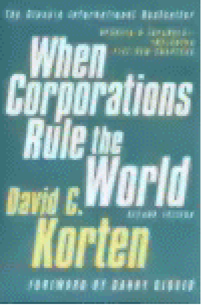

THE BETRAYAL OF ADAM SMITH

Excerpt from

When Corporations Rule the World

by David C. Korten

It is ironic that corporate libertarians regularly pay homage to Adam Smith as their intellectual patron saint, since it is obvious to even the most casual reader of his epic work *The Wealth of Nations* that Smith would have vigorously opposed most of their claims and policy positions. For example, corporate libertarians fervently oppose any restraint on corporate size or power. Smith, on the other hand, opposed any form of economic concentration on the ground that it distorts the market's natural ability to establish a price that provides a fair return on land, labor, and capital; to produce a satisfactory outcome for both buyers and sellers; and to optimally allocate society's resources.

Through trade agreements, corporate libertarians press governments to provide absolute protection for the intellectual property rights of corporations. Smith was strongly opposed to trade secrets as contrary to market principles and would have vigorously opposed governments enforcing a person or corporation's claim to the right to monopolize a lifesaving drug or device and to charge whatever the market would bear.

Corporate libertarians maintain that the market turns unrestrained greed into socially optimal outcomes. Smith would be outraged by those who attribute this idea to him. He was talking about small farmers and artisans trying to get the best price for their products to provide for themselves and their families. That is self-interest, not greed. Greed is a high-paid corporate executive firing 10,000 employees and then rewarding himself with a multimillion-dollar bonus for having saved the company so much money. Greed is what the economic system being constructed by the corporate libertarians encourages and rewards. [See *An Economic System Dangerously Out of Control.]*

Smith strongly disliked both governments and corporations. He viewed government primarily as an instrument for extracting taxes to subsidize elites and intervening in the market to protect corporate monopolies. In his words, "Civil government, so far as it is instituted for the security of property, is in reality instituted for the defense of the rich against the poor, or of those who have some property against those who have none at all." Smith never suggested that government should not intervene to set and enforce minimum social, health, worker safety, and environmental standards in the common interest or to protect the poor and nature from the rich. Given that most governments of his day were monarchies, the possibility probably never occurred to him.

The theory of market economics, in contrast to free-market ideology, specifies a number of basic conditions needed for a market to set prices efficiently in the public interest. The greater the deviation from these conditions, the less socially efficient the market system becomes. Most basic is the condition that markets must be competitive. I recall the professor in my elementary economics course using the example of small wheat farmers selling to small grain millers to illustrate the idea of perfect market competition. Today, four companies--Conagra, ADM Milling, Cargill, and Pillsbury--mill nearly 60 percent of all flour produced in the United States, and two of them--Conagra and Cargill--control 50 percent of grain exports.

In the real world of unregulated markets, successful players get larger and, in many instances, use the resulting economic power to drive or buy out weaker players to gain control of even larger shares of the market. In other instances, "competitors" collude through cartels or strategic alliances to increase profits by setting market prices above the level of optimal efficiency. The larger and more collusive individual market players become, the more difficult it is for newcomers and small independent firms to survive, the more monopolistic and less competitive the market becomes, and the more political power the biggest firms can wield to demand concessions from governments that allow them to externalize even more of their costs to the community.

Given this reality, one might expect the neo-liberal economists who claim Smith's tradition as their own to be outspoken in arguing for the need to restrict mergers and acquisitions and break up monopolistic firms to restore market competition. More often, they argue exactly the opposite position--that to "compete" in today's global markets; firms must merge into larger combinations. In other words, they use a theory that assumes small firms to advocate policies that favor large firms.

Market theory also specifies that for a market to allocate efficiently, the full costs of each product must be born by the producer and be included in the selling price. Economists call it cost internalization. Externalizing some part of a product's cost to others not a party to the transaction is a form of subsidy that encourages excessive production and use of the product at the expense of others. When, for example, a forest products corporation is allowed to clear-cut government lands at giveaway prices, it lowers the cost of timber products, thus encouraging their wasteful use and discouraging their recycling. While profitable for the company and a bargain for consumers, the public is forced, without its consent, to bear a host of costs relating to water shed destruction, loss of natural habitat and recreational areas, global warming, and diminished future timber production.

The consequences are similar when a chemical corporation dumps wastes without adequate treatment, thus passing the resulting costs of air, water, and soil pollution to the community in the form of health costs, genetic deformities, discomfort, lost working days, a need to buy bottled water, and the cost of cleaning up contamination. If the users of the resulting chemical products were required to pay the full cost of their production and use, there would be a lot less chemical contamination in our environment, our food and water would be cleaner, there would be fewer cancers and genetic deformities, and we would have more frogs and songbirds. If the full cost of producing and driving cars were passed on to the consumer we would all benefit from a dramatic reduction in urban sprawl, traffic congestion, the paving over of productive lands, pollution, global warming, and depletion of finite petroleum reserves.

There is good reason why cost internalization is one of the most basic principles of market theory. Yet in the name of the market, corporate libertarians actively advocate eliminating government regulation and point to the private cost savings for consumers while ignoring the social and environmental consequences for the broader society. Indeed, in the name of being internationally competitive, corporate libertarians urge nations and communities to increase market distorting subsidies--including resource giveaways, low wage labor, lax environmental regulation, and tax breaks--to attract the jobs of footloose corporations. An unregulated market invariably encourages the externalization of costs because the resulting public costs become private gains. In the end it seems that corporate libertarians are more interested in increasing corporate profits than in defending market principles.

The larger the corporation and the "freer" the market, the greater the corporation's ability to force others to bear its costs and thereby subsidize its profits. Some call this theft. Economists call it "economies of scale."

Neva Goodwin, ecological economist, head of the Global Development and Environment Institute at Tufts University, and an advocate of cost internalization, puts it bluntly. "Power is largely what externalities are about. What's the point of having power, if you can't use it to externalize your costs--to make them fall on someone else?"

Corporate libertarians tirelessly inform us of the benefits of trade based on the theories of Adam Smith and David Ricardo. What they don't mention is that the benefits the trade theories predict assume the local or national ownership of capital by persons directly engaged in its management. Indeed, these same conditions are fundamental to Adam Smith's famous assertion in *The Wealth of Nations* that the invisible hand of the market translates the pursuit of self-interest into a public benefit. Note that the following is the only mention of the famous invisible hand in the entire 1,000 pages of *The Wealth of Nations.*

By preferring the support of domestic to that of foreign industry, he [the entrepreneur] intends only his own security, and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.

Smith assumed a natural preference on the part of the entrepreneur to invest at home where he could keep a close eye on his holdings. Of course, this was long before jet travel, telephones, fax machines, and the Internet. Because local investment provides local employment and produces local goods for local consumption using local resources, the entrepreneur's natural inclination contributes to the vitality of the local economy. And because the owner and the enterprise are both local they are more readily held to local standards. Even on pure business logic, Smith firmly opposed the absentee ownership of companies.

The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private co-partnery frequently watch over their own .... Negligence and profusion, therefore, must always prevail, more or less in the management of the affairs of such a company?

Smith believed the efficient market is composed of small, owner-managed enterprises located in the communities where the owners reside. Such owners normally share in the community's values and have a personal stake in the future of both the community and the enterprise. In the global corporate economy, footloose money moves across national borders at the speed of light, society's assets are entrusted to massive corporations lacking any local or national allegiance, and management is removed from real owners by layers of investment institutions and holding companies.

It seems a common practice for corporate libertarians to justify their actions based on theories that apply only in the world that by their actions they seek to dismantle. Economist Neva Goodwin suggests that neoclassical economists have invited this distortion and misuse of economic theory by drawing narrow boundaries around their field that exclude most political and institutional reality. She characterizes the neoclassical school of economics as the political economy of Adam Smith minus the political and institutional analysis of Karl Marx:

The classical political economy of Adam Smith was a much broader, more humane subject than the economics that is taught in universities today.... For at least a century it has been virtually taboo to talk about economic power in the capitalist context; that was a communist (Marxist) idea. The concept of class was similarly banned from discussion.

Adam Smith was as acutely aware of issues of power and class as he was of the dynamics of competitive markets. However, the neoclassical economists and the neo-Marxist economists bifurcated his holistic perspective on the political economy, one taking those portions of the analysis that favored the owners of property, and the other taking those that favored the sellers of labor. Thus, the neoclassical economists left out Smith's considerations of the destructive role of power and class, and the neo-Marxists left out the beneficial functions of the market. Both advanced extremist social experiments on a massive scale that embodied a partial vision of society, with disastrous consequences.

If corporate libertarians had a serious allegiance to market principles and human rights, they would be calling for policies aimed at achieving the conditions under which markets function in a democratic fashion in the public interest. They would be calling for an end to corporate welfare, the breakup of corporate monopolies, the equitable distribution of property ownership, the internalization of social and environmental costs, local ownership, a living wage for working people, rooted capital, and a progressive tax system. Corporate libertarianism is not about creating the conditions that market theory argues will optimize the public interest, because its real concern is with private, not public, interests.