

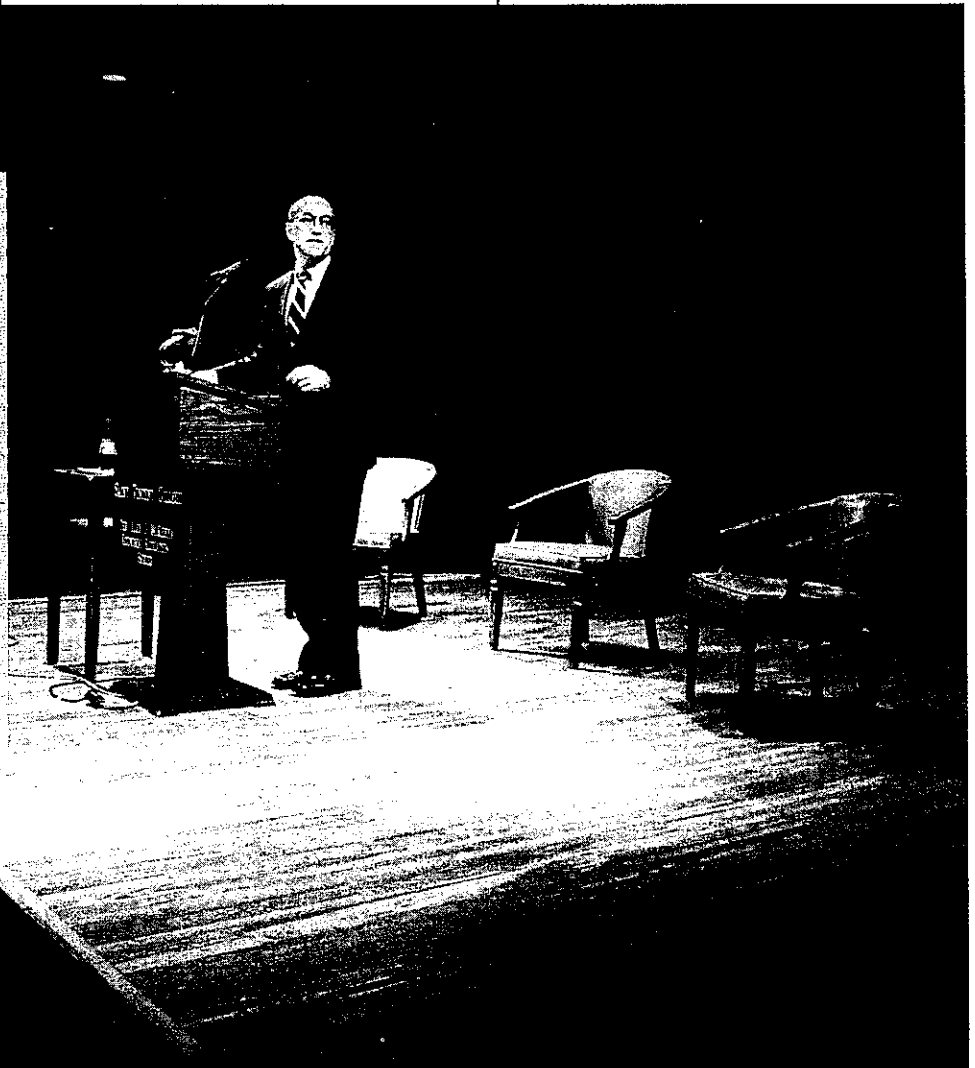
# ECONOMIC DIRECTIONS

A Publication of Saint Vincent College's Alex G. McKenna Economic Education Series

Saint Vincent College, Center for Economic Policy Education, Latrobe, Pennsylvania

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## "AN ETHICAL AND MORAL EVALUATION OF PRIVATE PROPERTY AND MARKET FREEDOM"



*(The following is a transcript of a lecture delivered by Dr. Kevin C. Sontheimer, Chairperson, Department of Economics and Director, Economic Policy Institute, University of Pittsburgh, at Saint Vincent College, Latrobe, Pennsylvania, on April 8, 1992. The lecture was the fourth presentation in the 1991-1992 Alex G. McKenna Economic Education Series of lectures on privatization, taxation, and government deregulation.)*

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For people in the United States it might seem strange to pose the question: Is there anything morally good about the institution of private property? But it is a very reasonable question. For example, one of the best economic philosophers in the country, Allan Gibbard, considers private property to be simply a fetish, useful in supporting the market system, which itself he argues is simply one way of resolving disputes that is not ethically or morally superior to alternative economic systems. On the other hand we are seeing in the former Soviet Union the end of a seventy year era in which private property was

outlawed and considered to be evil. Private property also is being re-instituted in Central Europe, which struggled with variations of the Marxist-Leninist system for forty years. So it is not an empty question to ask whether or not there is a moral value to private property.

Let us go back to sources of our understanding of good and morality. We could take the book of *Genesis* and ask "has private property always been with us?" In the book of *Genesis* we have the story of creation, but nowhere is there mention of God establishing private property. Private

"... it allows us to achieve the maximum amount of cleanup for any given amount of costs imposed on firms and their employees and customers."

property is a man-made invention: it is a social device. We then could look elsewhere in the *Torah*, the *Bible*, and other religious texts for a Divine sanction of private property. We would not find it explicitly but we could find it implied. It is implied, for example, in the seventh commandment. Saying *thou shall not steal* does not make much sense unless there is some notion of property. But property does not have to be private. We have the concept of public property, so maybe there should be only public property and the seventh commandment only means that we ought not steal from the public sector. But I think that to maintain that stance would require a very tortured interpretation of the *Old Testament* and so we can confidently say there is in the *Old Testament* an implied sanction of private property, and in that sense private property has moral value. But let us go further. If there is nothing in religious documents that gives a direct sanction to



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*Associate Professor of Economics*

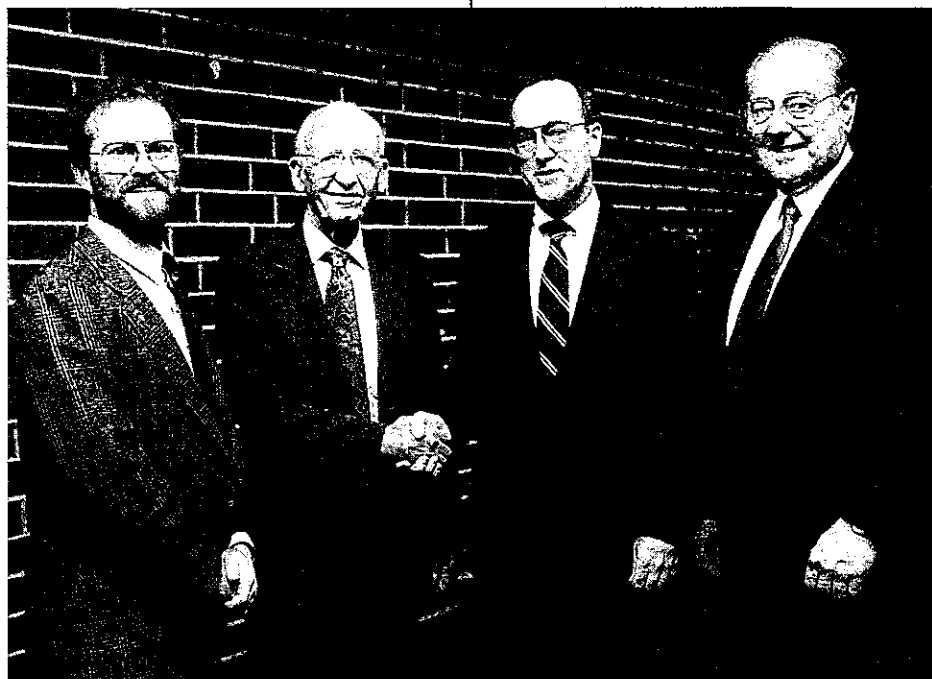
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WELCOME — Greeting Dr. Sontheimer (second from right) to Saint Vincent College were Dr. Gary M. Quinlivan (left), director of the series, Dr. Alex G. McKenna (second from left), chairman of the Philip M. McKenna Foundation, and Mr. John C. Marous, Jr., retired chief executive officer of Westinghouse Corporation.

private property, are there other things that are addressed with regard to property that enable us to find a moral value in property being private? In the *Old Testament* and the *Torah* there is a very strong repetitive statement about property: Property comes from God's creation, and one of our primary responsibilities is to be stewards of that property. The strongest point of emphasis with regard to property in the *Torah* and *Bible* is the responsibility for *stewardship*, and it is within that emphasis that I think we can begin to look for the function, the purpose, and the moral value of private property.

There are basically three forms in which we can hold property. First, it can be held in common. In this holding there are no exclusive property rights; everybody has access to the same property. An alternative form is to establish a public sector, whether it is a tribal government or a federal government, and hold all assets and resources as public property. It is not the commons — the government can control and regulate usage and no individual or subset of individuals has exclusive claim to the property. Or third, we can have private property.

The principle of stewardship is that we are to take care of and use what we have been given, to maintain it and use it to good effect, because in religious texts man also was given the charge to multiply and subdue the Earth. *We then can ask, how do these three forms of holding property work; how well do they enable man and woman to provide stewardship?*

When we think of the commons we might think of historical examples or we might think of a contemporary problem — air pollution. The atmosphere is a grand commons. We do not have individual property rights to the atmosphere, nor does it belong to the government. We all have common access to it. The problem we experience with the atmosphere as a common is just the same kind of problem that shepherds, cattle ranchers, and so on have with range land when it is held in common — there is excessive usage. The problem is that any individual user of the atmosphere does not experience the full loss of air quality related to his or her use, and therefore he or she does not have a measure of the full cost of usage. However, he or she does know the full benefit received from environmental use, and therefore in his or her decisions they are comparing full benefits against a fractional or negligible cost. So it is easy to see why so many individuals use the environment extensively, and do so simultaneously. We all operate our vehicles; many of us burn wood in fireplaces for personal pleasure; we all engage in some form of employment, working for employers who use the atmosphere. So the result, with everyone coming to the same conclusion at the same time, is that many people use the atmosphere extensively. For example, it is because of such simultaneous reasoning that the Los Angeles basin is badly polluted and the Grand Canyon is a relatively polluted area in which the geological aging process has speeded up greatly (because the prevailing winds carry

chemicals from the extensive vehicle usage and industrial processes in the Los Angeles basin into the Grand Canyon and speed up the geological aging processes).

The problem is that we have not inherited from nature any mechanism that enables people to experience the full effect of their use of the atmosphere, and therefore no mechanism for forcing people to pay the full incremental cost of their use of the atmosphere. And as population and production have increased over time, so too has the use of the atmospheric commons. The use in some parts of the world has grown to overuse. The first reaction post-World-War II to the growing problem of atmospheric pollution was to move toward converting the atmosphere into public

*"The moral value of private property is as an instrumentality than enables us to keep one of our moral obligations."*

sector property, and using government regulatory schemes as a means of controlling usage. But we have done a pretty poor job in that regard. We have learned the hard way that the public sector does not have the information needed to make cost effective decisions regulating environmental use. For example, when the public sector dictates a particular kind of technology for all firms in a given industry as a means to reduce their environmental use, the government increases the cost of production and cleanup. The reason for the adverse effect of government ukases is that what is a cost effective method for limiting air pollution for one firm in one location is not necessarily cost effective for a different firm in a different location. To the extent the direct regulation approach has improved environmental usage, it also has raised the cost structure of firms and induced other problems, problems of economic viability, reduced employment, and so forth.

If we track the environmental policy of the United States over the last thirty years what we see is a lesson that is finally being driven home: the best way to use the environment is not to continue to treat the atmosphere as a commons, nor to turn it into public sector property and control its use by direct regulatory methods, but rather to establish something like individual property rights in the atmosphere by developing pollution charge schemes and tradeable pollution credits, so that

individual decision makers can see the cost of atmospheric use as clearly as they can see the costs of cleanup equipment, labor costs, and sales revenue. Firms then make the decisions as to whether it is cost effective for them to continue to use the environment (and buy pollution credits, or pay taxes, etc.) and let other firms who can reduce their environmental usage more cheaply, more effectively, do the cleaning up, or vice versa. That is, let those firms that can clean up at a lower cost clean up more and let the firms who have high cleanup costs clean up less, and maybe not at all, while bearing alternative costs of pollution taxes or purchasing pollution credits. This kind of approach can enable us to achieve targeted amounts



of cleanup at the least cost to firms, and therefore the least loss of employment, competitiveness, etc. Alternatively, *it allows us to achieve the maximum amount of cleanup for any given amount of costs imposed on firms and their employees and customers.* The EPA's so called "bubble" concept for addressing problems of air pollution is a partial step in this direction. The lesson of the last thirty years is that it's better to use the powers of government to create a market-like setting in which firms and other polluters will act as if there are exclusive property rights to the atmosphere and therefore pay for the use of the property in proportion to the cost of use. Stewardship, with regard to the environment and environmental usage, is best advanced by bringing the market into the environmental picture. *Stewardship is better advanced by the market process than by the commons or by public sector property.*

Now let's consider the public ownership of property further. I would like to point east to the former Soviet Union and countries of Central Europe and look at their experience. They have had a great deal of experience with not having private property and instead having public sector property and management. What was the outcome? The outcome is summarized in a common Russian saying: "What belongs to everyone belongs to no one, so why should it not be mine?" Most Russians are like you and me, human and imperfect. The problem is that when we look at the enterprise in which we work and the building within which we reside, if we do not have an ownership claim to it then we are not guaranteed a return on the investments which we might make in maintaining it. If we live in an apartment building that is owned by the state and occupied by another hundred families, our efforts to maintain or improve the quality will be shared by everybody. We cannot capture the full gains of our efforts. And the frail human being then says, why bother? Similarly with managing an enterprise. If none of the managers or employees has a sense of ownership, and the amorphous and distant state captures the gains of investment, then there is little incentive to search out and execute the best investments for the enterprise, nor is there a significant incentive for maintenance. What happens when none of us can capture the returns from our investments, and we will not let others free ride on our productivity and they will not let us free ride on their productivity? The result is too little investment and too little maintenance. Again, the issue of stewardship and a failure to perform.

The Russians, Czechoslovaks, Poles, and others learned the lesson the hard way. We also can see the lesson closer to home: who tends to provide better care of property, renters or owner-occupiers? I think the answer is pretty clear, statistically and in our own individual experiences. Private property promotes the fulfilling of the obligation we have to be stewards. *The moral value of private property is as an instrumentality that enables us to keep one of our moral obligations.*

The first part of the Russian saying tells us that the absence of private property promotes the opposite of stewardship. The second part tells us that it promotes theft (and theft from state enterprises and organizations was a chronic problem in the USSR). Here I might add parenthetically that many of the greatest evils that occurred in the Soviet Union and Central Europe had to do with the desire to make the new socialist man. Why was it necessary? Why did the realization of the socialist paradise require the creation of a "new socialist man"? The reason is

*"To be committed to market processes is to be committed to a way of doing things, not an outcome or class of outcomes."*

because few people are saints. Most people respond to incentives in terms of what benefits them and their families, not the whole community. So the Soviets destroyed people whose responses to incentives were typical of human nature and tried to develop a different human being. But they of course failed, the Marxist-Leninist system failed, and in the process they created the world's worst environmental tragedies and destroyed millions of lives. *The experiment in universal social property resulted in a gross failure of stewardship and incalculable other costs.*

Let me move on to talk about market processes or the market system, of which private property is a very key part. The market system is the mechanism for solving economic issues by (1) production and trade, based on the (2) institution of private property with freedom of contract; (3) legal processes designed to protect and enforce contracts among individuals who have a certain freedom of mind; and (4) individuals are goal oriented and make

decisions so as to advance their interests as they define those interests. What I am going to do is to argue that if we have a commitment to market processes or the market system, there are then certain implied behavioral characteristics that we must accept also. Then I am going to turn around and argue that there are some philosophical commitments we could make and ask, if we make them, what kind of economic system must we embrace?

The market system, remember, works in the following way: If we want something that we do not have, then we have to find someone who has it and offer them something that they value at least as much as what we want from them in order to get them to voluntarily give us what we want (or find some other individuals who will engage in intermediate exchanges that come to the same end). *So a commitment to market processes is a commitment to give in order to get.* Let us now ask what would be implied by a community in which everybody was committed to the market process? I am using the word commitment here in the same sense as you would understand it if someone professed they were committed to the Catholic or Jewish or some other religious faith. It is a commitment to adhere to what is professed and *all* that is implied by the profession. If we had a community of people who were truly committed to market processes, what would that community look like? First, there would be no theft and therefore no fraud. Wages paid would be wages earned. If we are committed to market processes, then we are committed to the

proposition that whatever we want we are going to get by virtue of someone else voluntarily engaging in trade with us, whether it's our labor time and their payment of their money, wheat or their baked goods, or their labor for our money, and so on. There would be no redistribution of wealth by violence, blackmail or any other coercive means. This is part of what it would mean to be committed to market processes. It also would mean that reputations were deserved reputations. There would be no unjustified besmirching of a reputation whether it was a corporation's, an individual's, a product's or service's reputation. This is because for market processes to work you need good information. When I say for market processes to work, I mean work well, work the way they are intended to. So if you have a community that is committed to market processes there would be no problem of reputation maintenance. It is against that commitment to make a false statement about the quality or reliability of products and services, or a person, or an enterprise.

It also would mean a commitment to discretion. This is very important. What do I mean here by a commitment to discretion? Well, if you want, you can link it up to the notion of the exercise of free will, but not in a grand sense, just in economic transactions. A commitment to discretion means that everyone has the option of making their own decisions about what to buy, what to sell, what employment to take, what employment to refuse, and it means a commitment to preserving that same kind of decision making capability for everybody else. It is a commitment to recognize the independence and integrity of each individual.

It would mean a commitment to proceduralism rather than consequentialism. What do I mean by that? Consequentialism is a philosophical perspective that says that the goodness of a situation is to

## About the Series

*The Alex G. McKenna Economic Education Series is presented by the Center for Economic Policy Education at Saint Vincent College. These periodic lectures are open to the general public and their purpose is to explore the role of free markets in solving many of the social problems confronting the United States and the world today. Dr. Gary M. Quinlivan, associate professor of economics at Saint Vincent, directs the series.*

*The Alex G. McKenna Economic Education Series is made possible by a grant from the Philip M. McKenna Foundation Inc. of Latrobe, Pennsylvania.*



SVC ALUMNI — Photographed with Dr. Sontheimer (far right) are, from left, Michael Sinnott, C'86, Frank Peagler, C'87, and Ann Peagler.

be judged simply on the outcomes. Utilitarianism is a form of consequentialism, for example. Utilitarianism in its barest form says that if you can measure and aggregate individuals' well being, you should take those actions that would obtain the greatest aggregate well being or utility, period. Now what bothers people who think about it seriously is that bare statement means, for example, if aggregate welfare would be made greater by killing somebody (and this may seem like an extreme example but nonetheless it is within the logic of the system) then it is alright to kill someone. Another example of consequentialism is the concept of Pareto efficiency or Pareto optimality. Pareto efficiency is a consequentialist criteria for judging the goodness of a situation that says nothing about how the outcomes are attained. The process just says it is good if it meets the defining characteristics of Pareto efficiency. But a commitment to market processes is not a commitment to any particular outcome or to any particular class of outcomes. *To be committed to market processes is to be committed to a way of doing things, not an outcome or class of outcomes.* In some of the outcomes, you might lose your shirt, in others you might make a million; but it is the process that counts in the commitment. This aspect of the commitment might start to bother us because the market can generate some outcomes we do not particularly like or feel comfortable with (here is where the shoe starts to squeeze a bit). The commitment to the market would mean that charity was the principle mechanism for redistributing wealth, not government taxation. Why is that? Because in the commitment to market processes there is a commitment to the public sector, but it is a commitment to provide the legal framework within which freedom of contract and property rights can be defined and implemented and disputes resolved. There is nothing in the notion of market processes and a commitment to them that implies a role for the public sector purely for the purpose of redistributing income.

Now that might sound pretty harsh. But we also need to be aware that within a commitment to the market, and a commitment to proceduralism, is a commitment to procedural equality or equal access. What does that mean? It means that everybody has to have in some sense an equal opportunity to participate in the market, where the method of the market is to give and the purpose of the market is to get. But the realities of life tell us that not everybody has equal access naturally. Some lack access by virtue of disabilities. In the cases where there are disabilities that would make the commitment to equal access an empty commitment there is then within the commitment the implica-

tion that we have to provide for the mentally impaired, the severely handicapped, etc. All must have an opportunity to get. The commitment to the market mechanism implies there should be some meaningful compensatory adjustment made in the case of the impaired. So there is room for redistribution to keep the commitments of access for all.

Importantly, the commitment to equal access applies in intertemporal situations where people do not get an adequate education in their early years. Within the commitment to market processes we have to address the issue of what does equal access mean? For example, we know that an infant cannot effectively participate in the market process. There is no magic, no logic, and no clear scientific measurement that tells us that a person is mature at 10, 16, 18, or at 21 or whenever. But the commitment to equal access means that we have to make a determination that at some age people's human capital ought to be brought to a minimum level of development, i.e., their human capital must be developed or made available. Since the development of human capital as part of the maturation process requires complementary investments, i.e., investments by the individual and investments by others such as parents and teachers, there are multiple sources of possible failure. That then means we must allow a claim for people who not through their fault, but the fault of others, whether it was the school's or their parent's or both, did not have the opportunity to develop their human capital.

But the commitment to equal access does not mean that someone who ends up short in the market process because they have not developed much human capital, by virtue of their own decisions, has any claim on others for redistribution in their favor. So here again we have a certain sternness implied by the commitment to the market process. For example, if we shirked in high school or college and did not make a reasonable effort to develop our human capital, we cannot hold our subsequent employment problems against society. A commitment to the market does not entail an obligation to help those who failed themselves. On the other hand it does not mean that people cannot help those who failed themselves, or that people ought not be forgiving. Within the commitment to market processes is a tremendous scope for the exercise of individual charity and individual forgiveness.

This dual role of obligation and elective charity also is found in the Bible and other ancient religious texts in connection with an obligation toward or priority for the poor. If we look in the religious texts we will often find that there is a special status

to be accorded to widows, orphans, and the disabled; that we have an obligation to assist them. What we will not find are statements about an obligation to be charitable to those who wind up in tough situations by virtue of their own sins. But that does not mean that we cannot assist them, and it does not mean that there is not great moral merit in being charitable to those who failed themselves. It is indeed morally enhancing to help those who failed themselves. But there is no such obligation.

Let us turn the question around and ask, if we made certain moral or ethical commitments, would there be an implied commitment to a particular economic mechanism? For example, if a community of people committed themselves to (a) truthfulness; (b) a notion of merit in a strict economic sense, meaning that in order to lay claim to something we either have to produce it, or obtain it by giving something compensatory to other people, or obtain it as a voluntary gift from another; (c) constrained maximization of individual discretion (this means that it is good if, given the limits of discretion I have in my own decision making and behavior, your discretion is as great as possible); (d) procedural equality; and (e) the rule of law, which means that everyone will in fact respect whatever rules are established to govern behavior and are consistent with (a)-(d); what kind of economic processes might they be bound to?

If we ask what kind of economic systems would we get with a commitment to truthfulness and merit, and think it through, we will see that we would wind up with an exchange system in which final prices reflect costs, quality, and preferences, and there would be no fraud, violence, blackmail, or other forms of coercion to achieve economic gains. The commitment to constrained maximal discretion, if added to truthfulness and merit, would imply an exchange economy based on private property. If procedural equality is in turn added to the list of commitments, then the private property based exchange economy would have a mechanism for raising the means to compensate those for whom nature has made equal access an empty commitment, i.e., individuals committing to equal access are committing themselves to overcome severe deficiencies dealt out by nature to others. So the private property based exchange economy would have a public sector. Now even in an economy characterized by truthfulness and merit, circumstances can arise that allow for alternative interpretations and disputes. Thus a body of law and legal system would be developed to cover such situations. That is, the society would develop a public sector with the responsibility for developing

and enforcing a body of contract laws. But the commitment to the rule of law, coupled to a commitment to constrained individual maximal discretion, would also mean that the body of contract law would incorporate a wide scope of freedom of contract for the use and disposition of private property; there would be a bias toward the private sector. What we obtain from the moral and philosophical commitments listed above is a market economy based on private property. And again it is a market system that has some firm edges to it — it leaves a substantial role for individual charity.

In conclusion, a true commitment to a market economy based on private property would generate a morally robust economy with a reasonable scope for the exercise of charity, and therefore morally enhancing activity. It is also true that a real commitment to a moral society defined by commitments to truthfulness, merit, individual discretion, equal procedural access, and the rule of law would lead us to a market economy based on private property with a reasonable scope for the exercise of charity. Either direction of commitment implies a society that calls upon its members to meet some of the challenges that have been laid down to us as Christians, Jews, and members of other faiths.

If the commitment to the market mechanism implies a highly moral society, why do we not see it? And if people are moral, why do we not see a well functioning market economy? The answer is that we do not have that strong a commitment to the market economy any more than we have strong commitments to truthfulness, merit, and so on. The constant parade of people to Washington and to Harrisburg seeking special government help, special government bestowed advan-

tage, is direct evidence of the lack of commitment to market processes just as lying is evidence of a lack of commitment to truthfulness. But if we had a greater commitment to market processes, we would have a more moral society. Therein lies the moral value of private property and market processes.



## Center Announces Advisory Board, Upcoming Programs

The Center is pleased to announce the formation of its Academic Advisory Board. The members include the following distinguished professors: **Ryan C. Amacher**, President, the University of Texas at Austin, **Peter B. Kenen**, Walker Professor of Economics and International Finance, Director of International Finance, Princeton University; **Bennett T. McCallum**, Chairperson, Department of Economics, Carnegie Mellon University; **E. S. Savas**, Chairperson, Department of Management, Director, Privatization Research Organization,

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The 1992/93 Alex G. McKenna Series theme will be **Election Year Topics**. The relevant dates, speakers, and topics are as follows: September 30, 1992, **Patricia Danzon** of the University of Pennsylvania will present a lecture entitled "Health Care Reform: A Review of the Options"; October 28, 1992, **Robert Barro** of Harvard University will present a lecture entitled "The Economics of the Candidates"; February 17, 1993, **Richard McKenzie** of the University of California at Irvine will present a lecture entitled "Reality is Tricky: Exorbitant Claims that Misguided Public Policy Debates During the Last Decade"; and April 28, 1993, **Rachel McCulloch** of Brandeis University will conclude the series with a lecture entitled "Foreign Investment in the United States: Source of Strength or Sign of Weakness?"

On June 29, 1992, the Center will host its second annual Economic Education for the Clergy Conference. The conference is sponsored by Economic Education for the Clergy, Inc. which is centered at Indiana-Purdue University in Indianapolis.

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