

## **Markets & morality**

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I'm afraid this blog post focuses on something that might appear esoteric to most of us: the nexus between economics and our moral compass. This has come up in several presentations I've had the good fortune to attend and is something that people seem to be paying more attention to than usual given a desire to reimagine a "new normal" – or in government parlance to "build back better".

Intriguingly, there seems to be quite a clear left/right division on this issue. Those on the left wing of the political spectrum view markets (and particularly large firms, often labelled "corporations") as inherently immoral. In contrast, those on the right tend to view markets as not merely efficient allocation mechanisms but "correct" ones.

I find this puzzling since it is pretty obvious that both are wrong. Equally puzzling is the belief of many economists that the market economy is somehow innate. There is certainly evidence to suggest that markets – as a means of trading resources – are quite fundamental. However, there is also strong evidence to contradict this (from both other species and hunter-gatherer societies).

So what is a market? It is ultimately a set of rules governing trade and the exchange of resources. Intimately connected is the question of property rights, which are the rules of ownership. Collectively, the two determine the allocation of resources. The determination of these rules, and their imposition, is a collective endeavour.

Thus, my right to exchange my labour to my employer in exchange for a currency that I can then use to purchase, for example, a washing machine and the conditions under which these exchanges can occur represent the rules of the market. These markets are not free: the washing machine shop cannot intentionally mislead me (e.g. by lying about the price), nor are they permitted to deliberately trick me (e.g. by knowingly selling a faulty washing machine without the right to return it).

Property rights determine ownership. It is these that determine that I own the washing machine (once it has been paid for). It is not permissible to break into my house and simply take the washing machine. The rules of exchange and property rights work in tandem: if I sell the washing machine then exchange must be by mutual agreement. I cannot force someone to buy it nor can they force me to sell it. The determination of a price must be acceptable to both parties.

This seems primitive, but actually requires quite a complex architecture to enforce. The police, judicial and penal system are costly. It is also not obvious: much of human history has been dominated by conquest and theft – the acquisition of resources by force.

Markets as a mechanism of exchange are not inherently immoral, but neither are they guaranteed to deliver morally acceptable outcomes. They are, fundamentally, amoral. The same is true of companies, however large. Companies are not people; they do not have an ethical or moral framework, although those who work for them do.

Companies do not choose more polluting modes of production or fail to take adequate safety precautions in developing countries because they are evil. They do so because society incentivises such choices through the property rights (broadly defined) and rules that we choose to apply to market interactions.

Similarly, the fact that any given set of property rights and market rules leads to a particular outcome does not make said outcome morally right. Take the use of sweatshop labour. Under existing market mechanisms, there is an incentive to use sweatshop labour in certain garment-manufacturing industries.

A company that uses it will, *ceteris paribus* undercut its competitors on price. However, even if companies actively wish to avoid the use of sweatshop labour (perhaps for reputational reasons), properly policing the entire supply chain is costly and difficult. Poor practices can be hidden by unscrupulous contractors.

As consumers, we lack detailed information on whether companies use such practices. We might suspect that cheap clothing is manufactured in sweatshops, but there have been alleged instances where even quite expensive garments have been produced using very poor labour practices (often without the knowledge of the ultimate brand).

As a society, we need to make a judgement as to whether we consider sweatshop labour immoral or not. This is an ethical decision, not a financial one. Some will argue that it is better than the alternative, others suggest it is abhorrent in its own right.

However, if society decides that such behaviour is outside the rules that we set for market engagement then it needs to be properly policed. We force companies to get their accounts professionally prepared and audited (at considerable cost). Detailed rules on this have grown up over a long period. There is no reason why such strictures could not be implemented to force companies to get their supply chain properly audited, with spot checks and “mystery workers”. Separately, there is also the question of penalties for non-compliance.

Of course, such procedures would be costly. However, that is also true of preventing crime in general. In a perfect society, there would need to be no need for police, courts, penal system or external auditors. The resources expended in such areas are very considerable, but society considers them worthwhile.

In general, where iniquities and moral failings arise it is because of the allocation of property rights. These are not set in stone. One of the rights we have determined is that we own our own labour. We have collectively decided that anybody has the right to withdraw their labour. This was not the case throughout most of human history: slavery, serfdom and various forms of indentured servitude were all common (and, tragically, still exist today).

However, property rights (economically speaking) are quite broad. It includes, for example, the right to pollute. Typically, such rights have lain with the polluter – if I buy a car and fuel, I have the right to drive it past your house and pollute the air you breathe. You would need to pay me to choose a different route. Today, that is changing: as more places introduce clean air zones, property rights are being transferred to those who live and work in such areas. You have the right to clean air and it is I who needs to pay in order to be allowed to drive down your street.

The upshot of all of this is that markets do not give an ethical framework. Neither good nor bad, they are simply amoral. As such, we need to take ethical ownership of the rules and rights that we set. The allocation of resources is one of ethics as well as economics.