In his comment on last week’s post, “How Businesses Create Wealth,” Arthur Franke, who seems to have inscribed me on his list of “endangering socialists,” allows that “your economic analysis is flawless, but I am wondering where you are trying to go with this essay.”

Actually, I was not trying to go anywhere with my analysis, other than to point out that businesses create value and wealth beyond the usually narrow slice that accrues strictly to the owners.

In most firms, the largest fraction of the gross value that businesses create with the goods and services they produce is channeled to employees. That allocation helps create household wealth, which may be held in the form of a home or other real estate, pensions or investments in mutual funds, or highly productive human capital — that is, highly educated offspring.

With their chronic suspicion of for-profit business, commentators on the left of the ideological spectrum insufficiently acknowledge that major contribution that business makes to social welfare.

In his comment, Mr. Franke worries further that this analysis “makes me wonder what you think is the purpose of business.”

That is a good and deeply philosophical question on which there are at least two distinct schools of thought: (1) the “neoclassical” or “liberal” theory of capitalism and (2) the “communitarian” or “stakeholder” theory.

Before exploring these theories, however, I should point out that I actually had not even thought of them in my post.

Merely observing that under certain circumstances businesses can redistribute wealth to the owners from their customers or employees is not a proposition that it is wrong to do so. It merely illustrates that increases in a company’s market capitalization may or may not constitute an increase in national wealth.

The neoclassical perspective: Mr. Franke argues that neither employees nor the communities in which a company operates nor government are stakeholders in the business, and that the sole “purpose of a corporation is to generate profits, hopefully obscene profits, for the benefit of its owners.”

Although other commentators took sharp issue with his vision, in proffering it Mr. Franke is actually in very good company.

It is, after all, precisely a normative proposition that economics professors the world over, myself included, now drum into the heads of their students. Either implicitly or explicitly all modern textbooks in economics adopt that vision.

This vision has its roots in Adam Smith’s celebrated passage:

> 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 interest. We address ourselves not to their humanity, but to their self-love, and never talk to them of our own necessities but of their advantages.” (“An Inquiry into the Nature and Causes of the Wealth of Nations” (1776), Book I, Chapter 2, Par. 2)

Economists posit the singular objective of maximizing the owners’ “advantage” not only because it greatly facilitates modeling the behavior of business owners or executives. Most economists, if not all of them, also sincerely believe that if every individual and owner of a business maximizes his or her own advantage, collectively they will create the good society.

The neoclassical model does have stark implications that trouble people.

For one, it reduces human labor to just another input that is sometimes useful and dispensable at other times, like Kleenex. As such, the livelihood of employees and their families become just another adjustment factor that managers can use to protect the owners’ profits.

It is so even if corporate executives commit serious managerial errors — as most surely the executives of financial companies did in spades and as often happens in ill-conceived business acquisitions. The income and wealth of the corporation’s employees then typically are readily sacrificed to shore up the owners’ stake.

Lehman Brothers employees, who should have known better, probably have resented it. Not so economists

---

*Uwe E. Reinhardt is an economics professor at Princeton.*
and their disciples. They find nothing wrong with that form of “labor-market flexibility.” On the contrary, they routinely praise it.

Similarly, in this vision of business, one can hardly blame companies when they inject carcinogenic pollutants into the environment — unless there is a law that expressly forbids this — or, as in the financial crisis, when they trash the rest of the economy. Neoclassical disciples then put the blame on government for not regulating managerial decisions more tightly.

Indeed, it should be clear that in this vision of capitalism only very strict and pervasive government regulation can protect the rest of society from the enormous damage that capitalist enterprise sometimes can inflict on society, along with all of the blessings capitalism also provides.

One must wonder how many corporate executives feel comfortable seeing their decisions modeled in this crass depiction of their activities. For public consumption, at any rate, many of them routinely declare themselves deeply concerned with their customers and employees, and even express concern for the communities in which they operate. That posture slouches toward what is known as the “communitarian business model” or the “stakeholder model.”

The communitarian view: The stakeholder model of capitalism was most recently defended in The Wall Street Journal by none other than Klaus Schwab, founder and executive chairman of the renowned Geneva-based World Economic Forum, and guru to the world’s corporate and government executives.

Mr. Schwab argues that the singular focus strictly on shareholders’ wealth — so celebrated by neoclassical economists and in the Anglo-Saxon world — bears much of the blame for the financial, economic and moral crisis currently faced by that form of capitalism.

That view is more fully stated by Surendra Arjoon in “A Communitarian Model of Business: A Natural-Law Perspective” published in the fall 2005 issue of The Journal of Markets & Morality. Mr. Arjoon writes that neoclassical economics (also called “liberal” economics) is

... mistaken in thinking that there are natural-economic laws which, if left alone, will automatically bring about the best results for all concerned. For example, we continue to witness the moral decadence of the last two decades stemming from mergers and acquisitions; savings and loan scandals; environmental pollution; and issues in corporate governance, corporate social responsibility, and insider trading. Liberalism has also failed mainly because it could not deal with the human persons who demanded respect for their dignity and enough security to make their freedom worth having.

Recent contemporary political philosophy has now focused on the communitarian-liberal debate.

One finds a similar strain of thought in the writings of Amitai Etzioni, the éminence grise of communitarianism this side of the Atlantic. His views on capitalism were recently explored in a number of celebratory essays on his seminal book “The Moral Dimension: Towards a New Economics” (1988).

In short, the argument put forth by the “communitarian” or “stakeholder” school is that if capitalist enterprise disregards the social and economic welfare of employees, of their families and of the communities in which that enterprise operates, it will ultimately destroy the very socio-economic basis on which modern capitalism flourishes.

The communitarian school is the proper target for Mr. Franke’s lancet — not this hapless country economist from rural New Jersey who demurely teaches the narrow and simple neoclassical vision of capitalism that most American economists fancy.

©2010 The New York Times Company