, one is also removing the major institution *potentially* capable of remedying the problems and failures of a market economy, along with moral prohibitions and social bonds. "The more we fail to recognize their roles and use the neoclassical as a guide for theory and policy, the more the market economy is undermined. Markets depend on normative means and internalized values without which the transactions costs of maintaining the markets would be simply prohibitive; without them the system is pushed in an amoral, anarchic direction" (Waters 1990, p. 65).

Obviously, the goal of a civil society which effectively and equitably meets the needs of its citizens, provides opportunities to all, prevents the persistence of economic power, and opens up democratic possibilities is not something that can be legislated into existence overnight. There are many contributing elements necessary to accomplish this goal, but it may be useful to focus on one, because it is one thoroughly rejected by the reformers and their advisers: the role of a (re-made) state. This is no surprise to social economists, who are well aware of the importance of various social institutions in administering an economic system which does not, and cannot, rule itself.

Keynes' theory of the state is a particularly appropriate starting point for a consideration of ethical policy making in the socialist economies in transition, although it must be remembered that it is by no means thoroughly worked out. He insists that the philosophical premises of theory are important (Waters, 1993). Thus the underlying philosophy of classical economics, on which market liberalism is based, is that natural laws predominate; an idea that produces a view of a market economy that is

misleading when used as a basis for policy making today. Keynes' particular concern, of course, was with the 1930s, when the failure of the capitalist market system was threatening the survival of democratic traditions. The parallels with the problems facing Eastern Europe now are very similar to those facing Western Europe and the United States in the 1930s. What provided the remedy then was a Keynesian solution, although the remedy was not applied as a result of a deliberate attempt to demonstrate the theory. But if we can learn from this, it seems suitable to apply these lessons.

As Jensen points out, Keynes defined the political problem as the need to combine economic efficiency, social justice and individual liberty. This view of liberty is not the *laissez-faire* of the classicals, but a liberalism aimed at building a true social republic (Jensen 1991, p. 298). Its aim is to control and direct economic forces in the interest of social justice and social stability; possibly an amalgam of capitalism and socialism (Jensen 1991, p. 299). Further, Keynes does not think there is an antithesis between socialism and individualism: "... liberal socialism, by which I mean a system where we can act as an organized community for common purposes and to promote social and economic justice, whilst respecting and protecting the individual -- his freedom of choice, his faith, his mind and its expression, his enterprise and his property." (Keynes 1982, p. 500).

This is clearly in the English liberal tradition which does not take an either-or attitude towards the goodness or badness of the state, but rather a more pragmatic approach. That is, what can and should the State do? What can and ought to be left to individuals and other groupings? In other words, the focus must be on what needs to be done to secure the well being of the community, and who or what can best do it. While Keynes later became less optimistic about the power of human rationality, he still believed that the state can be a positive force for reform, an idea no longer in vogue.

What is also interesting about these ideas, which are not specified in great detail, is the idea that other non-governmental institutions such as universities, banks or various voluntary associations, for example, also have a role to play, a role also omitted in the restructuring proposals. Their function is compatible with a progressive view of human progress which contrasts with the "individual versus the state" concept implicit in neoclassical thinking. Keynes even thinks that the trend of corporations to increase in size can be co-opted for the general good. That is, as they grow larger, they are no longer so devoted to single-minded profit maximization; other goals, which may be compatible with attending to social needs, such as community activities or simply being good corporate citizens, could become more important. In other words, large corporations do not wish to attract unfavorable attention to themselves, so may well behave in ways that are appealing to society but that do not add to profits, and that have no place in the mainstream description of them as rational economic agents (Keynes 1972, p. 289).

Such outcomes are not automatic. The key to taking advantage of these developments is coordination and direction. That is, to prevent anarchy or institutions working at cross purposes, it is essential that the state become involved in planning, the general organization of resources (Jensen, 1991, p. 305). The point of planning was to bring together all the component organizations of a society to improve the potential for wealth creation. As Keynes put it, "For my part, I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life" (Keynes 1972, p. 294).

All this seems remarkably pertinent to the problem at hand: how to remake the socialist economies in transition without including capitalism's negative aspects. It gives a role to the state, but it is a re-made state with different functions. These functions are predominantly oversight and coordination functions, making sure that the different component institutions all work towards a common end. They are not ownership functions or micromanagement ones. There are also specifically economic functions that only the state can perform, such as a role in financing and allocating investment in such a way as to avoid the old problems of wealth inequity and industrial slumps, while encouraging innovation and entrepreneurship. In fact, a market economy cannot operate without such a state, which defines the conditions and the "rules of the game", influencing the balance of power of the groups involved in market behavior (Marshall and Arestis 1991). It is a role for a strong state, and possibly also a thriving public sector, that is perfectly compatible with a flourishing private sector, and would also avoid the problems that have become inherent to the privatization-at-any-cost strategy.

## NEW POLICY DIRECTIONS

Once the legitimacy of this role of the state is recognized, then it becomes possible to sketch the outlines of comprehensive policy recommendations. Unlike most of those suggested for Eastern Europe, which concentrate more on the need to improve efficiency at the enterprise level and on limiting government's involvement, these will incorporate four related areas: macroeconomic, microeconomic, institutional and behavioral. The goal is to improve the functioning of the entire society, so it is important to recognize the interrelationships between the economy and the polity. Especially important for these economies is to develop pluralist democratic traditions, which need to be constantly reaffirmed if they are to protect against any resurgence of totalitarianism or repression. This means that people must know that they can play a genuine role; the effectiveness of citizen power over government is more than just holding elections. Much more relevant is to develop an environment that generates confidence and credibility in processes and outcomes. It will not result in consensus, but rather provides the means by which disagreeing parties can agree to disagree, peaceably.

At the microeconomic level, enterprise functioning needs to be improved, again within the parameters set by society. Currently, the Eastern European reformers think this is best achieved by transferring all productive assets to private owners and leaving them free to set their own prices. While the aim is to encourage greater attention to consumer needs, in the actual conditions, the results have been less than desirable. Enough has been said elsewhere about the problems with these reforms (see, for example, Baumol 1993; Keren and Ofer 1992; Knell and Rider 1992; Rider 1994); in short, there is no reason to expect success *without the supportive institutions necessary to make them work in a socially desirable way*. That is, any enterprise seeing itself as an individual unit could immediately improve efficiency by laying off workers, cutting costs, raising prices (especially possible if it has any market power) -- the traditional western approach. But if the result simply increases unemployment, the burden of higher enterprise profitability is borne by society as a whole, and there is no guarantee that democratic considerations are taken into account by enterprise decision makers.

In fact, the idea of enterprise efficiency needs to be rethought. There are many ways in which economic democracy and security can be incorporated into management's decisions, and a conscious effort can be made to identify the changes which simultaneously meet both corporate and social goals. For example, how can efficiency be improved with greater worker participation in decision making? Will involving workers in managerial decision making, which implies sharing in both rewards and penalties, improve accountability and thus the quality of decisions? How can the interests of the community (or, as some prefer to put it, the interests of stakeholders) be attended to?

The macro-level of reform has been relatively ignored because of the implicit assumption that everything will fall into place if government controls are removed, and because mainstream models implicitly assume full employment conditions. Clearly both are fallacious assumptions. There are two important considerations to be made here. First, *if* the enterprises are successful in their attempts to downsize and improve efficiency, where will the demand come from to purchase the expanded, and presumably improved, output? It is unreasonable to expect that the newly-unemployed will suddenly find entrepreneurial skills they never had before, or that new entrants will start up new operations needing workers. So one of the roles of the State is to provide the social security cushion, encourage innovation and entrepreneurship, increase information available, finance public works (a good start would be in urgently needed infrastructural development), and, in general, play a supportive role in assisting the transition to a high employment/high wage economy. This is an important undertaking which is unlikely to occur quickly; fast results should not be expected, therefore there must be an acceptance of continuing outlays. The second related consideration is more directly Keynesian in nature: how to maintain a high level of employment and encourage growth? Here, the importance of a more equitable distribution of income must be recognized because it will keep the collective propensity to consume high. Various other policies such as a

progressive tax and transfer policy and interest rate policies will also help, but even a high propensity to consume will not be enough to generate full employment on a permanent basis. So what can be done to influence investment and accumulation? Several Keynesian possibilities emerge. Any policy that encourages capital accumulation so that capital is no longer scarce and the rate of interest falls, will encourage more investment spending, keeping in mind the importance of the right kind of investment spending, and presumably incorporating the state's role in overall guidance in resource allocation. This policy also overlaps with an incomes policy and one encouraging capital mobilization and innovation. Any activity that encourages creativity and opens up opportunities is also relevant here, which connects with the two remaining areas of concern.

Institutional development is usually considered to include the design of an underlying constitution which establishes guidelines and a legal and regulatory infrastructure necessary for a well functioning market economy (see Rausser 1992, for example). So far, those institutions necessary for the addition of a monetary sector -- such as developing a capital market, central banking, commercial banking, commercial and contract law -- are being put into place. One should also include here an antimonopoly policy, necessary to control the concentration of economic power and the takeover of government by entrenched economic interest groups. Other types of institutional development that should be encouraged include various economic and noneconomic groupings or voluntary associations that mediate between citizen and state or represent various affinity groups. The obvious examples are educational institutions, professional associations or non-profit institutions. The point is that they contribute to the development of a pluralist society, hence are important in preventing the usurpation of power by one particular group. It is likely that many such groups already exist in Eastern Europe. If so, encouraging these new functions can revitalize them while at the same time, recognizing their importance in providing continuity with the past.

Finally, western mixed economies work the way they do because people know how to behave and what types of reaction to expect from different types of behavior. Appropriate behavior is not inherent, it is learned, and it can only be learned in an accommodating environment. So it is necessary that all the components and aspects mentioned above encourage the type of behavior considered appropriate to the type of society desired. If the appropriate behavior patterns are based on the "right" of individuals to pursue their own self interest, then the resulting society will reflect that. If on the other hand, cooperation, generosity, concern, fulfillment, opportunity, creativity, and security, for example, are socially desired values, then the outcome is likely to be a society where morality has been put back into economics (Stickers 1993). A survey of these policies reveals the important role of government, not the heavy hand of a "big brother" government, but one appropriate for restructuring and encouragement in a society where different functions are performed by the agent most appropriate for performing them. If this makes the task of the economist, policy maker or citizen more difficult, it should be remembered that this is the trade-off for an improved society and greater freedom.

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## **TELKOM TELETRA: A POLISH MANUFACTURER IN TRANSITION FROM STATE ENTERPRISE TO PRIVATE COMPANY**

Edward J. O'Boyle

Telkom Teletra is a state-owned and operated manufacturer of telecommunications equipment with offices and manufacturing facilities in the City of Poznan, Poland. Poznan has a population of 586,500 (Background Notes 1991, p. 1), making it equivalent in population to such U.S. cities as Boston and Washington, D.C. (*Statistical Abstract* 1993, pp. 42-4). Poznan is 306 kilometers west of Warsaw and 276 kilometers east of Berlin in the western part of Poland, which prior to World War II, was part of Germany.

The German influence in Poznan is clear even to a first-time visitor and the people of this part of Poland are quite explicit in regarding themselves as more highly skilled and industrious than Polish workers in other parts of the country. In Poznan, one hears that Poland is divided into an eastern part and a western part along an imaginary north-south line that lies about midway between Poznan and Warsaw. In Poznan, the disregard appears to be greatest for Poles living in the largely rural, agricultural southeastern part of the country.

If one accepts the word of Poles in Poznan as more than the usual regional braggadocio, Telkom Teletra may be especially instructive because it approximates a limiting case. That is, if workers in Poznan truly are superior to other Polish workers any problems that are traceable to Telkom Teletra's workforce likely are no better or perhaps even worse elsewhere in Poland.<sup>1</sup>

This author visited Telkom Teletra on three occasions in 1991: April 17, April 22, and May 7. On all three occasions, a person employed by the company served as interpreter. The initial visit was arranged by the president of Poznan School of Management who knew the senior management and who participated in that visit, assisting with the interpretation. The second and third visits were arranged directly by this author. An academic specialist grant from the United States Information Agency made his 1991 trip to Poland possible.

The president of Poznan School of Management made the arrangements for a fourth visit on October 25, 1993. The same person who interpreted during the first three visits served as interpreter for the fourth as well. Taking into account all four visits, most of the author's time was taken up in direct discussions with the company's senior management.

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<sup>1</sup> See Jebb (1993, pp. 23-27) for a report on the privatization of another major state enterprise in the Poznan area, the furniture manufacturer Swarzedzkie Fabryki Mebli SA, which was accomplished in May 1991 through a public offering.

The chief purpose of the visits was to observe first hand a major state enterprise in transition from a command economy to a market economy. In this regard, the timing of the fourth visit is especially significant: 80 percent of the shares of Telkom Teletra were bought by the French firm Alcatel in March 1993.

### KNOWN BIAS: TYPES AND SOURCES

The findings reported herein are influenced in at least three ways. First, much of the discussion was carried on through an interpreter and no doubt some questions and replies were not accurately communicated. Second, although company officials answered every question put by the author, those officials determined which parts of the plant the author was allowed to see. Third, the author brings certain values to the task of interpreting the information gleaned from the visits; another observer with different values might interpret the same information much differently.

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Under the circumstances, little can be done about the bias arising from the way in which company officials controlled what the author was allowed to observe. Ultimately, the honesty of company officials is the central factor determining distortion from this source. Even so, the author's experience in making more than 40 visits to Louisiana firms to review their quality- and productivity-improvement efforts or their innovational activities serves to reduce distortion from this source. Virtually nothing could be done about the bias originating in the use of an interpreter.

As for the third source of bias -- the author's own values brought to bear in interpreting what he has seen and heard -- it is advisable to state as clearly as possible at the beginning his own values so that the reader can decide how a different set of values might lead to different conclusions.

First, there are three principles that organize the workplace: competition, intervention, and cooperation. Competition and cooperation are actuating; intervention (on the part of the government) is limiting. As with Marshall (1948, p. 5), the author accords a much larger role to cooperation than one finds among mainstream economists. Cooperation, which may degenerate into collusion but is not invariably collusive, takes place at the intra-firm, inter-firm, and supra-firm levels. Authentic cooperation is positive-sum activity. Collusion, on the other hand, is zero-sum or negative-sum activity.

Second, the author is no advocate of either individualism or collectivism. Rather, his personal philosophy runs toward personalism wherein the principal purpose of any economic system, whether market or command, including the system's various institutions and firms is to provide for human material need by means of what it produces.

Third, efficiency is a means rather than an end in itself. It is one means by which a company survives in a market economy and through which it is able to better address the human material needs of its customers, employees, suppliers, and owners.

Fourth, profits are not an end but a necessary condition for the survival of the firm. By helping to meet the human material needs of the owners, profits help assure that the company will continue operations. The linkage between profits and productivity is so clear there is no reason to dwell on it further.

Finally, over the long term the firm must innovate and remake itself organizationally in order to survive in a market economy. Innovation is understood to include new goods and services, new production processes, new materials, new markets, and new organizational arrangements in the workplace and the marketplace.

### TELKOM TELETRA BEFORE PRIVATIZATION

*First Visit.* At the first visit, Telkom Teletra was represented by the plant director who was the plant's first deputy director and has been the director since 1972. Several senior managers also participated in the first visit which addressed three main subjects: history of the industry and the firm, current operations, and privatization. The visit took place entirely in the director's office.

After World War II, there was no telecommunications industry in Poland. The industry was built by two companies, one of which was located in Warsaw. Telkom Teletra was established in 1950 and subsequently has undergone many re-organizations. The company began with repair work on telecommunications equipment and then branched into production of telecommunications switching equipment which was quite primitive. At the beginning, the German firm Siemens provided some assistance. Two central problems plagued the industry in Poland: lack of a skilled workforce and inability to produce sophisticated equipment.

By the early 1960s, there were four large firms and eight small firms operating in the Polish telecommunications industry, employing approximately 15,000 workers. It was then that the industry began to specialize.

Since 1972 Telkom Teletra has been producing a line of electronic automatic telephone exchanges under a licensing agreement with the French firm Alcatel which, after ITT, is the second largest producer of telecommunications equipment in Europe. The licensing agreement covers both process and product technology. In addition, Telkom Teletra produces data transmission systems (modems) and a variety of other electronic equipment for radio and telegraphic communications, including products for use in areas other than telecommunications. The company's two main products are its

electronic automatic telephone exchanges and its pulse-code modulation (PCM) system equipment. Over the years Telkom Teletra had developed an export market for its products in Czechoslovakia, the former Soviet Union, Germany, Syria, and Greece.

The director stated that in 1972 several Polish firms were negotiating with Alcatel but only Telkom Teletra was interested in the French company's electronic technology and Telkom Teletra was the only one to continue negotiations. Telkom Teletra's bid was accepted by Alcatel for three reasons: (1) the size of the firm; (2) the firm's workforce; and (3) the need in Poland to convert from mechanical/manual switching equipment to electronic/semi-automatic equipment. The director claimed that in 1972 Telkom Teletra was regarded as the best firm in the Polish industry. He said that, even though at that time Alcatel's telecommunications was leading edge, the licensing agreement between the two firms covered state-of-the-art technology.

Under the agreement, Telkom Teletra began with a three-month training program in French for some of its workers. Afterwards, these workers were detailed to Alcatel's facility in France for four months of technical training. At the completion of that training, the Telkom Teletra workers returned to Poznan along with some Alcatel employees. The French-speaking Telkom Teletra workers served as interpreters for the workers from Alcatel.

Assembly work began in Poznan in 1973, with 100 percent of the components manufactured outside Poland. According to the director, the Telkom Teletra workforce quickly mastered the new technology, making the company a pioneer in Eastern Europe. However, software was a problem at the beginning and as a consequence Polish telephone customers were improperly billed due to switching mistakes made with the newly installed equipment. The problem was finally resolved in 1974-75.

At the time of visit, the Telkom Teletra plant in Poznan was capable of producing ten units per year of a system officially designated the E-10 system which was installed first by Alcatel in 1972 (Evolution in Digital Switching Systems, 1989, p. 5). About 75 percent of the components were manufactured by Polish firms. The plant employed approximately 1,600 workers of whom roughly one-third were "touch" labor. In 1972, employment stood at 2,000. Company officials stated that 1,000 workers would remain on the plant payroll by 1992. Each E-10 unit was capable of servicing 10,000 telephone subscribers. The unit was built from printed circuit boards with many integrated circuits which were assembled into a rack with five shelves. The racks were linked together by cables in the narrow channels at the top. A 3,000 subscriber exchange required 18 to 20 racks (Electronic Time-Division Switching System, no date). An entire unit cost about \$6 million. The E-10 system was touted to subscribers for:

excellent reproduction of the spoken word -- a result of the digital coding -- with no attenuation or parasite noise, high-speed switching: the waiting time for every tone is less than one-half second, various optional special services are made available to subscribers: a choice between a telephone set with a dial or a keyset; abridged dialing; automatic transfer of incoming calls; conference calls; registered calls; charge indication; clock-alarm service, etc., and compatibility with any kind of data transmission system. (Electronic Time-Division Switching System, no date).

Company officials claimed that in Eastern Europe the E-10 system in 1991 was the most technologically sophisticated. Telkom Teletra, they stated, had been the driving force behind change in the Polish telecommunications industry. With regard to electronic automatic telephone exchanges, Telkom Teletra's only customer was the state-owned and operated telephone system -- Polish Telephone and Telegraph (PTT). Company administrators admitted that since 1989 there had been a dramatic change in competition from other sophisticated producers of telecommunications equipment in Poland.

One way Telkom Teletra measured productivity was in terms of the number of labor hours to produce the switching equipment for one subscriber. Over the years, the company stated that labor hours per subscriber dropped from 7.5 to 5.0 -- a savings of 250,000 hours per year. From the perspective of hours per unit produced, the savings amounted to approximately 33 percent: from 75,000 labor hours per unit to 50,000 labor hours. The management did not state the time period over which this improvement had taken place and, for that reason, it is not possible to estimate the annual savings in labor hours per unit produced.

The company received some research and development funds from the state for new technologies and for improvements in productivity. Telkom Teletra officials stated that the company had entered cooperative agreements with Polish universities for technical research but not for marketing research. They stated that in Poland in 1991 eight percent of households had telephone service, whereas 50 percent of French households had telephones. In the United States, they said, telephones were available in 80 percent of all households. Their estimate of the market in Poland was one million new lines per year for the next five years. The shortage of capital funds for such an upgrading of telephone service, they asserted, was a serious barrier.

Officials at Telkom Teletra expressed anxiety about the company's future under privatization in Poland. They stated that Alcatel, Siemens, ITT, and AT&T had been making overtures to PTT and that each one was able to offer government (French, German, or U.S.) credits. In addition, they said that Samsung was trying to penetrate the Polish market with its own credits and that there were

several Italian firms that had expressed interest.<sup>1</sup> Their anxiety derived from the inability of Telkom Teletra to extend credits. In this regard, the company already had an agreement with Alcatel to assist with the installation work should the French company be selected by PTT.

With regard to privatization, officials at Telkom Teletra affirmed a "positive" attitude but admitted that the new competition and the transition to a market economy had made them insecure. No rapid changes in the size of the company workforce was planned, they said, in order to avoid worker retaliation in the form of a strike. Further, they said that they had no orders for 1992. By their own admission, the company's PCM was five years behind the leading-edge competition because it does not incorporate fiber optics. The administrators said that there would be no market for this product in two to three years and that it was impossible for the company to be "brought up to speed" without additional resources.

Company officials, including the person charged with drawing up the company's privatization plan for the Ministry of Ownership Changes<sup>2</sup>, were vague as to the future of Telkom Teletra in a market economy. They expected that the new government eventually would sell Telkom Teletra to private individuals and that, unless it were purchased by Alcatel, they would be replaced under a new management regime.

They perceived one other major option: to break up the company into its various departments, privatizing each one separately through some employee buyout scheme, and reconstructing Telkom Teletra as a holding company. They admitted that their preference was to have Telkom Teletra acquired by Alcatel.

*Second Visit.* The second visit began at mid-morning in the director's office, opening with a discussion of privatization and continuing for about two hours. Prior to privatization, Telkom Teletra was a state enterprise in which 100 percent of the shares were state-owned. Company privatization plans were being drawn up internally for submittal to the Ministry of Ownership Changes which had been established in 1990. These plans roughed out three principal strategies for Telkom Teletra: (1) a breaking up and spinning off of the various departments of the company into small-and medium-size employee-owned businesses in which Telkom Teletra would be reconstructed as a holding company; (2) a sale to another firm such as Alcatel; and (3) complete liquidation. By their own admission, a sale to Alcatel was the senior managers' first preference because they thought they would be able to keep their jobs.

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<sup>1</sup> On a much broader front, the Japanese have been actively courting Polish business persons and intellectuals since at least early 1991.

<sup>2</sup> Also known as the Ministry of Privatization.

The Ministry of Ownership Changes requires the sale of a state enterprise two years after the company's privatization plan has been submitted to the Ministry (cf. Article 19.1 of the Act on the Privatization of State-Owned Enterprises, 1993). At the time of the visit, Telkom Teletra had not been requested to submit such a plan. The week prior to that visit, a stock exchange was opened in Warsaw and five state companies were listed for sale. The company's senior management agreed, with a nervous smile, that with respect to state enterprises it was a buyer's market.

Company officials were not certain as to whether a state enterprise could be bought by its senior managers. The new law, they said, stated that employees may own up to 20 percent of the shares of stock held by the State Treasury (cf. Article 24.1 of the Act on Privatization of State-Owned Enterprises, 1993). Even so, they stated, it is theoretically possible for workers to hold all of the shares by buying through the secondary market whatever they do not own outright.

Foreign capital may purchase up to 10 percent of the shares. However, official approval from the President of the Agency of Foreign Investment is required for such investors to exceed the 10-percent limit on the original sale (cf. Article 19.2 of the Act on Privatization of State-Owned Enterprises, 1993). Some Poles are concerned that foreign investors will buy up Polish assets. There are no capital funds available through the Ministry of Ownership Changes to help the management, the workers, or other interested Polish parties buy state enterprises such as Telkom Teletra.

The Ministry of Ownership Changes was established by the Polish Parliament and structurally is similar to other ministries. Most of the persons appointed to serve in the Ministry were quite new to government and many were from Gdansk, suggesting (understandable) ties to President Lech Walesa through Solidarity. The Parliament, according to officials at Telkom Teletra, spelled out how privatization is to proceed only in general terms. One such regulation is that there are to be no sudden changes. Through the prime minister's office, the National Bank of Poland, whose management was chosen by the Parliament, is involved in advising the Ministry of Ownership Changes as to how to undertake privatization (cf. Article 2.2 of The Office of the Minister of Ownership Changes Act, 1993).

The conversation then turned to privatization at Telkom Teletra in the context of the various products that are manufactured there, including telegraphy, small-capacity exchanges, the E-10 system, and PCM equipment. Company officials said that there was some new product development occurring in the area of small-capacity (maximum of 800 lines) exchanges. PTT was seen as the main customer, with some sales possible outside Poland. In addition, some new devices were under development in the area of PCM system equipment that would incorporate fiber optics.



Prior to privatization, some of the product development work at Telkom Teletra originated there and some came from the Ministry of Telegraphy. The company's design staff was fixed in number and was organizationally independent of production. In the past, recognition for work well done came in the form of state awards. No one at Telkom Teletra was able to say with any assurance what would happen to this staff under privatization. The senior management admitted that some of them already had working relationships with various universities.

A short tour of the plant followed during which this author was allowed to see directly the various steps in the process of producing the E-10 system, including the areas in which inspection of the printed circuit boards and final assembly of the rack take place. The tour was conducted by the head of the engineering department.

In the inspection stage, this author inquired as to the defect rate for the printed circuit board. The worker replied that he did not know and after a second inquiry stated that he did not keep records on the number, type, or origin of defects. In the final assembly area, the visitor asked which assembler was the most productive. The head of engineering pointed to a man whose production rate was twice the typical assembler's. Another inquiry revealed that he was paid the same wages as the others doing the same work in that area.

The plant tour was instructive as regards other aspects of operations at Telkom Teletra. Housekeeping, for instance, was sloppy. Materials and work in process were stacked in hallways and in various work areas. Lighting in some areas was quite dim especially in hallways and staircases. The plant layout was such that small groups of employees work in confined space behind doors and walls where they could not be readily observed. No one smiled.

At virtually every turn, pornographic pictures covered the walls, even in work areas where most of the employees were women. A huge pornographic calendar was displayed in the plant director's office; a similar one was hanging in his secretary's office. Students at the Poznan School of Management stated that under the communist regime such displays were not permitted and that it was simply an expression of the worker's new-found freedom.

Based on visits to private enterprises in Louisiana, this author regards what he saw during the first plant tour as symptomatic of both a lack of discipline on the part of the workforce and a lack of respect for the enterprise's senior management.

*Third Visit.* The third visit to Telkom Teletra began at mid-morning and was by far the briefest of the three in 1991. Unlike the other two, the third visit did not involve the plant director and other senior line managers. Instead, this author had an opportunity to meet with the company's senior staff economist and several members of his staff.

This discussion centered on workplace organization and marketplace competition. It was pointed out that the company had much more experience with the former than the latter. As to the workplace, the visitor underscored the importance of motivating, recognizing, and rewarding the workers for doing their jobs right the first time, for improving the work process, and for participating actively in new product development. As to the marketplace, the visitor called attention to the importance of retaining Telkom Teletra's customary markets and discovering which new products would allow the company to penetrate new markets. He observed that the company has some chance for survival only if the senior management is active and successful in both the workplace and the marketplace.

During the course of this discussion, it seemed that the younger persons on the staff understood better the points that the visitor had chosen for emphasis than the senior economist. The impression left with this author, in part based on an exchange relating to the difference between the cost of production and the market price, was that the senior economist who had been educated and trained in a command economy was having difficulty accepting the changeover to a market economy. This discussion marked the end of the third visit.

Immediately prior to that meeting, however, this author had an opportunity to talk privately with the interpreter who had participated in all three visits. In this conversation, the interpreter confided that none of the Telkom Teletra's senior officials knew what they were doing in managing the company during the transition to a market economy. The visitor replied that he had formed the same opinion himself.

#### TELKOM TELETRA AFTER PRIVATIZATION

When the Polish government offered Telkom Teletra for sale, only Alcatel and Northern Telecom submitted bids. The bid by Northern Telecom was substandard because it did not provide for the purchase of both plants: Telkom Teletra in Poznan and PZT Teletra in Warsaw. Alcatel concluded a purchase agreement on March 30, 1993. The author's fourth visit to the Poznan facility took place almost seven months after the sale to Alcatel.

*Fourth Visit.* The fourth visit began in the offices of the plant director and lasted about three hours. At that time, the plant director -- the same person who managed the facility prior to the sale -- was in Spain for orientation and training by Alcatel. The meeting involved the plant's deputy director and director of finance. Both spoke some English but, as with the first three visits, an interpreter was necessary.

The visitor noticed the Panasonic telephone instrument on the desk of the director's secretary. In response to his question as to why the company no longer used Telkom Teletra instruments, she

replied "Panasonic is better." The visitor noted silently that the office had been moved to smaller quarters since 1991 and that there was no evidence of the pornography so conspicuous two and one half years earlier.

The deputy plant director and finance director stated that under the purchase agreement, Alcatel purchased 80 percent of the shares of Telkom Teletra and that the remaining shares were retained by the Polish government for sale at reduced prices to employees who are free to re-sell their shares later in the secondary market. Under the agreement, Alcatel paid \$37.5 million for both plants and made commitments to spend \$10 million on training and \$60 million over a six year period for physical improvements that would allow Telkom Teletra and PZT Teletra to produce state-of-the art telecommunications equipment.

In the future, the management of Telkom Teletra, according to the agreement, is to be 100 percent Polish. The two company representatives said that at that time the management was two-thirds Polish. Investment decisions are made at the corporate level in Alcatel's headquarters for international operations in Spain. Further, the engineering consultants GLEES was advising on the purchase and installation of new equipment in the Poznan facility.

Telkom Teletra will continue to produce the E-10 system and PCM equipment for two more years under existing and new purchase orders. The two company officials stated that a total of 120,000 lines had been installed in the Poznan and that 11-12 percent of Polish homes have telephone services. Many, however, cannot afford the installation charges.

The agreement reached by Alcatel and the Polish government requires the company to protect the jobs of all employees for one and one-half years, after which they may be terminated and replaced. Training is to be made available without exception to the employees and 60 percent of the training funds are to be expended in the 18-month period immediately following the March 1993 purchase date.

At the time of the fourth visit, the company had 800 employees, 503 of whom were "touch" labor. The remainder held management positions. In spring 1991, Telkom Teletra employed twice as many workers of whom only one-third were "touch" labor. A considerable downsizing had taken place since the sale by offering employees severance pay equivalent to two-years' earnings if they would leave voluntarily.

Some 358 employees accepted the offer which, given low labor rates throughout Poland, averaged about \$2,500-3,000 per employee. Two-thirds of those accepting the offer held management positions; the others were hourly employees. The workers who remained with the company were awarded a 25 percent pay increase.

In the ensuing reorganization of the facility, even though none of the departments have been eliminated, some have been downsized. The research and development department, which used to employ large numbers of engineers, is one example. Some employees have been reassigned to other duties and certain activities notably shipping have been contracted out to former employees of Telkom Teletra. The two company officials asserted that the company had achieved a 50 percent increase in productivity by contracting work to former employees. New job descriptions, they said, are to be prepared when work begins on new product lines.

The Poznan facility is expected to achieve ISO (International Standards Organization) 9000 certification by 1995. ISO certification increasingly is demanded in Europe because, by documenting work processes to assure product quality, it allows industrial customers to purchase from certified vendors without a prior audit of the vendor. Alcatel already has achieved this certification in France but not in Spain.

Just in time manufacturing and total quality management are to be implemented in the Poznan facility when the new product lines are introduced. Accordingly, senior management will go to Spain for training and will train the Poznan workforce when they return. In the future, there will be no research and development activity in Poznan and corporate headquarters will be responsible for marketing research and for decisions regarding product lines.

By the terms of the agreement, Alcatel is required to operate in Poland for a period of six years after which it may sell or liquidate its Polish facilities. In this regard, it was not clear to the two company officials as to whether Alcatel requires some minimum profit from these facilities to continue operating in Poland beyond the guarantee period. They did state that any surplus generated in Poland would be distributed by Polish Alcatel. The Poznan facility has a one-year operating budget with some leeway to pay employee bonuses. Otherwise salaries are administered at the corporate level. A tour of the plant followed.

Improvements were visible immediately. Much of the space in the administrative building was vacant reflecting the downsizing of the company. Housekeeping was much improved as was the lighting. As before, work in process was stacked in the hallways but fewer employees were standing around idle. All visible signs of pornography had been removed.

Production areas had been cleared of old equipment and were being prepared for the installation of new equipment and new work processes. Eventually all production is to be consolidated into 7,000 square meters. Some old machines were being relocated at the time of the visit. In general, they were set up and running again in two-three days.

Even a brief tour of the plant was sufficient to establish that the company indeed is undertaking a major overhaul of production. Eventually it will shrink to 500 employees, the visitor was informed, and based on the tour it appeared that the older employees were more threatened than the younger ones.

In contrast with the way work was organized in 1991, the company is able to track the quality of the work through a 100 percent testing and adjusting process. Much of the work at the time of the 1993 plant tour involved manual labor which cannot be automated without loss of quality. The company is able to track labor units per unit of production and to identify defects and hours expended by type, frequency, and source of defect. These new systems were comparable to what U.S. companies have been doing for years.

Over the years and consistent with the planned move toward just-in-time manufacturing, the company has achieved considerable savings through reductions in supplies held in inventory. In 1983, the visitor was told, the company kept on hand 12 months' inventory of supplies. Five years later, that figure had been reduced to 6 months. At the time of the 1993 visit, the company had only 1 month's supply. In the United States, a comparable company might operate with 1 - 2 week supply.

### CONCLUSIONS AND LESSONS TO BE LEARNED

The visits in spring 1991 indicated that the company had neither the state-of-the art or leading-edge products, the financial resources, nor the human resources necessary for survival. Further, this author saw no evidence that the company had a business plan, that it was conducting market research, that it knew much at all about marketing, that it could handle performance evaluation and salary administration in a market economy, or that it was able to measure the overall cost or unit cost in any of its departments. In addition, this author saw little evidence that it was capable of new product development in a market economy. At the time of that visit, the author saw no one at Telkom Teletra schooled or experienced in the business disciplines -- accounting, marketing, finance, management, market economics -- necessary for success in a market economy.<sup>1</sup> Telkom Teletra knew how to build sophisticated telecommunications equipment, but it did not know what it takes to make a profit.

By comparison with the best firms this author has visited in Louisiana, Telkom Teletra in 1991 compared quite unfavorably. The plant director appeared befuddled by privatization. The rest of the senior management seemed no less paralyzed. Even if capital funds were not a problem and notwithstanding the huge potential market for residential telephone services across Poland, this

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<sup>1</sup> General Electric has discovered a similar problem at Tungsram, its recently acquired light-bulb manufacturer in Hungary (Schaes, Schiller & Oster 1993, p. 102)

author saw no confirmation that the top company officials could re-make Telkom Teletra into a profitable telecommunications business. He concluded in 1991 that if this company truly was one of the better state enterprises in Poland, the privatization of those enterprises will not proceed smoothly, will bring considerable economic dislocation, and may lead to a Poland dominated by outside economic interests including the dreaded Germans.<sup>1</sup>

Telkom Teletra's chances for surviving in a market economy are vastly better after privatization than before. There is abundant evidence that the company has begun to learn about the actuating power of competition as an organizing principle. Further, there are some signs (e.g., achieving ISO 9000 certification by 1995 and contracting with former employees to handle shipping) that the company is making an effort to harness the energizing power of cooperation, the second actuating principle for organizing economic affairs.

The sale to Alcatel in effect produced solutions to many of the problems plaguing Telkom Teletra previously. First, the facility in Poznan will be a manufacturing site. There will be no marketing or marketing research there. Second, steps have been taken to implement systems on the shop floor that allow senior managers to know more about defective production and to implement corrective measures. Third, salary administration should be less problematical, because it is largely the domain of Alcatel at the corporate level.

Fourth, Alcatel is able to supply the funds necessary to install new manufacturing equipment and work processes so that the plant will be able to produce state-of-the-art telecommunications equipment for the market in Poland and elsewhere. In a sense, Alcatel's decision to manufacture in Poland promises labor-cost advantages similar to those available to a U.S. manufacturer locating in Mexico. Fifth, through its severance pay offer Alcatel was able to reduce the cost of production without impairing its manufacturing capability, thus making the facility more competitive than prior to privatization.

The workplace environment at the facility has changed remarkably not just in terms of its capital resources but its human resources as well. The company no longer operates in an industrial-welfare mode. The workforce appears to understand and accept that either the facility operates competitively and profitably or it will not operate at all. To illustrate, the "touch" labor observed by the visitor during his 1993 visit generally seemed more serious about their work and doing it properly the first time because, it appeared, they understand that re-work raises costs, absorbs profits, and thereby threatens their jobs. "Disciplined" is a suitable descriptor for the workforce following privatization.

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<sup>1</sup> In 1989, 42 percent of the registered joint ventures with participating foreign parties originated from the Federal Republic of Germany (Poland - International Economic Report 1991, p. 47). The German government expects trade with the East to increase above the combined West German and East German levels prior to unification (Smyser 1993, p. 226).

As crass as it may sound, they appear to recognize that their reward for work well done is that they get to keep their jobs.

The evidence to support these conclusions is twofold: (1) vastly improved information systems operating on the shop floor and (2) less acceptance of visible waste in its various forms, most especially in non value-added worker activity and waste. The non value-added indicator is all the more remarkable given the workplace makeover has significantly reduced the ratio of managers and supervisors to "touch" labor.

One concern of the author, however, should be underscored. Given the decision to reconstruct the facility without the resources for marketing and marketing research, innovation focuses entirely on the workplace. Thus, it will be quite difficult for the senior management to explore marketplace innovation on their own which in turn could make it more difficult over a long period of time for the plant to remain competitive and to provide secure and reasonably well-paid jobs.

Quite apart from the financial obstacles that must be surmounted, the foreign investor who acquires an interest in and begins operating a former state enterprise in Poland faces at least two central challenges, one relating to the workplace and one relating to the marketplace. As to the workplace, the foreign investor-director must decide whether to retain the old company officials or discharge them. If the decision is for retention, a determination must be made as to whether the development of the old senior managers is best accomplished through a formal training process or by pairing them with or putting them under the supervision of other managers brought in for their experience in operating private enterprises in a market economy.

As to the marketplace, the foreign investor-director must determine whether to focus strictly on the domestic market or to seek markets outside Poland. In either case, the new business plan should spell out whether the reconstructed company will (1) utilize the relatively low wages of Polish workers in a strategy that sells inexpensive products in impoverished, soft-currency markets to the east and the south or (2) innovate and develop more expensive products for the more prosperous, hard-currency markets to the west. No doubt, these types of decisions will determine the long-term survivability of the reconstructed enterprise and thereby the long-run prospects for the improved material well-being of the people of Poland. In this regard, the privatization of Telekom Teletra is a hopeful sign.

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