The Humane Side of Capitalism

By Russell Roberts, *John and Jean De Nault Research Fellow, Hoover Institution*

A lot of people reject capitalism because they see the market process at the heart of capitalism—the decentralized, bottom-up interactions between buyers and sellers that determine prices and quantities—as fundamentally immoral. After all, say the critics, capitalism unleashes the worst of our possible motivations, and it gets things done by appealing to greed and self-interest rather than to something nobler: caring for others, say. Or love. Adam Smith said it well:

> It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-interest.

Capitalism, say its critics, encourages grasping, exploitation, and materialism. As Wordsworth put it: "Getting and spending, we lay waste our powers." In this view, capitalism degrades our best selves by encouraging us to compete, to get ahead, to win in business, to have a nicer car and house than our neighbors, and to always look for higher profits and advantages. In the great rat race of the workplace, we all turn into rats. Is it any wonder so many want to kill off capitalism and replace it with something more just, more fair, more humane?

This urge to try something else seems to be on the rise. In a 2019 Gallup poll, 43 percent of respondents said socialism would be good for the country. A self-avowed socialist, Bernie Sanders, came closing to winning the Democratic nomination for president in 2020, finishing a close second as he had four years earlier.

One answer to this increased taste for socialism is that socialism has to be specified in order to compare it to capitalism. I think a lot of people are attracted to socialism because they believe it means capitalism without the parts they don't like. How to get there from here is left unspecified. A second answer is that the American economic system is, in fact, a hybrid of capitalism and socialism. Some parts of the American economy are pretty free market, or what we might call capitalist: those parts where profit and loss determine success or failure, where prices and wages are mostly free to adjust to what the market will bear, and where subsidies are small or nonexistent. But other parts of the American economy, such as education, health care, and housing, are highly distorted—they are heavily subsidized or regulated in ways that make innovation and competition very difficult. They're not fully socialist, but you can't really call them free market, either.

Capitalism, somehow, gets blamed for anything that goes wrong. Consider health care—it is highly subsidized; its prices are distorted by those subsidies along with incredibly complex regulations; the supply and allocation of doctors are highly constrained by regulations; hospital competition is curtailed by certificate of need requirements; and finally, on top of that, a highly regulated private insurance business is tangled up with everything. And when outcomes go sideways, people claim it proves that markets don't work for health care. One of the essential pillars of capitalism is people spending their own money on themselves. The essence of the health-care market is people spending other people's money, often on other people.

People decry the high price of housing in New York and San Francisco, and some blame it on the greed of landlords. But greed is as old as humankind. What has changed in recent decades and driven prices upward is ever more restrictive zoning that has made it harder to build new rental units in cities where the demand is highest.

But let's put aside the question of whether capitalism can fairly be blamed for the ills of health care in America or the high price of housing in certain American cities. Let's look at the more basic charge of immorality.

Is capitalism good for us? Does it degrade us or does it lift us up? The critics are right that competition is an important component of the capitalist system, but the dog-eat-dog nature of that competition is greatly exaggerated. We call it competition, but it can also be thought of as the availability of alternatives. As Walter Williams likes to point out, I don't tell the grocery store when I'm coming. I don't tell them what or how much I want to buy. But if they don't have what I want when I get there, I "fire" them. The existence of alternatives, choices of where to shop, and competition incentivizes the grocer to stock the shelves with what I want.

My cleaning crew speaks almost no English and has little or no formal education. Yet I pay them about double the legal hourly minimum. It isn't because I'm a nice person. If I paid them only the minimum, they wouldn't show up, because many other people are willing to pay much more to have their houses cleaned. Competition, not the minimum wage, is what protects my cleaning crew from the worst side of me and anyone else they work for.

Competition in sports is typically zero sum. The team with the higher score wins and the other team must lose. But economic competition is positive sum. Market share has to sum to 100 percent. When highly reliable Hondas and Toyotas showed up in the United States at very reasonable prices in the 1970s and 1980s, for example, they took market share from American companies. But the total number of cars sold wasn't fixed. By making better and cheaper cars, the number of cars sold increased. And the quality wasn't static, either. Spurred by Japanese competition, American car companies improved their products' quality. And the American consumer was better off.

The essence of commercial life is positive sum. You hire me at a wage that makes it worthwhile for you to do so. I work for you because the wage is high enough to make me better off as well. Without both of us gaining, there's no deal to be made.

Of course, some people have fewer or less attractive alternatives than other people. Why does Walmart pay what its critics claim are inadequate wages? It's not because Walmart is especially cruel or greedy. (After all, I could make more on Wall Street than I do in academic life. That's not because Goldman Sachs is kinder than Stanford University.) Walmart pays what it does because it can. And it can pay what it does because the people who choose to work there have unattractive alternatives. Otherwise, they'd take a job somewhere else.

Similarly, workers in overseas factories make very little relative to their American counterparts because their alternatives are much worse than those available to American factory workers. It's not the cruelty of greedy international corporations that keeps the wages low. It's the poor alternatives those workers have available to them. In fact, poor workers in poor countries typically line up for the opportunity to work for an international corporation. Wages there, while low by American standards, are much higher than in other parts of the economy.

Over time, the poorest workers in countries such as China have seen their wages rise dramatically. Again, this is not because of the compassion of corporate employers but because of the competition they face in attracting good workers. There are two positive ways to help both foreign workers and low-wage American workers at places such as Walmart: increase the demand for their services and find ways to help them increase their skills. That makes them more attractive to employers, who can pay them more because the workers are more productive.

Competition in a free-market system is about who does the best job serving the customer. Unlike traditional competition, there isn't a single winner—multiple firms can survive and thrive as long as they match the performance of their competitors. They can also survive and thrive by providing a product that caters to customers looking for something a little different.

Finally, there is a great deal of *cooperation* in capitalism. One kind is obvious: investors cooperate with managers, who cooperate with employees to produce a great product or service. Many people find the opportunity to work with others in this way—to produce something of value for the consumer—deeply rewarding in ways that go beyond money. Part of the reason people start businesses is money, of course. But there is a large nonmonetary component: the experience of joining with others to create a great product or service that people value.

In the second Keynes-Hayek rap video I created with filmmaker John Papola, we tried to capture the best of this entrepreneurial side of capitalism:

> Give us a chance so we can discover
> The most valuable way to serve one another.

When Apple introduced the iPod in 2001, the 10GB model held two thousand songs, the battery lasted ten hours, and its price was $499. By 2007, the best iPod held twenty times that number of songs, the battery lasted three to four times longer, and its price was $299. Apple didn't improve the quality and lower the price because Steve Jobs was a nice or kind person. Apple improved the iPod because its competitors were, as always, constantly trying to improve their own products. But I don't think money was the only thing motivating improvement at Apple. Steve Jobs was happy to get rich. But he was also eager to keep his firm afloat in order to employ thousands of people at good wages and to work alongside those workers to create insanely great, ever better products. The money was nice. But it was not all (and maybe hardly at all) about the money.

Steve Jobs wanted to put what he called a dent in the universe. He wanted to make a difference. To do that, he needed to convince people of his vision, and then that vision had to be made real in a way that could profitably sustain an enterprise. Free markets gave Jobs the landscape where he could make his vision a reality.

You do have to pay the bills. The money that comes from consumers who value your product has to be sufficient to cover your costs. That's the profit-and-loss criterion that underlies capitalism—you have to do as good or better than your competitors at serving your customers. But that's not enough. You also have to do it at a price and pay a wage to your employees that result in a profit.

The other moral imperative of capitalism comes from repeated interactions between buyers and sellers. When there are repeated interactions, sellers have an incentive to treat their workers and their customers well—otherwise, they would put future interactions at risk. The safety of air travel, for example, is highly regulated. But cutting corners to save money and thereby putting passengers at risk are bad ideas for an airline that wants to exist past tomorrow. Crashes caused by negligence destroy an airline's reputation. In markets, reputation helps ensure honesty and quality. Being decent becomes profitable. Exploitation is punished by future losses.

None of the above rules out a role for government. You can defend free markets and capitalism without being an anarchist. Government plays a central role as the most effective enforcer of property rights and contracts. It administers the legal system. And it can and should restrict opportunities for people to impose costs on others. There's nothing un-capitalist about making it illegal to dump your garbage into the air or water.

But what about the poor? How can we applaud the morality of capitalism if its gains go only to the richest Americans? Who wants to champion a system that gives the 1 percent the richest of chocolate cake and leaves everyone else with crumbs?

While there is evidence that supports this claim of the poor as bystanders who are left unchanged by decades of economic growth, this evidence typically looks at snapshots of workers at two different points in time, comparing changes in income or wealth of the top 1% to the to the standing of the top 1% decades later. The implicit assumption is that the people who were at the top in the past got much richer over time. This approach ignores economic mobility and falsely assumes that the top 1 percent are a fixed group. The people composing that 1 percent change; the same people do not simply get richer while everyone else treads water. The 1 percent includes people who once were much poorer but, now that they have reached the top, are richer than the people who previously were at the top. Similarly, the bottom twenty percent today are not the same people who were at the bottom in the past. When you follow the same people over time, rather than comparing group snapshots at two different points in time, all groups—poor, middle class, rich become more prosperous over time. A rising tide lifts all boats and not just the yachts. (I've explored these issues in videos and essays published elsewhere.)[1]

I would also point out that the guards in Cuba face south; they prevent Cubans from escaping the egalitarian paradise of Cuba for the unequal American economy. Poor people from all over the world risk their lives to come to the United States. Certainly they come here for opportunity for themselves and for their children. They expect—correctly, in my view—to share in the future growth of the American economy.

But I think poor people come here for more than just the financial opportunities of the American economy. They come for a chance for their children, and for themselves, to flourish, to use their gifts and skills in ways that bring meaning well beyond financial rewards. Money is pleasant, and not starving beats starving. But the real morality of capitalism and of the American system, with all its flaws, is that it gives people the chance to flourish through their work.

Not everyone has this chance in America today. But I believe that many of the challenges that the poorest among us face are not the fault of capitalism but the result of the breakdown of other institutions, which makes it hard for people, especially young people, to acquire the skills that would allow them to thrive. The US school system needs an overhaul. In particular, it could use more competition. The charter school movement is one part of a potential policy improvement. Even more competition—including private school options funded by scholarships—would go a long way toward allowing the poorest among us a chance to share in the American economic system, imperfectly capitalist that it is.

Endnotes

[1] See, e.g., Russ Roberts, "The Numbers Game," PolicyEd, https://www.policyed.org/numbers-game and Russ Roberts, "Do the Rich Get All the Gains from Economic Growth?," *Medium*, October 23, 2018, https://medium.com/@russroberts/do-the-rich-capture-all-the-gains-from-economic-growth-c96d93101f9c.

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