Roelof Salomons, Maartje Schulz
& Ruben Oude Engberink

A Free Market For All

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Foreword

As a species, we owe a great deal to the Enlightenment. In his book, *Enlightenment Now* (2018), Steven Pinker explains why. In the early nineteenth century, nearly ninety percent of humanity lived in poverty. Today, this is only the case for a mere ten percent. Pinker demonstrates that we have not only progressed economically, but in many other areas as well: 'Our lives have become longer, healthier, safer, happier, more peaceful and more prosperous—not just in the West, but across the globe.' This is no coincidence, he writes: 'This is mainly because we have embraced, often implicitly, the values of the Enlightenment: reason, science, humanism and progress.' The Swedish liberal Johan Norberg reached a similar conclusion in his book *Open* (2020). Throughout history, our openness to other people, ideas and trade has always been a key to success.

All these values are key pillars of liberalism as we know it today. The market economy is an example of this. All closed systems without a free market economy have ultimately failed. Let us remember this and not fall into the trap of resurgent centralism and populism that restrict progress, freedom and openness. Our society is so complex that simplistic answers do not suffice. The comprehensive government intervention we experienced at the start of the corona pandemic is only desirable or effective in exceptional circumstances and may only be temporary.

At the same time, however, insights and preferences can change significantly. For example, we are realising that we're not paying the true price for polluting products. The external costs still carry too little weight in the current economic system. I am a strong believer that sustainability, biodiversity and nature deserve a prominent place in the future market economy.

This is one of the aspects where capitalism can be refined to fit the modern age. When *The Economist* celebrated its 175th anniversary, the weekly wrote about the future of liberalism. It stated that the 'true spirit' of liberalism is radical and disruptive. This idea appeals to me. I see liberalism in terms of progress and the freedom to make your own choices. The rules of the market economy are not set in stone either; we must continue to think in terms of solutions. The market should serve us all, not the other way around.

So let us change the market to match today's and tomorrow's world. In this book, we propose several adjustments. It's the start of a discussion in which we prefer not to throw out the good with the bad.

Robert Reibestein
Chairman of the curatorium of the TeldersStichting

Introduction

The free market has brought a lot of good to the world. It has enabled individuals to enjoy unprecedented prosperity in freedom. Liberal democracies that integrated a regulated free market into society have experienced exponential growth in wealth over the past two decades. Growth in terms of prosperity initially emerged in the West and this trend continues on a global scale to this day.

At the same time, critique of capitalism is making a comeback. In public opinion, 'the market', or capitalism appears to be failing on many levels. It is said to cause inequality and destroy the environment, while CEOs and shareholders collect high bonuses and dividend payments and multinationals evade taxes. In this view, free-market capitalism is focused purely on profit, neglects social goals and leads to a culture of excess. Critics say the state should seize more power over the market, especially now the momentum is there due to the corona pandemic. Market criticism comes from all directions: from Pope Francis to Piketty. They tend to speak out against the so-called 'neoliberal' market society.

It is high time to outline the liberal outlook on the matter and to set a different tone in the public debate. Capitalism, or—as liberals prefer—'the free market', demands a serious, liberal reflection on the critiques as well as a renewed plea. For in the storm of criticism, we must not lose sight of the blessings of the free market. The many merits the free market has brought us, and will continue to bring us in the future, deserve to be emphasised. At the same time, this does not relieve us, liberals, of the obligation to continue to explore how the market can be better designed so that it continues to serve humanity. The aim of this writing is to arrive at a vision of a market that works in the best way possible—for everyone.

Structure of the Book

This book will begin with a section (A) explaining the relationship between liberalism, capitalism and the free market. Furthermore, it outlines why liberals are in favour of a free market and which basic conditions and rules are deemed necessary for a well-functioning free market. The accomplishments of societies with liberal democracies and markets will be demonstrated.

In the second part of this book (B), the most important contemporary critiques, each accompanied by a reflection, are featured in independent chapters. Some criticisms are refuted, but other critiques are (partly) included in a liberal sense. These eight chapters are all structured in the same way. The specific critique is described, followed by our reflection on the matter. Each chapter concludes with ideas for the way forward. The book ends with a brief plea for why we should continue to embrace the market and recommendations for a future-proof market that works for all of us. Before we go onto the substantive chapters, we present a summary of the main criticisms and our answers to them below.

Overview of the Critiques and Our Answers

The Critiques of Capitalism

1. Capitalism no longer benefits ordinary people and small and medium-sized enterprises (SMEs), but mainly benefits large companies/multinationals.

2. Capitalism harms the climate, our immediate living environment and depletes our raw materials. We should no longer focus on (limitless) economic growth, but stay within the boundaries of what the planet can handle.

3. There is too much concentration of power. In some sectors, only a handful of companies hold power, as is the case with Big Tech. A disadvantage of power concentration is the lack of competition and the fact that a dominant market position is sometimes exploited. As a result, companies no longer have the incentive to innovate, there is less choice for consumers, prices are artificially high and buyers get less value for money.

4. Shareholder capitalism focuses only on short-term profit. Shareholders have too much power. Other types of stakeholders need to gain more say in companies. Companies must pay more attention to social objectives.

5. Capitalism leads to inequality and that is problematic/undesirable. Inequality has increased excessively in recent decades.

6. More is needed for a well-functioning market than a government that merely keeps an eye on the rules of the game. We need a strong government, one that can intervene in the market and invests in goals that we—as a society—deem important. The corona pandemic has demonstrated the importance of a strong, guiding government. Our public sector deserves a greater role and more appreciation.

7. The free market—in the sense of international free trade—has too little consideration for the protection of vital interests. There is too much emphasis on the economic benefits of a highly intertwined international market and too little attention is paid to national security. For example, when it comes to self-sufficiency with regard to certain medical supplies or when building the 5G network.

8. The market is immoral and does not provide 'the good life'. Market thinking is also spreading beyond the economic field. People only regard each other in terms of usefulness, while life should not revolve around 'the economy' and money, but be centred around values such as community spirit, tranquillity and beauty. The market is overly focused on self-interest, which results in greed.

Our Answers

Critique 1: The market only works for multinationals

Adam Smith and other liberal thinkers were not in favour of the free market in order to enrich large entrepreneurs at the expense of consumers, but because it can help better the lives of ordinary people. Translated to the present, this means that large companies should not be favoured. Wherever this does happen, perverse incentives should be removed from the system. Citizens, SMEs and large companies should contribute their fair share to the public facilities that everyone benefits from. The state should not facilitate constructions such as 'letterbox companies'. At the same time, it is in *no one's* interest to drive companies away with sky-high taxes or overload them with regulations. An economy stands or falls with the various companies that comprise it. Good jobs are in the interest of us all.

Critique 2: Capitalism harms the climate

Liberals also value a pleasant living environment and a habitable planet, both now and in the future. There is no need to get rid of the market economy to save the planet. In fact, it is precisely the progress that the market has brought us, which has created the space and opportunity to pursue goals related to the climate and environment. We must focus on innovation. The government and the market can complement each other by linking fundamental research to innovation in companies. In this way, we can continue along the road of dematerialisation and technologies can be developed that contribute to combating the depletion of the earth on a global scale. In addition, external damage, whether immediately visible, for example waste discharged into a river, or only visible in the long term, such as climate change, must be priced effectively according to the 'polluter pays principle'. The government can also set rules to prevent serious damage. Furthermore, companies will have to adapt to the increasing call in society to prevent damage to the planet. Let the market take its course here.

Critique 3: There is too much concentration of power

Liberals distrust power. Not just powerful governments; powerful companies as well. Individuals benefit from spreading and limiting power. Liberals also believe in competition. Competition creates freedom of choice. Consumers are free to choose from different services and products, employees can choose from different employers and companies continue to develop through innovation. Exploitation of dominant market positions, such as obstructing small competitors from developing into fully-fledged contenders, must be prevented. A strong, knowledgeable regulator that monitors the market process is essential.

Critique 4: Shareholder capitalism focuses only on short-term profit

Shareholders sometimes have the reputation that they do not take social values into account. This image is not supported by reality. In addition to taking their shareholders into account, companies also have to create value for employees, customers, and society as a whole. Companies that

don't take good care of their employees will lose them. Companies that don't treat their customers well, will see those customers buying products elsewhere. And companies that fail to comply with ESG standards are increasingly having a hard time with shareholders and experience more difficulty in attracting funding. Committed shareholders therefore pay attention to the interests of all stakeholders. This is long-term value creation. Capital often flows to these very places. But this process is not always perfect. Excesses occur, where shareholders have no connection with the company at all. And sometimes, interests between investors and companies are not aligned.

Critique 5: Capitalism leads to inequality

Inequality in income and wealth has increased in recent decades. In earlier work by the TeldersStichting, it has been argued that the increase in inequality in the Netherlands is not as significant as it is sometimes perceived to be. Especially when taxes and supplements are taken into account. Furthermore, in the case of wealth inequality in the Dutch context, pension accumulation is often disregarded. This nuance is relevant, but it doesn't help the discussion any further. Let us be clear: for liberals, inequality in income and wealth is *not* a problem *if* it is the result of a fair process where everyone has a chance. Low social mobility leads to an undesirable situation, where inequality exists not only in outcomes, but also in opportunities. Outcomes may differ, but the place of your cradle should not determine where you end up. Our policies, for example when it comes to education, skills training and job opportunities, should be geared towards this. The generational transfer of wealth also plays a role in unequal opportunities. Inheritances should be taxed as income of the recipient. Own merit, such as work, should be rewarded more.

Critique 6: The government has let the market run its course too much

Some see the corona pandemic as the perfect opportunity to make the temporary market interventions by the government permanent. This is a scenario we do not wish to see. The corona pandemic is an exceptional situation, and what is needed for the exception is not sensible policy for ordinary times. More government is not the solution to every problem:

the market is much better able to deal with complexity than a government as a central planner. The government has a number of important core tasks and should let the market run its course. 'Zombie companies' should not be left on government aid for too long. Support people through social security and on their path to new employment, instead of supporting low-viability companies. Bankruptcies are part of a healthy economy. There are areas, however, where more governance is needed to enable the market to work better. For example, investing in growth potential through knowledge, research and innovation. The government also has a part to play in ensuring that everyone in society is given the opportunity to grow and move forward.

Critique 7: The free market takes too little account of vital interests

The corona pandemic has shown us that dependence on other countries creates vulnerability when, in times of crisis, countries focus on their own survival. Producing everything ourselves is not the solution. That is impossible and undesirable. International trade has brought us a great deal of prosperity and security. It is, however, necessary to keep our security interests in mind—in addition to our commercial interests. That's why it's good to have a plan B, should international trade come to a standstill. It would also be sensible if the Netherlands, in collaboration with the EU, would invest in strategic (technological) sectors such as artificial intelligence. Where strategic (medical) stocks are still lacking, these must be built up. In addition, when it comes to vital sectors, we should not be dependent on a single player in the market. What also matters is who you depend on: working with (state-supported companies from) countries such as China, for example, entails additional risks.

Critique 8: The market is immoral and does not provide 'the good life'

The free market does not equate to selfishness, unlimited consumerism, greed and disregard for human relations, as is sometimes suggested. For liberals, it is important to tell a story about the free market which differs from the image of an atomistic playing field of individuals driven by financial gain. The market is characterised by a great many interactions and collaborations between people, and is therefore an excellent place

for moral development. It also offers one the freedom to organise one's own life. The free market that, when it works well, gives you the opportunity to make choices. Choices about what kind of work you do, what you buy, sell, how you conduct yourself morally and how you spend your time. It leaves room for your own interpretation of what the 'good life' is. This market, one that is free to a certain extent, is a precondition for any liberal society. This does not mean, however, that the market itself is declared a life goal for liberals.

A. Liberalism and the Free Market

> 'We pay too little attention to the reserve power of the people to take care of themselves. We are too solicitous for government intervention, on the theory, first, that the people themselves are helpless, and second, that the Government has superior capacity for action. Often times both of these conclusions are wrong.'
>
> Calvin Coolidge[1], Philadelphia, 25 September 1924 (during the celebration of the first *Continental Congress*)

This section will discuss how liberalism relates to the free market and capitalism. To this end, it is necessary to clarify a few concepts first. What do we mean by terms such as 'free market' and 'capitalism'? A brief description of liberalism will be offered next, followed by an explanation of why liberals favour an economic system based on the market and private property. Subsequently, the achievements of the free market are discussed in more detail. Finally, the question of what a well-functioning free market is understood to mean by liberals is addressed. This will make apparent that in liberal thinking, the free market is not as limitless as is often thought.

I. Concepts

For the sake of clarity, we will now define several concepts, which will be referred to frequently throughout this book.

Capitalism: Capitalism is an economic system in which the emphasis lies on private property. Capitalism is characterised by the following

1. Between 1923 and 1929, Calvin Coolidge was the 30th President of the United States.

factors: the means of production are privately owned, labour is the legal property of the individual, and markets serve as a mechanism for dividing production and consumption. Capitalism thus stands in contrast to socialism, where property and labour are seen as collective goods and the means of production are under social control, which in practice, often comes down to government control.[2]

The free market: The free market can be regarded, in the most original sense of the word, as a natural phenomenon where people interact and trade freely. Today, the market is characterised by the exchange of goods and services by individuals or collectives, with money being the usual intermediary. This leads to the establishment of prices.[3] In a free market, individuals make the most important decisions regarding production, distribution and consumption, collectively or otherwise (as in companies).[4] The market mechanism ensures dissemination of information regarding these individual decisions. However, the free market as it is implemented in many western democracies is not a *laissez-faire* mechanism as is sometimes believed.[5] It is a signifier for the market mechanism wherein the individual can enter into transactions within certain legal limits and rules, and where private property is legally protected.

Liberalism: A political movement that comes in many forms. Characteristic of each form is that the organisation of society revolves around the freedom of the individual.[6] In addition, liberal philosophy assigns an intrinsic value—or dignity—to the individual. Liberals take the individual as the starting point for their thinking and acting, whereby—as a general rule—they see individual freedom as the most important goal.[7]

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2. Pablo Gilabert and Martin O'Neill, 'Socialism', *The Stanford Encyclopedia of Philosophy*, 15 July 2019, (https://plato.stanford.edu/archives/fall2019/entries/socialism).
3. Lisa Herzog, 'Markets', *The Stanford Encyclopedia of Philosophy,* 8 September 2017, (https://plato.stanford.edu/entries/markets/).
4. Peter Berkowitz, 'Capitalism, Socialism, and Freedom', *Essay Series Socialism and Free-Market Capitalism: the Human Prosperity Project*, Hoover Institution, 2020, p. 2.
5. Fleur de Beaufort, *Ben Telders: Moedig, strijdbaar en onverzettelijk*, in: de Beaufort a.o. (red.), Amsterdam, 2020, p. 165.
6. Gerald Gaus, Shane D. Courtland and David Schmidtz, 'Liberalism', *The Stanford Encyclopedia of Philosophy*, 22 January 2018, (https://plato.stanford.edu/entries/liberalism/).
7. Fleur de Beaufort and Patrick van Schie, *Sociaal-liberalisme,* Amsterdam, 2014.

In recent times, the term ***neoliberalism*** has re-entered the public debate. A concept used to label a great many things people dislike about the market, capitalism or liberalism. Neoliberalism is blamed for all sorts of misery: from loneliness to over-achievement (see also Chapter 8). There is no consensus on what neoliberalism is exactly. In fact, definitions vary greatly. The term is used to emphasise the untamed market, deregulation and the *laissez-faire* mechanism. At the same time, it is also used to describe an active government, one that constructs market forces everywhere, resulting in increased bureaucratisation and regulatory pressure. On the contrary, neoliberalism is sometimes interpreted as a kind of third path, somewhere between *laissez-faire* economics and the tendency towards central planning.[8] In short: a general conceptual confusion exists.

What is striking is that hardly anyone identifies as a neoliberal, while people do identify with terms as liberal or social democrat. Nowadays, the term neoliberal is predominantly perceived as an insult. We are therefore not inclined to adopt this confusing and negatively charged term, let alone embrace it. Besides, the term is completely redundant. A liberal who wants as little interference from the government as possible and who would typically argue for deregulation? A classical liberal. A liberal who envisions a more active role for the government? This liberal will feel more at home within social liberalism. Someone who wants to introduce market forces in government bodies? A supporter of the *New Public Management* thought. The latter is not something liberals are necessarily in favour of, however. It's a misconception that liberals wish to introduce market forces everywhere. In the liberal view, the market does its job and where a government is needed, this is a public task that should generally not be artificially organised as a market. As we describe in Chapter 6, liberals value the distinction between the public

8. As far as we are concerned, this last explanation still has the most historical validity. It was about a group of thinkers in the 1930s who advocated an orderly market economy. For example, there were German Ordo liberals who called themselves neoliberal and believed that markets should be actively constructed. Remarkably enough, this historical interpretation is rarely used in the public debate. For a more extensive treatise on the history of the term (and its use), we refer to a 2014 article by Professor Peter-Wim Zuidhof 'De wonderlijke geschiedenis van het neoliberalisme: Alles wat je ooit wilde weten over het neoliberalisme maar nooit durfde te vragen.' Also see: Martin van Hees, Patrick van Schie and Mark van de Velde, *Neoliberalisme: Een politieke fictie*, Amsterdam, 2014.

and private domain. Also, most liberals are not in favour of a complete *laissez-faire* of the market. Many liberals recognise the need to restrict the market, for example by having the government act as a regulator. *Laissez-faire* is more in keeping with the ideas of a libertarian, who places an even more radical emphasis on freedom and envisions little or no tasks for the government.

In most cases, liberals are not in favour of the various matters neoliberalism is criticised for. What exactly is so liberal about the current associations with the term neo*liberalism*, remains a mystery. When excesses of an unregulated market occur, or problems arise when a government half-heartedly wants to establish competition everywhere and causes bureaucracy through 'performance agreements', we can simply call out those problems for what they are. If necessary, we can set (new) preconditions for the market, arrange several public core tasks more publicly, and transfer some tasks that are currently performed by a government back to a *real* market. But such relevant discussions do not require a neoliberal phantom.

II. Liberalism, the Free Market and Capitalism

Liberalism is a comprehensive term that can be interpreted and defined in different ways in different contexts. However, the core of any liberal conception always revolves around the freedom of the individual. Every movement within liberalism takes the fundamental political value of freedom as its starting point. While there are various conceptions of freedom, the most commonly used definition in liberal democracies is negative freedom as defined by Isaiah Berlin:

> 'I am normally said to be free to the degree to which no man or body of men interferes with my activity. Political liberty inthis sense is simply the area within which a man can act unobstructed by others. If I am prevented by others from doing what I could otherwise do, I am to that degree unfree; and if this area is contracted by other men beyond a certain minimum, I can be described as being coerced, or, it may be, enslaved. Coercion is not, however, a term that covers every form of inability. If I say

> that I am unable to jump more than ten feet in the air, or cannot read because I am blind… it would be eccentric to say that I am to that degree enslaved or coerced. Coercion implies the deliberate interference of other human beings within the area in which I could otherwise act. You lack political liberty or freedom only if you are prevented from attaining a goal by other human beings.'[9]

It is about the freedom *of*, that is, the domain in which the individual can act undisturbed: the personal sphere of life.[10] Some liberals also attach great value to Berlin's second concept of freedom: positive freedom. Also known as the freedom *to*. Think, for example, of actively creating life opportunities for people. Nevertheless, negative freedom for liberals is, as far as we are concerned, the foundation of the concept of freedom. As John Locke wrote in 1689, each individual has the freedom to shape their behaviour as they please, without having to ask permission or having to take the other into account.[11] This is in line with the classical liberal philosophy that every individual can act as they wish, without being restricted by, or dependent on, outside factors. Being able to act freely without restriction can logically result in the restriction of others, therefore, this conception of freedom never holds for everyone at the same time. To make freedom manageable, John Stuart Mill formulated *the Harm Principle*, which states: 'The only purpose for which power can be rightfully exercised over any member of a civilised community, against his will, is to prevent harm to others.'[12]

This brings us to the free market as a mechanism wherein the individual can pursue their goals and wishes, without harming the freedom of the other. The market, embedded in a good framework[13], is the right instrument to implement this individual freedom. In fact, the market provides nothing more than a guarantee of individual freedom (of choice)

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9. Isaiah Berlin, *Four Essays on Liberty*, Oxford, 1969, p. 122.
10. Fleur de Beaufort and Patrick van Schie, *Sociaal-liberalisme*, Amsterdam, 2014, p. 23.
11. John Locke, *Second Treatise on Government*, 1689, Chapter II, §4.
12. This well-known John Stuart Mill quote comes from *On Liberty*, published in 1859. It is one of the standard works of liberal philosophy to this day.
13. Consider the importance of an effective legal system in a society, in which property rights and consumer safety are safeguarded, among other things. Other harmful side effects can also be banned, such as waste discharge into open water or soil.

within the economic sphere.[14] After all, in the free market, people can decide for themselves which employer they want to work for and which products they want to buy at which prices. Ergo, the fundamental value of individual freedom, which is central to liberalism, can be translated into individual freedom in economic transactions, by structuring it in accordance with the principles of the free market. The framework in which this market is embedded ensures that the liberal harm principle can also be guaranteed.

Now that we have an image of how the free market fits within the liberal framework, the next question is how liberalism then relates to the concept of capitalism. The term capitalism, given its emphasis on the word 'capital', is less favoured than the concept free market. Capital is not central to our thinking. In our view, capital is merely one of the tools necessary for a well-functioning market (in the sense that financing/capital is needed to realise good business ideas).[15] Capital is not a sacred goal for liberals, freedom is the ultimate goal. We therefore prefer to speak of the market or the free market, where—by definition—the emphasis is on *free exchange,* or in a broader sense: the *individual freedom in economic traffic*.

Nevertheless, it's good to realise that a system centred around private property—a core part of the concept of capitalism—is a precondition for guaranteeing the individual freedom that is much loved by liberals. Friedrich von Hayek explains this in his famous book *The Road to Serfdom (1944):* 'What our generation has forgotten is that the system of private property is the most important guarantee of freedom, not only for those who own property, but scarcely less for those who do not. It is only because the control of the means of production is divided among many people acting independently that nobody has complete power over us, that we as individuals can decide what to do with ourselves.'

Thus, according to Hayek, freedom cannot exist if a dominant power, such as a state, has complete control over property. Without private

14. See also §6 of the Declaration of Principles of the VVD from 2008.

15. The liberal thinker Deirdre Nansen McCkloskey even completely rejects the term capitalism, because—according to her—capital plays only a very limited role in progress. She calls the concept of capitalism a 'scientific mistake'. In her opinion, developing good ideas is much more important than capital accumulation. See her book: *Why Liberalism Works: How True Liberal Values Produce a Freer, More Equal, Prosperous World for All*, 2019, New Haven and London, pp. 231-235.

property, there is no control over your own life. In short, a society based on private property is the only way to organise a society that is consistent with primary liberal principles such as individual freedom and responsibility.[16] But if capitalism goes too far, for example in the glorification of big business, that is not befitting a liberal. Adam Smith believed in the free market because it would help the common man—the consumer. He was not in favour of a system that would benefit or enrich big earners. Chapter 1 discusses this in more detail.

In summary, economic freedom naturally springs from general liberal freedom-thinking. The pursuit of economic freedom is therefore an important pillar of liberalism. At the same time, it is good to emphasise that liberalism is a broad movement that does not focus merely on economic freedom. For instance, the pursuit of spiritual and political freedom has always been important in the liberal tradition.[17] Liberalism is more than the quest for a free market.

III. The Blessings of the Free Market

In that which preceded, we discussed how liberalism relates to the free market and capitalism. In what follows, we will address the blessings the free market has brought us and continues to bring us today. In a general sense, we can say that successful Western democracies are often rooted in a form of liberalism where the market guarantees individual freedom and creates prosperity.

If you zoom in a little further, you'll see that free market advocates commonly use three kinds of arguments to justify it. These relate to the freedom of the individual, the outcomes of the free market and the role of the market in moral development.[18] We have already outlined the first argument: each individual has an *a priori* right to freedom. The market is consistent with the principle that individuals make their own decisions in freedom. Liberals assume that most people are capable of making their own choices and bearing the associated responsibility.

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16. See also §2 of the Statement of Principles of the VVD from 2008.
17. Fleur de Beaufort and Patrick van Schie, *Sociaal-liberalisme*, Amsterdam, 2014, p. 19.
18. Lisa Herzog, 'Markets', *The Stanford Encyclopedia of Philosophy,* 8 September 2017, (https://plato.stanford.edu/entries/markets/).

The free market has led to unprecedented prosperity

The second argument relates to the outcomes of a market economy society. The bottom line is that the market is an effective instrument to provide for the distribution of scarce resources, by bringing supply and demand together in a natural way. This requires some more explanation.

Adam Smith introduced the theory of the individual pursuing their own self-interest in the market. The market functions as a dynamic playing field where supply and demand find a balance. It is important here, not to confuse self-interest with selfishness at the expense of the other. In fact, individuals who pursue a well-understood self-interest are able to achieve collective prosperity. Individuals often work together in that process and earn their living by serving the consumer well. Specialisation makes it possible for everyone in the collective to efficiently produce their part. The resulting trade ensures that needs are met at a more efficient production. Smith described this as follows: 'It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regards 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.'[19]

It must be said that Adam Smith developed his theories in the pre-industrial era of the Scottish Enlightenment. Yet, with his analysis of supply and demand, he has paved the way for the development of economic science and its implementation in Western societies, which have led to a massive growth in wealth over the past two centuries. After him, many (well-known) economists and philosophers followed, who contributed to economic science from their own zeitgeist. While entire books could be written on this development, we will limit ourselves here to examining a few prominent thinkers whose ideas have contributed greatly to market-thinking.

After *The Wealth of Nations*, a great deal of literature followed that was devoted to the elaboration and further understanding of the market mechanism. A distinction can be made here, between the objective and subjective theory of values. The first relates mainly to the production

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19. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, London, 1776, book 1, chapter 2.

side: the supply side of the economy. The central idea is that the value of a product is manifested by the input needed to produce it. This can take the form of raw materials, capital and labour. The more of a particular type of input is required, the higher the final value of the product. In *On the Principles of Political Economy and Taxation* (1817), David Ricardo explains this theory of value from the production perspective. His analysis begins with the observation that specialisation requires an extensive exchange of goods. In this process, the exchange ratio of goods is determined by the amount of input used, and that's how prices are established.[20]

The subjective theory of values, which mainly stems from the Austrian School, is based on the individual's point of view. The individual assigns value to products and services based on their ability to meet individual needs. The price mechanism serves as an efficient and effective way to disseminate information about needs. Entrepreneurs then respond to these needs and satisfy them at a cost that makes it worthwhile for them to deliver to the consumer.[21]

The market ensures that information regarding demand is disseminated, which is subsequently used by entrepreneurs to determine their production (supply) and supplies. Trade arises from a multitude of individual plans. Outcomes of trade arise from the dissemination of all these plans. The strength of the market lies in the use of all these points of information which manifest themselves in prices. Unlike a comprehensive government plan, the price mechanism is able to combine and coordinate all these individual trade-offs. From the subjective theory of values, it can be concluded that profits are a reflection of what is valued. It indicates that scarce resources are distributed in such a way that individual needs are satisfied.[22] If these profits are higher, it means that a product is highly valued. The objective theory of values is somewhat outdated in the sense that, in determining the value of a product or service,

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20. Jan Reijnders, 'David Ricardo', in: Mark van de Velde (red.), *Marktmeesters. Portretten van vooraanstaande liberale economen*, Amsterdam, 2004, pp. 71-92.
21. Rudy van Zijp, 'Oostenrijkse School', in: Mark van de Velde (red.), *Marktmeesters. Portretten van vooraanstaande liberale economen*, Amsterdam, 2004, pp. 114-140.
22. Frans de Graaf a.o., *Vertrouwen in de markt. Naar een liberaal privatiseringsbeleid*, TeldersStichting, The Hague, 2007.

it does not necessarily matter how hard you have worked for something. What counts is the value that individuals attach to it.

In past centuries, we have seen many socialist systems fail. The communist Soviet Union and Mao Zedong's China are two well-known examples. Both have led to widespread poverty and many deaths among the population. These systems were unable to create an amount of wealth even remotely comparable to that of western free market capitalism.[23] So, besides the fact that these systems limit the freedom of the individual, they have also proven to be ineffective with regard to wealth creation. Even today, in Venezuela, for example, you can see that a socialist regime is unable to escape a situation of deep poverty.

Why have these societies not been successful in creating wealth and economic growth? The main issue is in what Hayek refers to as *planning*:

> 'In ordinary language we describe by the word "planning" the complex of interrelated decisions about the allocation of our available resources. All economic activity is in this sense planning; and in any society in which many people collaborate, this planning, whoever does it, will in some measure have to be based on knowledge which, in the first instance, is not given to the planner but to somebody else, which somehow will have to be conveyed to the planner. The various ways in which the knowledge on which people base their plans is communicated to them is the crucial problem for any theory explaining the economic process.'[24]

In other words: you can only fight complexity with complexity (decentralisation). A central planner is not capable of this, because it's simply not possible to collect all the information needed to streamline the economic process. A central planner does not have the advantage of the pricing mechanism that coordinates the numerous individual points of information. Thus, from both a theoretical and historical perspective, socialist societies are ineffective at creating prosperity. Western liberal

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23. Steven Pinker, *Enlightenment Now: The Case for Reason, Science, Humanism and Progress*, New York, 2018.
24. Friedrich von Hayek, 'The Use of Knowledge in Society', *The American Economic Review* 35(4), 1945, pp. 519-530.

democracies that are rooted in the price mechanism, have been more successful. The free market, with its price mechanism, is better able to deal with this complexity, because a free market allows information to spread naturally across society. In this way, a process of evolving spontaneous order is created in the market, resulting in economic prosperity.[25]

Despite the recent criticism, there's no denying that there has been an unprecedented growth in global wealth over the past two centuries. The global GDP per capita has grown since 1870 (Figure 1). Extreme poverty has also declined on a global scale. The percentage of the world population living below the poverty line has dropped considerably in recent decades (Figure 2). The general level of people with a minimal form of education has increased enormously worldwide (Figure 3). Living

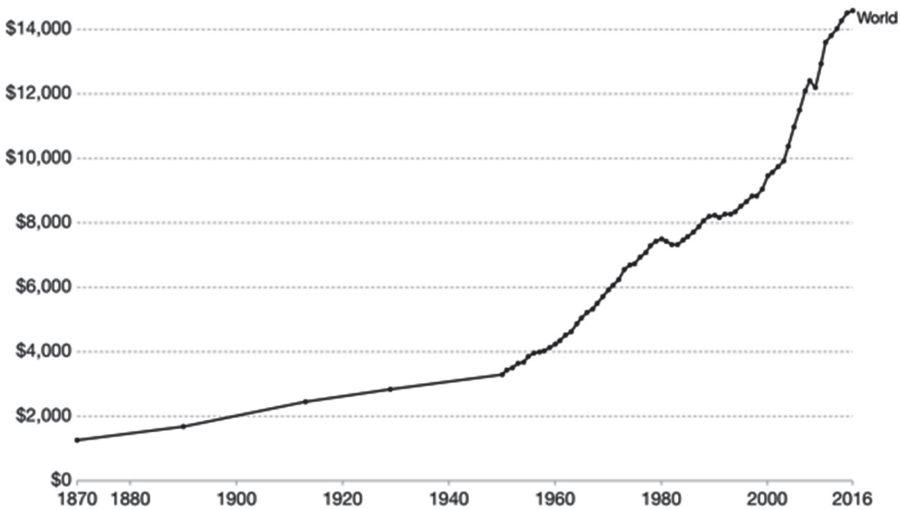

Figure 1. **The rise in global GDP per capita in the period 1870-2016***

Source: OurWorldInData (GDP per capita, 1870-2016). Based on data from *Maddison Project Database*, version 2018. Jutta Bolt, Robert Inklaar, Herman de Jong and Jan Luiten van Zanden, 'Rebasing "Maddison": New Income Comparisons and the Shape of Long-Run Economic Development', *Maddison Project Working paper 10,* 2018.

*The figure shows the increase in real GDP per capita of the world population, measured as the international dollar price from 2011, adjusted for differences between countries and inflation. A clear exponential growth is visible in the income per capita of the world population.

25. Frans de Graaf a.o., *Vertrouwen in de markt*, TeldersStichting, The Hague, 2007.

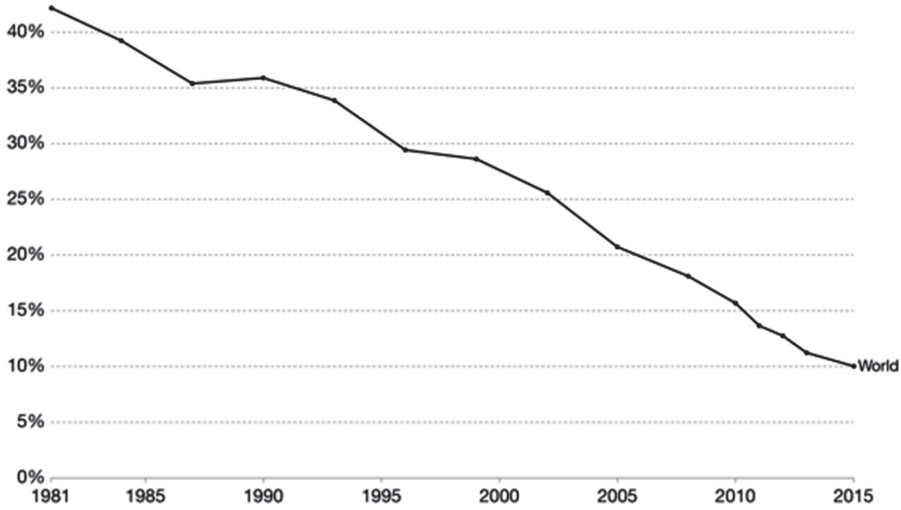

Figure 2. **The percentage of the world population living below the poverty line in the period 1981-2015***

Source: OurWorldInData (Share of population living in extreme poverty, 1981-2015). Based on Worldbank data (1977-2017).

*The figure shows that the proportion of people worldwide living below the poverty line (set at $1.90, adjusted for price differences between countries and inflation) is becoming smaller and smaller, when measured in terms of income and consumption at the household level.

conditions have thus improved exponentially since the Industrial Revolution. People all over the world are becoming increasingly educated, the average life expectancy has increased enormously and an increasingly smaller percentage of people live in poverty.[26] 'Every additional long-lived, healthy, well-fed, well-off person is a sentient being capable of happiness, and the world is a better place for having more of them' writes Harvard professor Steven Pinker in his well-known, optimistic work, *Enlightenment Now: The Case for Reason, Science, Humanism and Progress*, New York, 2018.[27]

26. Anna Rosling, Hans Rosling and Ola Rosling, *Factfulness: Ten Reasons We're Wrong About the World—and Why Things Are Better Than You Think*, New York, 2018.
27. Steven Pinker *Enlightenment Now: The Case for Reason, Science, Humanism and Progress*, New York, 2018, p. 88.

In the public debate, the discussion on the distribution of wealth often overshadows the need to create wealth and the (liberal) mechanisms underlying it. The development of shared knowledge and science, evolving norms and values and increased trade opportunities as a result of openness and globalisation have enabled an ever-increasing part of humanity to build a life without poverty.[28]

Statistics indicate that wealth is spreading more and more widely. Western democracies have been at the forefront of this exponential development of prosperity. This took place after market thinking grasped politics in these regions.

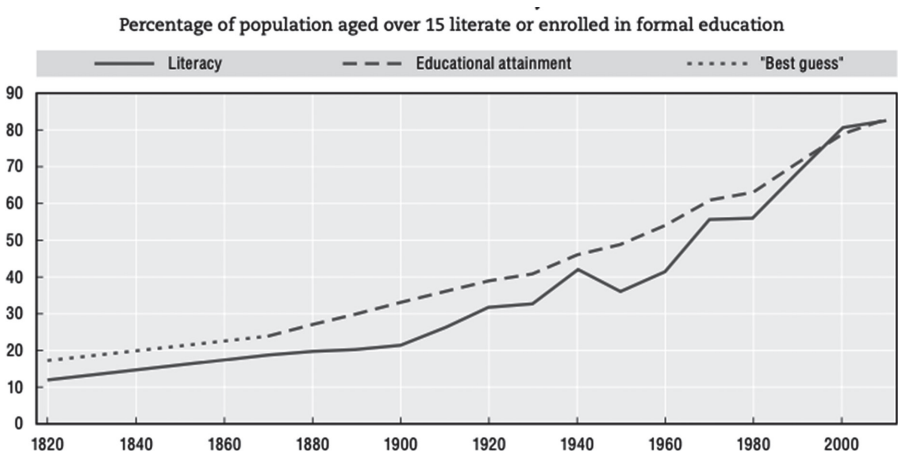

Figure 3. **Global literacy development and completion of primary education in the period 1820-2010**

Source: Jan Luiten van Zanden a.o. (red.), *How Was Life?: Global Well-being since 1820,* OECD publishing, 2014, p. 94.

Moral development

The free market also plays a role in the moral development of individuals, and thus of society. Growing prosperity has created a form of security for many, which means that one does not have to deal with securing their own livelihood every minute of the day. This leaves time

28. Steven Pinker, *Enlightenment Now: The Case for Reason, Science, Humanism and Progress*, New York, 2018.

for self-development and moral development. This idea—the market as a medium for exchanging information contributing to moral development—can already be attributed to Adam Smith. The Scotsman, who is considered the founding father of economic science, was first and foremost a moral philosopher. Today, especially among economists, he is most famous for his book *The Wealth of Nations*, which is considered to be one of the first works to outline supply and demand and to promote specialisation. Smith introduced the concept of *the invisible hand*, which brings supply and demand together and ensures a balance in production and consumption.

Smith coined the term seventeen years before *The Wealth of Nations* was published, in his moral philosophic work *The Theory of Moral Sentiments*, published in 1759. According to Smith, the invisible hand—through the exchange of information between individuals—guarantees the development of norms and values. Because people are continually exchanging information and ideas through spontaneous interactions, they are constantly developing themselves morally. So, the market does not only facilitate a practical exchange of financial-economic information, but it also results in moral development.

Besides, the monetary value of a product or service is merely an expression of the value individuals attach to it. This monetary value is based on all kinds of non-monetary values. Personal preference and ethical considerations are also important when choosing a product or service. It is up to the entrepreneur to respond to these preferences. In this way, it is precisely the market that ensures that these non-monetary values are expressed in society. In this sense, it's not up to the government to bring about moral development, it's an automatic process that results from individual actions in the market.[29]

In his book *Open: The Story of Human Progress*, the Swedish liberal thinker Johan Norberg explains why a society with a free market is more capable of establishing this moral development. Firstly, in a society with a market economy, norms spread much more widely. After all, you're trading with all types of unknowns. In more closed societies, normative development is much more limited to the immediate family circle. Second, good behaviour is rewarded in the market: people prefer not to

29. See also the market forces poster by the TeldersStichting.

deal with others who are unjust or ruthless. By means of trade, you learn that you have to be accountable for the interests and values of others. In addition, as Norberg writes, regular exchange in the market contributes to the idea that interaction and collaboration with others is beneficial. In a society where a market is central, more connections are established between strangers and people learn to trust each other more. According to him, an 'open economy' also translates to an 'open mind'.[30]

The state should therefore not hinder this process of free exchange too much, because this obstructs the natural process of moral development in an open society. Liberals also have difficulty with the paternalistic character of a state that imposes a normative framework on the individual, because it restricts the freedom of the individual. Liberals will always oppose such forms of paternalism that limit individual thought. Therefore, also for reasons of moral development, liberals embrace the free market as a core mechanism, where the freedom of the individual is key.

To Conclude

To summarise, only the regulated free market has been able to produce unprecedented prosperity in certain parts of the world, while ensuring the freedom of the individual. On top of that, it is a system that enables the moral development of individuals. What remains is the question of what it takes for the market to work well within a society. We will discuss this in the next section.

IV. Rules for a Well-functioning Free Market

A market that works well is one that works well for consumers. After all, we—the citizens—are all consumers. In less economic terms: a market that works well is one that works for people. For us, individuals who can make their own life choices in freedom and bear the responsibilities for them.

The question of whether it will serve people if we let the market run its course completely without any rules ('laissez-faire') is an easy one.

30. Johan Norberg, *Open*: *The Story of Human Progress*, London, 2020, p. 35.

The answer is no. The past two centuries have taught us that liberal democracy with some form of a regulated market is the way to create both freedom and prosperity. This type of society has led to the most developed countries, where the majority of the population thrives under good living conditions.[31]

For a properly functioning free market, a clear set of rules are of vital importance. The government can serve as regulator. A role similar to that of a referee, where the state enforces the rules in the market and ensures the game is played fairly. Those rules serve to protect people; consumers in particular. A legal framework for action within the market is needed, so that everyone knows what to expect. On that basis, each individual can exercise the freedom to enter into transactions. In other words: how the game is subsequently played is up to the players.

Mill's harm principle serves as a guiding principle to provide for the freedom of the individual through the market, without harming another individual. A well-functioning state is crucial in this regard. For the market to function, it is of great importance that the state secures safety and property rights, by establishing clear rules that are legally enforceable. Consider, for example, the protection of consumer safety in the form of a ban on certain toxic substances or products. Rules regarding safe working conditions must also be put in place. Think of employment contracts that have to meet certain preconditions. Liberals are in favour of such rules and conditions. After all, liberals stood at the cradle of many social laws in the Netherlands in the early twentieth century. In an attempt to alleviate the distress caused by the often appalling conditions in factories and slums, the liberal administrations Röell (1894-1897) and Pierson (1897-1901) implemented various social laws in rapid succession. They established the Health Act (Central Health Council), the Accidents Act, the Housing Act, the Compulsory Education Act and the Children's Acts (including the start of child protection).

In the free market, all transactions should be transparent and voluntary. Unfortunately, this is not always the case. As consumers, we frequently look back with a sense of regret and wish we had acted differently. The source of this disappointment is often uncertainty; a lack

31. Joseph Heath, *Economics without Illusions: Debunking the Myths of Capitalism*, New York, 2010, p. 24.

of information. Uncertainty is part of the human condition and is inevitable to some extent. It becomes problematic when salespeople take advantage of that uncertainty by concealing relevant information. Take, for example, a used car salesman who knows a car has a defect, but does not share this information with the buyer. On the one hand, companies have the incentive not to disappoint their customers and to build a reliable reputation, but sometimes a company may choose to hide important information from the buyer when this is deemed to be less costly. Much regulation is aimed at counteracting the latter incentive. For example, the mandatory list of ingredients on every food product and the minimum hygiene standards for restaurants. Such measures are aimed at protecting citizens from being disappointed by an uninformed choice.

Another important aspect, in addition to the well-functioning state that protects property rights and the legal framework, is the enforcement of competition. Liberals have a natural distrust of power. They oppose an overly powerful state as well as excessive market power. To liberals, monopolies are undesirable. Exchange should be voluntary and any kind of dominant power could potentially limit this. An excess of market power, resulting in a lack of competition, can lead to a reduction in consumer choice. If the market is not able to maintain the level of competition necessary for the efficient performance of the market, supervision is necessary. Ensuring free entry and other competition incentives will then lead to a better functioning market.

In addition, within liberal democracies, there has always been room for the development of social security to complement the free market. The free market creates economic growth and wealth. As a result, there are more possibilities and resources within society and for the government to create social provisions, partly due to increasing tax revenues as a result of economic growth. Think of a social safety net for people who temporarily fall by the wayside. Or proper education, which ensures that everyone in society has opportunities. Within a dynamic playing field, where the free market complies with the rules of the game and the government correctly defines its tasks[32], prosperity can be created throughout society.

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32. Further on in this book, we will devote an entire chapter to the relationship between market and state.

V. To Conclude

Today's public debate and the expressions of growing distaste for capitalism revolve around some of the potentially negative aspects of capitalism. Capitalism is said to reward greed and selfishness, create inequality and power differences, and—in Marxist terms—create an oppressed and oppressive class.[33] These negative associations with capitalism and the market call for renewed attention to the progress the free market has brought us over the past centuries. This is all the more important now that, due to the corona crisis, there are ever louder calls to reform society. The common thread of the proposed reforms is the further containment of the free market and the further strengthening of the hand of the state.

Clear definitions and analyses are required to make the public debate more effective. Recognising that the government and the market are both a part of the very same dynamic playing field is a first step. Re-evaluation of individual freedom is another. The free market has proven to be an effective mechanism for simultaneously guaranteeing prosperity and individual freedom. Other systems have not been able to achieve this. Yet, today's capitalism is criticised by many. Before delving into these criticisms, this chapter served to remind everyone why we implemented the free market in liberal democracies in the first place; what its foundations are and how it has benefitted us.

The following chapters will reflect on several current critiques of capitalism. From a historical perspective and by the awareness of fundamental values such as freedom and prosperity within liberal democracies, we have every reason not to go along with all the critiques of the free market. That said, liberals also see the need to keep thinking about how to adapt the free market to today's and tomorrow's world. Not purely for the sake of defending the free market in light of the capitalism critiques, but rather to reinforce our liberal values.

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33. Peter Berkowitz, 'Capitalism, Socialism, and Freedom', *Essay Series Socialism and Free-Market Capitalism: the Human Prosperity Project*, Hoover Institution, 2020, p. 9.

B. Critiques of the Market

CHAPTER 1.

The Multinational Versus the Citizen

> 'Do not be surprised at the anger of many Dutch citizens, when you simultaneously show that you do listen to the multinationals, but not to the needs of the people living now and here, in the Netherlands.'
>
> PvdA leader Lodewijk Asscher in Parliament on 15 November 2017

The Critiques

To anyone living in the Netherlands, we don't need to explain that the cabinet's proposal to abolish the dividend tax caused a great deal of controversy. It was hotly debated in Parliament on November 15, 2017. According to Lodewijk Asscher, the proposal was 'a shiny Christmas present for foreign investors'. According to the then party chairperson of the PvDD, Marianne Thieme, we lived 'in a welfare state for multinationals'. GroenLinks leader Jesse Klaver characterised the plan as 'buying into the lobbies of large multinationals, which mean nothing when it comes to the future of the Netherlands'. PVV leader Geert Wilders was also critical: 'The corporate income tax rates will be reduced for multinationals and the dividend tax will be abolished for foreign shareholders of large companies. But for the average Dutch person, the VAT

will be increased, the healthcare premium will go up and the energy bill will rise.'

All these comments represent a broader criticism. Namely, that the economy no longer works for the ordinary hardworking citizen or for the small to medium-sized entrepreneur, but mainly serves the large multinationals. Critics claim that the economic power of domestic and foreign large companies has been translated into political power. Political power used to enforce favourable tax arrangements and other privileges, at the cost of the middle class and smaller companies.[34]

The reproach is that the state provides huge loans and support to large companies when they are in trouble, such as airline KLM and shipbuilder IHC during the corona pandemic, while many SMEs struggle to cope. In addition, the savings of the middle class would be used to lend money to large companies at low interest rates. These low interest rates make (potential) corporate profits of the same large companies more valuable due to the low interest costs, while it yields little for the saver. In this way, large companies would be able to live on the savings of the middle class in a dynamic that continuously reinforces itself.[35]

Another important part of the criticism is that companies do not contribute their fair share in the form of taxes. Due to their acquired global economic and political power, they're able to make deals with governments regarding the tax to be paid. In addition, their army of tax specialists and lawyers enable them to exploit complex tax structures. Due to the shifting of profits, both over time and between countries, they manage to pay virtually no profit tax.[36] And all this while the ordinary citizen (in most cases) dutifully pays their income tax, allowing public matters such as infrastructure and social security to be realised.

Under Article 116 of the Treaty on the Functioning of the European Union, it would be possible to rectify errors in the market on the basis of a general majority decision, without the right of veto. The EU would like to use this instrument to oppose favourable tax structures of

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34. Joseph Stiglitz, *People, Power, and Profits*, New York City, 2019.
35. Robert Armstrong, 'Rising markets and inequality grow from the same root', *The Financial Times*, 8 June 2020, (https://www.ft.com/content/a25bf8b6-a962-11ea-a766-7c300513fe47).
36. Joseph Stiglitz, *People, Power, and Profits*, New York City, 2019.

multinationals, whereby apparent tax havens such as the Netherlands and Ireland cannot exercise a veto right.[37]

The corona crisis has contributed to an increasing pressure on large companies, specifically multinationals, regarding the payment of taxes. Taxes are now considered especially relevant as governments worldwide are pumping billions into the economy to accelerate economic recovery. Those billions must (in the long run) come from somewhere: one source being taxes. In addition, it could be considered unethical that, in times of adversity, the citizen should bear the costs.

This chapter will reflect on the role of large (multinational) companies within society. Their relationship with small and medium-sized enterprises will be explored further. The apparent profiteering behaviour of companies and the issue of fair share in taxes will also be addressed.

Reflection

Sometimes, there's a misconception that liberals favour the free market because it would serve big money ('the capitalists' or 'the multinationals'). If you look at the ideas of liberal economic thinkers, you'll notice the opposite is true. Let's take the most famous—Adam Smith—as an example. Smith was in favour of the free market because it would help us all move forward. In *The Wealth of Nations*, he wrote that the ultimate goal of the economy should be: 'universal opulence which extends itself to the lowest ranks of people'.[38] In other words, he believed that everyone should have a good standard of living. Especially the ordinary person, and certainly also the poor.

Another quote from *The Wealth of Nations* demonstrates this as well: 'No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, clothe, and lodge the whole body of the people, should have such a share of the produce of their own labour as to be themselves

37. Mereen Khan and Sam Fleming, 'Brussels plans attack on low-tax member states', *The Financial Times*, 14 July 2020, (https://www.ft.com/content/4068b83a-2c64-43e9-b82a-0b77c454164b).
38. Adam Smith, *The Wealth of Nations*, London, 1776, book 1, chapter 1.

tolerably well fed, clothed, and lodged.'[39] According to Smith, the most adequate tool for achieving a prosperous society is a commercial system. He was aware, however, that forces could always arise in the market that would go against the interests of citizens. 'The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public.'[40] Proposals made by them regarding new regulations should therefore be greeted with the utmost suspicion. In line with this, Smith turned against monopolies, privileges, cartels and unfair play. Smith thought it important to safeguard strong competition, making it impossible to get away with practices harmful to the consumer (read more about this in chapter 3).

Translated to today, this means that the market should not work for the vested interests—big business, if you will. The liberal view favours the contrary, namely: a market that works for all of us. When an imbalance exists, for example because large companies or multinationals have more access to politics than smaller companies, and can therefore enforce more favourable tax constructions for themselves, then we find that downright undesirable.

The Existence of Multinationals

Before we get into more detail, we would like to emphasise that the existence of multinationals in a society in itself is not undesirable. Sometimes, in the public discussion, multinationals are portrayed as the world's big villains. And, although there are certainly concerns about damage to the climate and living environment (chapter 2), market power (more on that in chapter 3), inequality (more on that in Chapter 5) and lobbying power and the extent to which tax is paid (this chapter), the mere existence of companies that operate worldwide is not a bad thing.

On the contrary, multinationals have a useful function within the economic system. Globalisation and technologisation have made the global economy highly complex. In the case of greater complexity, the

39. Ibidem, chapter 8.
40. Ibidem, chapter 11.

market is an excellent instrument for providing the required coordination.[41] As Hayek emphasised in the previous century, complexity requires decentralised coordination. In this sense, globally operating companies act as an umbrella organisation, bringing together many points in the chain of coordination.[42] This doesn't mean that multinationals control or coordinate everything, they facilitate the coordination of various transactions as an important link in the value chain. Sometimes, companies are made to look useful to society, merely because they remit part of their income in the form of taxes. In our view, companies are more than that. Companies do indeed contribute by paying tax, which can then be used by the government for public affairs. But companies are also collections of people's dreams and ideals. People working together towards a shared goal. Companies provide work. And primarily, they serve to provide voluntary transactions. Companies do this by pooling production resources and thereby anticipating the needs of consumers. As the Swedish liberal thinker Johan Norberg puts it, you can only earn money on the free market 'by giving someone something they value more than the money it costs them'.[43] In this sense, companies facilitate voluntary transactions by bringing together information, resources and employees to fulfil consumer needs.[44] Who exactly fulfils these needs, does not matter to the consumer.

Large companies profit from their ability to integrate information and exploit advantages of scale, making production efficient and thus lowering the price for the consumer. Due to the global nature of multinationals, they are usually able to bring together factors from different geographic areas that result in prosperity in various locations. At least, that's the intention, and when the market functions well and companies act ethically, it works out that way.

In itself, making (large) profits is not an offence against society. The shadow that is sometimes cast on the term profit is unjustified. This might be the result of the associated exploitation and tax avoidance—not

41. Frans de Graaf a.o., *Vertrouwen in de markt*, TeldersStichting, The Hague, 2007. 30-31.
42. Friedrich von Hayek, 'The Use of Knowledge in Society', *The American Economic Review* 35(4), 1945, pp. 519-530.
43. Johan Norberg, *Open: The Story of Human Progress*, London, 2020, p. 35.
44. Joseph Heath, *Economics without Illusions*, New York, 2010, p. 83.

good business—but we must remember that there's nothing wrong with making a profit.

In fact, profit is vital. Ensuring the continuity of the company is a primary company objective. Ultimately, this can only be achieved through profit generation. When a company pursues profit, it is actively using its resources to achieve returns. This return is essential in order to meet all obligations towards employees, capital providers and taxes—and to avoid bankruptcy. In addition, profits are needed to make renewed investments and innovate. In a well-functioning market, companies have incentives to innovate. Otherwise, they will be overtaken by companies that serve the consumer better.

Profits are thus crucial for companies to be able to develop and maintain their raison d'être. In this way, companies also contribute to economic growth and the development of society as a whole. And not unimportantly: to improved living standards for all. When sufficient market incentives exist and proper rules have been installed by the government, multinationals can be regarded as important players, capable of creating jobs and wealth around the globe.

Contribution of SMEs and Multinationals to Society

Let's take a closer look at the contribution of SMEs and multinationals to society. A multinational is an enterprise with ultimate control over companies in at least two different countries.

In 2016, 23,700 multinationals were active in the Netherlands, 10,300 of Dutch origin and 13,400 of foreign origin. Multinationals account for 1.4 percent of a total of 1.75 million companies. However, the share of these multinationals in production value and profit was 39.1 and 31.6 percent respectively, compared to an employment rate of 21.7 percent on a working population of 7 million.[45] This implies that they are able to generate a higher production value and profit per employee. Possible explanations for this are advantages of scale and the higher capital intensity of these companies compared to smaller ones. The real causes and their part in this relationship are beyond the scope of this book. Table 1

45. CBS, 'Multinationals goed voor 30 procent economie', 12 October 2018, (https://www. cbs.nl/nl-nl/nieuws/2018/41/multinationals-goed-voor-30-procent-economie).

also shows us that multinationals are only a small part of the economy. All the more reason to ensure that the multinational is not given a disproportionate advantage. As far as we're concerned, it is important that Dutch small and medium-sized enterprises are sufficiently taken into account in political policy choices. After all, SMEs are an important driving force for our economy.

Table 1. **Relative share by type of business in the Dutch economy in 2016**

	Dutch multinationals (%)	Foreign multinationals (%)	Rest economy (%)
Production value	14.5	24.7	60.9
Profit	12.3	19.3	68.4
Added value	12.3	17.8	69.9
Wage costs	13.4	16.3	70.3
Employment	10.3	11.4	78.4

Source: Statistics Netherlands, CBS ('Multinationals goed voor 30 procent economie', 12 October 2018)

Now that we have analysed the role of the multinational in society, we will discuss whether there is a level playing field between the different types of companies within society, and whether the ratio of burdens between companies and citizens is appropriate. We start with the issue of low interest rates.

Large companies benefit more from low interest rates

There is no question that large companies benefit from low interest costs on their loans. Low interest rates even lead to the existence of companies that don't go bankrupt, but also have no viability: zombie companies. Low interest rates offer companies that are not viable the opportunity to take out additional loans at low costs and possibly (partly) cover for the payment of existing interest costs. At the same time, banks do not like to write off bad loans, so they hold on to loans at low interest rates of companies that are actually unable to meet all their obligations in the long term. The larger the loan, the greater the cost of writing it off. So the bigger the company, the greater the incentive not to write off

bad loans. This creates zombie companies that obstruct efficiency in the economy in various ways. Firstly, through a sub-optimal distribution of financial resources. These resources are used to finance companies that are not viable in the long term and are thus kept alive artificially. In addition, the loss of skills and the failure to retrain, or inadequate retraining of, employees results in a loss of productivity in the long run. A final, and perhaps most serious, constraint is that by allocating funds to the so-called zombie companies, other companies, which would deserve it based on the value they would (potentially) add, are not funded.[46] It is evident that low interest rates pose a problem. And that companies benefit from this. This issue is not rooted in company error, nor will the solution be found there. It is a result of structurally low interest rates (more on this in chapter 6).

For now, it is important to realise that low interest rates that benefit companies do not arise from the whims of the free market that enable companies to profit against the rest of society. Any sane individual does not request a higher interest rate than they have to pay at the bank. Not the owner of a sole proprietorship, nor the manager of a multinational. However, for larger companies, the capital flows are more extensive than for smaller companies. Besides this, the criticism that companies are receiving these loans from the savings of our middle classes does not make sense. The financial system is structured in such a way that providers (in this case savers) and demanders (in this case large companies) of capital are brought together through financial intermediaries, such as banks. In this way, money does not lie idle and investments are made that contribute to economic growth and prosperity within society. In fact, from this point of view, a sufficient supply of capital is crucial in order to stimulate innovation and development by companies.

There are many economists who 'blame' the central banks for the current low interest rates. Early 2020, *Economisch Statistische Berichten* (ESB) devoted a special edition to the subject. It would be going too far to list all the arguments here. Later in this book, we indicate that there are structural forces (including technology and globalisation) that keep inflation low. In addition, there are demographic developments and

46. Claudio Borio, 'A blindspot in today's macroeconomics', Bank for International Settlement, Presented at BIS-IMF-OECD conference *Weak productivity: the role of financial factors and policies*, 2018.

supervisory requirements that lead to additional savings. For now, it is sufficient to note that interest rates are lower than they would have been without central bank policies. But even without central banks doing their best to meet their imposed inflation target, interest rates would have been low.

The fair share large companies should contribute

As we have already established, (large) companies do not merely contribute to society by paying taxes. By pooling resources and interests, companies also play an instrumental role in economic growth and progress. At the same time, companies may be expected to pay their fair share of taxes on their earnings, as is expected of everyone else in society. After all, everyone benefits from the public provisions generated by tax revenues. Individuals, small businesses and multinationals all make use of infrastructure, proper education and safety. You can read more about the establishment of these public provisions in Chapter 6. For this chapter, it is important to understand that everyone benefits from these provisions and therefore, it can be reasonably expected that everyone contributes a fair share, in the form of taxes. In proportion to the extent to which an actor is able to contribute, they should pay a certain minimum in tax. In this way, taxes can be used by the government to regulate what cannot be achieved privately or what can be achieved more effectively through public channels.

Companies also benefit directly from this. In her famous book *The Entrepreneurial State*, Mariana Mazzucato demonstrates that companies, in their search for renewal and disruptive innovation, benefit from fundamental research that is publicly funded (and performed).[47] This type of research is not always conducted by companies, as the timeframes and outcomes are uncertain when it comes to the return required for a company to stay afloat. However, companies do use publicly funded research results and technologies in their own developments. This dynamic between companies on the market and basic research by the state requires a contribution from companies in the form of taxes. We

47. Mariana Mazzucato, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths*, London, 2013.

must not forget, however, that companies, especially large multinationals, are also the driving forces behind a lot of research and innovation resulting in economic growth and progress. In 2016, for example, multinationals spent 14.1 billion euros on research and development, which represents a percentage of 41 percent of the total Dutch expenditure by companies in this area.[48]

The local bakery, the regional company as well as Unilever and Starbucks have to pay tax on the value they add. In the Netherlands, (large) companies contribute through corporation tax. In this way, return on capital—profit—is taxed. The burden of this is partly borne by the consumer in the form of higher prices. The part that cannot be incorporated into higher prices is attributed to the shareholders. Corporate tax must be paid on that part of the added value that a company achieves in the Netherlands.[49]

The distribution of tax paid by different categories of companies in 2017 can be seen in Table 2. Figure 4 shows the distribution in the contribution between internationally and nationally operating companies. The companies in the top four rows of Table 2 are considered to be internationally operating companies. The ratio between the contributions of the national large companies and SMEs is shown in Figure 5. The Advisory Committee on Taxation of Multinationals concludes that there are no visible trends.[50]

However, these absolute numbers and ratios say little about the 'fair share' of tax that should be paid by the companies. For a more factual comparison of the contributions by SMEs and large (multinational) companies, the effective tax burden for the different categories of companies should be examined. The effective tax rate can be succinctly defined as the difference between taxable and commercial profit. A lower effective tax burden indicates less tax actually paid than would be commercially determined. This could be an indication of tax avoidance and/or favourable tax structures. Another possibility is that companies may be able to offset losses or face large liquidation losses.[51]

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48. CBS, 'Multinationals goed voor 30 procent economie', 12 October 2018, (https://www. cbs.nl/nl-nl/nieuws/2018/41/multinationals-goed-voor-30-procent-economie).
49. Advisory Committee on Taxation of Multinationals ([on behalf of the Ministry of Finance], *Op weg naar balans in de vennootschapsbelasting*, 15 April 2020.
50. Ibidem, p. 52.
51. Advisory Committee on Taxation of Multinationals ([on behalf of the Ministry of Finance], *Op weg naar balans in de vennootschapsbelasting*, 15 April 2020.

Table 2. **Corporate income tax by category in the Netherlands in 2017**

	Number of entities (2017)	Change in number of entities (2010-2018)	Taxes paid in millions of euros (2017)
Multinationals NL	370	20%	2,448
Multinationals US	982	46%	2,866
Multinationals other	2,193	33%	3,840
International large companies	945	–32%	2,515
National large companies	860	–11%	689
International SME	43,547	–19%	4,225
National SME	373,521	27%	6,155

Source: Advisory Committee on Taxation of Multinationals (*Op weg naar balans in de vennootschapsbelasting*, 15 April 2020, p. 51)

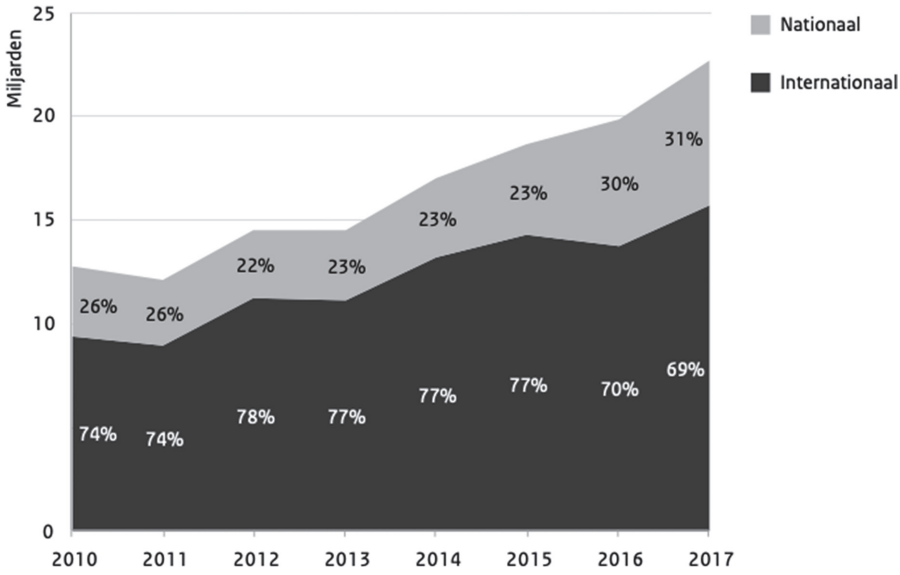

Figure 4. **Distribution of corporation tax contributions nationally and internationally operating companies***

Source: Advisory Committee on Taxation of Multinationals (*Op weg naar balans in de vennootschapsbelasting*, 15 April 2020, p. 52)

*International companies include multinationals, international large companies and international SMEs, as shown in Table 2. The national companies, as shown in Table 2, only include those companies that purely operate on a national level..

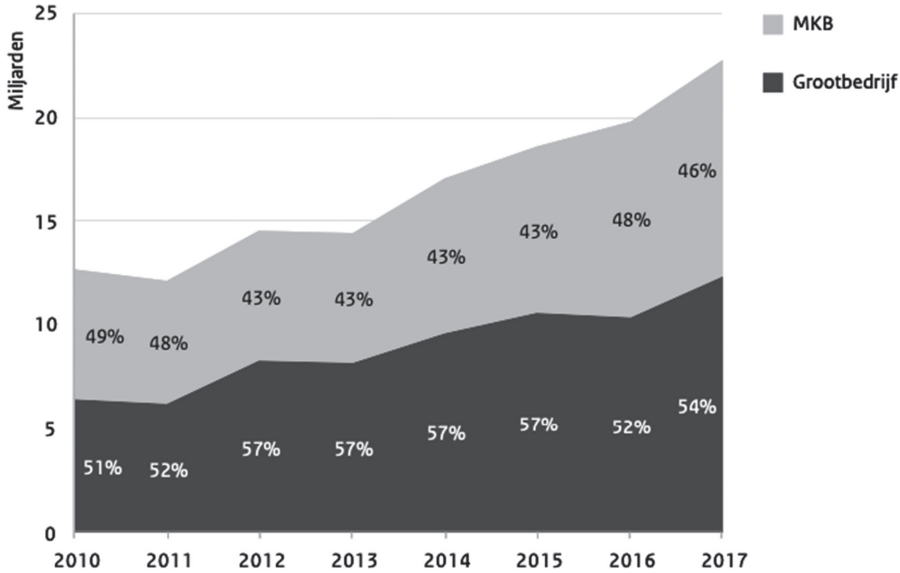

Figure 5. **Distribution of corporation tax contributions SME and large companies***

Source: Advisory Committee on Taxation of Multinationals (*Op weg naar balans in de vennootschapsbelasting*, 15 April 2020, p. 53)

*Large companies include the first five types of companies, as shown in Table 2. SMEs include the bottom two types of companies, as shown in Table 2.

Figure 6 shows no significant difference between the contribution of multinationals and national companies in the effective tax burden. However, the effective tax burden for multinationals is subject to greater shocks. In any case, we cannot conclude from this that large internationally operating companies do not pay their fair share. Also, when these large companies have a lower tax burden, this is—in many cases—due to the innovation box deduction, which reduces tax burdens to encourage innovation and research.[52]

52. Ibidem.

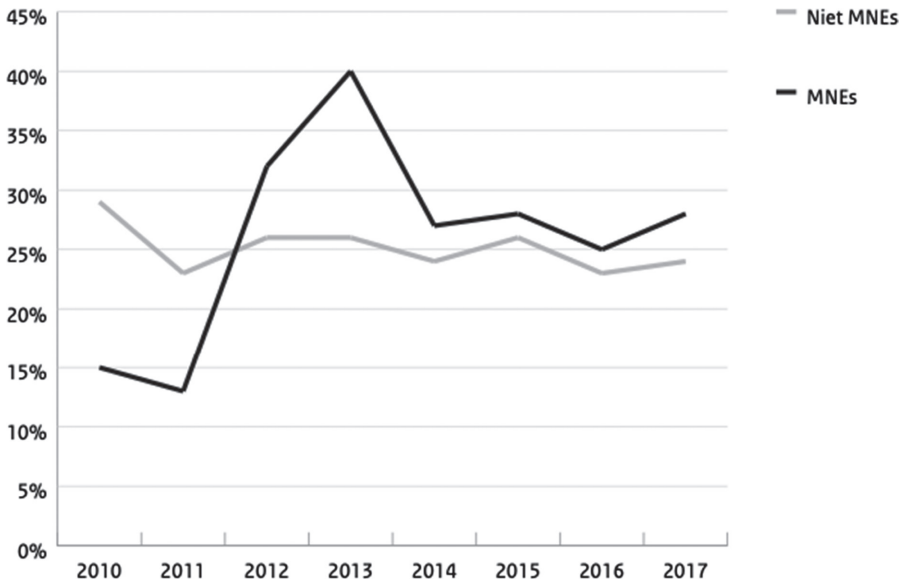

Figure 6. **Ratio of effective corporate tax burden between internationally and nationally operating companies***

Source: Advisory Committee on Taxation of Multinationals (*Op weg naar balans in de vennootschapsbelasting*, 15 April 2020, p. 58)

*MNE = multinational enterprise

In short, large companies account for a substantial share of the total corporate tax paid. Yet, it is still possible for a company like Shell to not pay profit tax in the Netherlands and, at the same time, record a commercial profit of billions (1 and 1.3 billion euros in 2016 and 2017, respectively.[53]). Although this may be legal, it is incompatible with our view that companies should contribute their fair share to society, just like everyone else.

The Advisory Committee broadly identifies eight bottlenecks with regard to corporate tax:

1. Opportunities for profit shifting to low-tax countries without substantial changes in the investment structure;

53. Gertjan van Schoonhoven and Joris Heijn, 'Shell bevestigt: geen winstbelasting betaald in Nederland', *Elsevier Weekblad*, 12 May 2019, (https://www.ewmagazine.nl/nederland/ achtergrond/2019/05/shell-bevestigt-geen-winstbelasting-betaald-in-nederland-689265/).

2. Taxation of a profit that is potentially different from the total consolidated profit, resulting in double taxation or taxation of less than the entire profit;
3. Asymmetry between (the location of) deductible costs and (the location of) taxable income for headquarters of multinationals;
4. Opportunities for profit shifting through the choice of equity or debt capital in intra-group financing;
5. Many disputes between countries, where the risk lies with taxpayers;
6. Administrative burden for companies;
7. A sub-optimal capital structure at corporate level;
8. Incentive for tax competition between countries.[54]

In our view, these eight points indicate that regulations are riddled with complexity. The major international disparities in regulations create a twilight zone that is skilfully exploited by multinationals. An important solution offered by the Advisory Committee consists of the harmonisation and consolidation of regulations. This is a message we wish to convey as well: one standard should be set internationally, a standard that demonstrates to any company what it must adhere to. More (international) political action is needed to tackle clever tax constructions, often made possible by complex regulations and deals with governments. We regret that such practices are associated with liberalism and regarded as inherent in the free market. We also find it undesirable that the Netherlands has the reputation of a tax haven, also within the EU. The domestic investment climate benefits from a good competitive position, and fiscal attractiveness is part of this. But other factors are relevant to our competitiveness as well, such as good education and infrastructure. In any case, our good competitive position does not require situations where companies that are based in the Netherlands pay no profit tax at all.

Furthermore, we see that the share of labour taxes as part of total tax revenues in the Netherlands increased from 48.3 to 57.5 percent between 2001 and 2012. Figure 7 also indicates a clear trend of households having higher tax payments, while companies are paying relatively less.[55]

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54. Advisory Committee on Taxation of Multinationals ([on behalf of the Ministry of Finance], *Op weg naar balans in de vennootschapsbelasting*, 15 April 2020.
55. Frank Notten, 'De inkomensverdeling tussen sectoren', chapter 10, in: CBS, *De Nederlandse Economie 2013*, 2013, p. 222.

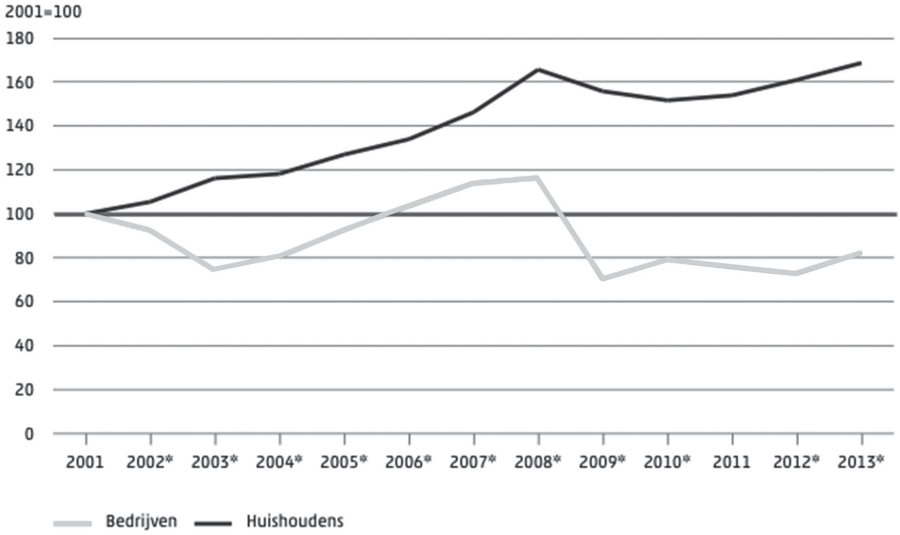

Figure 7. **Trend of corporate and household tax transfers between 2001 and 2013**

Source: Statistics Netherlands, CBS (Frank Notten, 'De inkomensverdeling tussen sectoren', chapter 10, in: D*e Nederlandse Economie 2013*, 2013, p. 122)

*On the y-axis, the index with base year (y-value = 100) 2001. The figure shows an increasing trend in the tax burden on the disposable income of households in the period 2001-2013. The opposite has happened for companies in the period up to 2013: the burden has decreased.

Liberals will always strive for a level playing field in the market, without privileges. If households pay taxes on their income from work, so should companies. This should not be skewed. In a well-functioning market, everyone acts within the same preconditions. This also means bearing proportional burdens; also for the multinational. Besides, we are of the opinion that work must be rewarded more. The burden on households should therefore be scaled down.

Lobbying

The last critique we address here focuses on the influence of corporate lobbying. A lobby is an attempt to influence policy, for example by selectively providing information to the policymaker. Not all companies have the same interests and will thus not provide the same information. This creates the necessity for every company to lobby, so that those in power

can make a well-informed choice. Providing information is costly, which is why—in practice—lobbying is especially worthwhile for large companies.[56] As a result, they may have a disproportionate influence on policy. Politicians should be (made) aware of this risk and receive proper guidance, so their information supply does not primarily come from lobbies.

We started this chapter with some fierce quotes from several Dutch politicians regarding the dividend tax issue. The proposal for abolition has been defended with the argument that retaining large multinational companies is important for the prosperity of our economy and therefore our society, and that a good fiscal climate is one of the things needed for this. It has been explained as an attempt to keep companies that are important for the Netherlands here. The intentions of the politicians in this matter need not have been wrong at all; it seems quite unlikely that politicians were offering 'a gift' to multinationals. Regardless of the motives of politicians—something that is always up for discussion—it is undesirable for large companies to pull the strings of politics by applying pressure. For politicians, it is important to listen to the concerns of companies (because a thriving business community is important to all of us), but not to be led by the corporate sector. It is up to politicians to carefully monitor this boundary and to continue to make their own well-informed assessments.

In a general sense, we can say: where economic power is converted into political power to favour the market position, this does not serve the consumer. This even goes against the principles of the free market. Clear examples exist from earlier times. In the Middle Ages, for example, guilds were protected by local authorities through the use of permits.[57] By offering the public servant a bag of money, insiders did not have to fear outside entrants. Such practices undeniably hinder progress in the sense of better living standards. While problematic guilds are mostly

56. Klaas Dijkhoff, for example, said the following in an interview with Zihni Özdil 'Then the small entrepreneur should be given a boost to be able to compete and not be held back because the large established parties have more access to politics and the rules such as subsidy flows can operate in such a way that they always get more out of it.' See: https://www.youtube.com/watch?v=zBPQ6H6cMQw.

57. See, for example: Sheilagh Ogilvie, 'The Economics of Guilds', *Journal of Economic Perspectives* 28(4), 2014, pp. 169-192.

gone,[58] the underlying mechanism still exists. The government is just a group of people. People with the ability to exchange political power for money or other valuable services and products. Fortunately, we now have proper control mechanisms in place, such as the judiciary, journalism and the democratic process. But incentives exist and are always lurking. To liberals, vigilance is always called for in this regard.

The Way Forward

Adam Smith and other liberal thinkers were in favour of the free market because it is (supposed) to help the ordinary person, not enrich the big entrepreneur at the expense of the consumer. Translated to the present, this means that large companies should not be favoured. Where this happens, perverse incentives should be removed from the system. For this, we require strong and independent politicians. We propose to give politicians more support, making them less dependent on lobbies for their information position.

Based on the foregoing analysis, we can conclude that the ratio in the tax share between smaller and larger companies is not inherently skewed. The existence of large companies that do not pay their fair share of taxes is not a given fact. However, excesses of large companies exist that don't pay corporate tax through tax constructions, and the share of companies in the tax contribution has become relatively smaller than that of households. We must counteract this imbalance. Work must be rewarded more.

As supporters of the idea that a free market should ultimately work for people, we are critical of the excesses of some international companies. This occurs, for example, when every effort is made to pay little or no tax, as letterbox companies do. The state should not facilitate such practices and constructions. Tax avoidance and evasion must be counteracted more actively. Citizens, SMEs and large companies should contribute their fair share to the public provisions that everyone benefits from. This has to do with the liberal principle of reciprocity.

58. Permits—or licenses (think of a doctor, notary, etc.)—still exist, and these have the same effect as back then. But in these cases, they solve a different problem, namely that of obscure markets (see also above).

In an international approach, the solution largely lies in the implementation, compliance and assessment of corporate income tax. Clear international agreements could be made, whereby profits of companies are taxed at a consolidated level and distributed pro rata between countries.[59] This solution would provide a harmonised, verifiable standard that companies must adhere to. Basically, it comes down to removing unnecessary complexity and promoting transparency by making adequate international agreements. This makes it a lot easier to assess profit tax and to comply with it. Most importantly, it would create a level playing field in the market, where everyone contributes appropriately. It's fair to say, however, that it will be difficult to implement this solution in practice.

The low interest rates that are benefitting large companies also pose a problem. But, as explained, it is a misconception to see this as profiteering behaviour of large companies. Low interest rates mean that the profits of companies are worth more. Normally, these interest rates are low to get the economy going. As they are now structurally low, the situation occurs where companies that are not viable in the long run are kept afloat. The way forward could be found in the interest rate policy of central banks, but also in the regulation of financial markets, allowing so-called *bad debt* to be tackled more effectively, and the balance sheets of banks to be filled with creditworthy buyers of capital.

In conclusion, it is good to emphasise that we must not forget that companies fulfil an instrumental role within society. We have to move away from the idea that every large company only wants to enrich itself at the expense of others. Through companies, various interests come together efficiently and voluntary transactions are facilitated. The company offers employment to the employee who wants to work for the company. Companies meet the needs of consumers. In addition, they can typically gather more capital in the capital market than individuals can. This capital is then used for investments and developments that entail economic growth. In this way, companies ensure the creation of wealth. It is important to reinsert this idea into the public debate. An economy fails or succeeds as a result of the diverse mix of companies it

59. Advisory Committee Taxation of Multinationals [under order Min. of Finance] (April 15, 2020). *Op weg naar balans in de vennootschapsbelasting*, p. 78.

entails. Good jobs are in the interest of us all. It is in no one's interest to drive companies away. We must, however, ensure that everyone actually contributes their fair share with regard to taxes.

CHAPTER 2.

Capitalism and Climate: Limits to Growth

> 'How could we call "rationalist" an ideal of civilisation guilty of a forecasting error so massive that it prevents parents from leaving an inhabited world to their children?'
>
> Bruno Latour in *Down to Earth: Politics in the New Climatic Regime,* Cambridge, 2018

The Critiques

In the spring of 2019, Philip McDuff kicks off his column in *The Guardian* with: 'Ending climate change requires the end of capitalism. Will we have the stomach for this?'[60] Swedish teenager Greta Thunberg organised global climate demonstrations among students. The influential American *Time Magazine* even named her *Time Person of the Year 2019*, as a global symbol of the call for climate action among the younger generation.[61] As a result of the corona crisis, many are appealing for more climate action. The pandemic has exposed the dangers to human health and serves as a wake-up call for that other threat that affects everyone's health: climate change.

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60. Philip McDuff, 'Ending climate change requires the end of capitalism. Will we have the stomach for this'. *The Guardian*, 18 March 2019, (https://www.theguardian.com/commentisfree/2019/mar/18/ending-climate-change-end-capitalism).
61. Charlotte Alter, Suyin Haynes and Justin Worland, 'TIME 2019 Person of the Year—Greta Thunberg', *Time Magazine*, (https://time.com/person-of-the-year-2019-greta-thunberg/).

The Intergovernmental Panel on Climate Change (IPCC) was established by the United Nations as early as 1988 to assess and pool academic research on climate change. The aim of the IPCC is to develop well-founded climate projections and scenarios on which policy can then be based. Global warming has consequences for ecosystems and biodiversity and entails risks to health, food security, human safety and economic growth. Limiting global warming to a maximum increase of 1.5 to 2 degrees Celsius compared to pre-industrial levels would yield huge benefits, as research indicates. Said negative consequences would be exponentially less than with higher temperature rises.[62]

So why have we not yet succeeded in drastically limiting these consequences? According to many critics, there is one logical culprit for climate change and a lack of action: capitalism. The free market system is said to have created a consumer society with all its associated consequences. Within this view, capitalism has led to a society where unlimited consumption has become the norm. This consumption is met by production that exhausts nature and leads to unlimited emissions of harmful gases. Land degradation and forest clearing have become standard practice in production. The Amazon rainforest is being cut down and Chinese coal factories are enabling western consumers to buy 'superfluous' products from all over the world at ever cheaper prices. In addition, the transfer of production to countries with little or no legislation has created appalling working conditions; only to satisfy the great consumerism of the West. A return ticket to Paris—two one-hour flights—can be booked at a bargain price. In short, economic growth entails all kinds of harmful side effects. It contributes to climate damage, depletes nature and endangers biodiversity.

According to the critics, a one-sided paradigm has existed in recent decades, one that only values economic growth and where the consequences for our living environment were not a priority. Inadequate government intervention—letting the market run its course freely—is said to have fuelled the problems. Companies were free to do as they pleased in their pursuit of profit maximisation. And excessive consumption was kept going. In this view, this has led to the climate crisis we find

62. IPCC, 'Summary for Policymakers of IPCC Special Report on Global Warming of 1.5°C approved by governments', *The Intergovernmental Panel on Climate Change*, 2018.

ourselves in now. Left-wing critics are calling for the fall of, or at least the fundamental reform of, capitalism. The government should tighten the reins to reduce damage to the environment. Both consumption and production should be restricted. Naomi Klein, for example, described in her international bestseller *This Changes Everything: Capitalism vs. the Climate*[63], that climate change and (neo-)liberal market thinking are incompatible. Another bestseller, by Kate Raworth, introduced the concept of doughnut economics[64], a visual framework for sustainable development where economic growth must be structured within the limits of the ecological system. The economy must not surpass its planetary boundaries.

In this chapter, we will offer a reflection on the call for market containment in the interests of the climate and a better living environment. We will take a closer look at the heart of the problem and the role of the market and the government in this.

Reflection

Externalities and the classic problem of collective action

It may be clear by now, that at least part of the problem lies on the production side of the market. There's no question that our natural environment is depleted and other undesirable effects occur for the sake of production. Companies are part of the problem, but also part of the solution. That solution does not lie in outsourcing production to other parts of the world where production is cheaper and subject to less stringent regulations.

Before we can offer any solutions, we must first analyse the root of the problem. Why does the solution not naturally derive from market forces? If global production is reaching the limits of the finiteness of the earth, why isn't this reflected in prices (as is the case with other forms of scarcity)?

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63. Naomi Klein, *This Changes Everything: Capitalism vs. the Climate*, New York, 2014.
64. Kate Raworth, *Doughnut Economics: Seven Ways to Think Like a 21-st Century Economist*, London, 2017.

Negative externalities

Externalities occur when actions cause external harm without this being internalised in the price. The market is perfectly capable of bringing self-interests together, but externalities can pose problems the market cannot solve. The market mechanism works well, without causing external damage, when individual and collective rationality coincide. Sometimes, however, there is friction between the two.

It has been evident for some time now, that it's necessary to act against climate change in order to maintain a habitable planet. It is also clear that this must happen on a large scale in order to be effective. In this situation, it would be desirable—from the collective's point of view—that externalities do not occur or that the perpetrator at least pays the price for this. However, if the individual does not have to bear these costs, self-interest may prevail over collective interest. In that case, externalities occur, without anyone being held responsible for them. That's exactly what happens when production causes cross-border damage to the living environment.[65] Think of clean air: it has a value, but it doesn't belong to anyone.

When damage occurs immediately, for example when a company dumps waste into a nearby river, the destruction is clearly visible. Harm to the climate, however, emerges in the long term and is therefore less tangible. Both forms of damage should not be ignored.

The solution to this issue must come from the government, by charging the costs to the causer, commonly in the form of taxes. Pricing CO_2 emissions creates an incentive in the market to find the most efficient solutions that lead to less CO_2 emissions. In addition, the government can play a role in other regulations to prevent serious damage, as was done in the case of acid rain (e.g. the obligation to put filters on car exhausts) and the hole in the ozone layer (a ban on CFCs). These benchmarks also encourage companies to adapt and become more innovative.

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65. There are many other externalities that arise during production. However, this chapter mainly focuses on the consequences for the global living environment. Another example could be the appalling working conditions in production facilities throughout Asia, which cater to the consumption of the West. These poor conditions can exist due to deficient legislation.

Two important barriers exist in relation to environmental damage and climate change. A general problem for all externalities is the problem of information: how will the government adequately price externalities? The second problem is that climate change and the associated damage to the environment, nature and biodiversity cannot be monitored locally. When controlling these externalities, we are faced with international political boundaries.[66]

In recent years, many conferences have been held, resulting in international climate agreements. A selection of the most important: the Kyoto Protocol in 1997, the Copenhagen and Paris climate agreements of 2009 and 2015 respectively, and the United Nations Sustainable Development Goals in which climate change is prominent. Still, this hasn't generated the desired change. The issue with these agreements is that they are hardly enforceable, which creates an incentive to take advantage of the efforts of others. National interest prevails over global interest.[67]

The role of the market and government

The market is characterised by transactions that are entered into voluntarily. Entrepreneurs respond to the needs of consumers. These needs stem from the values people hold. If entrepreneurs fail to respond to these, they will not make a profit and will not survive in a well-functioning market. Transformation in the market is taking place as a result of—in Joseph Schumpeter's terms—*creative destruction.*[68] Changing needs encourage innovation. Similar to how R&D[69] develops new products and technologies that make others superfluous. The call for sustainability offers entrepreneurs the opportunity to respond to this in a form of idealistic entrepreneurship, without compromising too much on their profit making nature. The finite nature of raw materials will also increase the need for new production options. The resulting

66. Paul de Grauwe, *De limieten van de markt. De slinger tussen overheid en kapitalisme*, Tielt, 2014.
67. William Nordhaus, 'The climate club. How to fix a failing global effort', May/June 2020, (https://www.foreignaffairs.com/articles/united-states/2020-04-10/climate-club).
68. Schumpeter used this term in his work *Capitalism, Socialism, and Democracy* (1942) to describe the process by which new innovations replace the status quo.
69. Abbreviation for Research and Development.

scarcity, with fewer raw materials or less fertile soil, makes production more expensive. As a result, prices rise and entrepreneurs look for new opportunities. In this way, it should naturally become more economical to produce in a more sustainable way and the incentive to look for such alternatives is triggered.

In fact, this process of producing more sustainably is already in full swing. MIT professor Andrew McAfee calls this *the dematerialisation surprise.* In western society, increasingly less finite raw materials which exhaust the earth and cause climate change are used per product. The upward trend of economic growth and the downward trend of spent input diverge further and further. An example of this is shown in Figure 8, which illustrates the diverging trend of GDP growth and stagnant energy use, and with it, the stagnant greenhouse gas emissions in the United States. This trend also applies to the use of, for example, metals

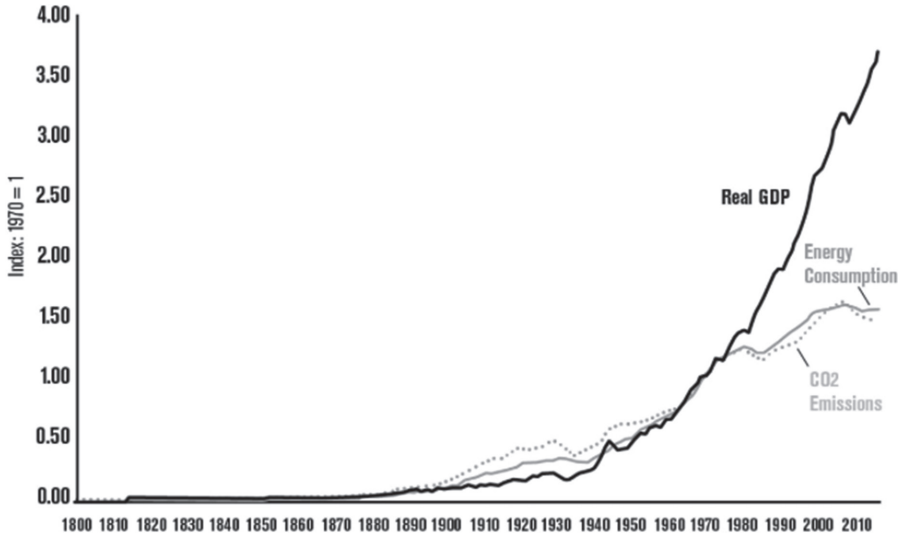

Figure 8. **The diverging trend of GDP and energy consumption growth in the United States from 1800-2017**

Source: Andrew McAfee, *More from Less: The Surprising Story of How We Learned to Prosper Using Fewer Resources—and What Happens Next*, 2019, New York, p. 71)

*On the y-axis, the index with base year (y-value = 1.00) 1970. The figure shows an exponentially increasing trend of *Real GDP* in the United States over the period 1800-2017. After an initial increase, *Energy consumption* and greenhouse gas emissions (= CO_2 emissions) show a stagnating trend.

and wood as input for the production process. This is a direct result of market forces and technological progress. While measures taken by administrative authorities in recent decades have mainly been aimed at limiting consumption (without much success), a more important factor could be the reduction of resources used for consumption.[70] Dematerialisation results in fewer emissions during production, and in less input of finite raw materials required for the production process.

A different trend is occurring in the capital market, namely the emergence of green bonds and their varieties. These concern debt securities issued by companies under the label of ESG (Environmental,

Social, and Governance) investing. With ESG investing, investments are made in companies that take into account the above social and sustainable goals. Investors value the way their capital is used and the consequences of this for the environment. With the growing collective awareness of sustainability, the supply of capital for companies that meet such standards is increasing. ESG investing promotes the call for green bonds and similar investments. A consequence is that the cost of capital[71] will decrease for companies that meet this standard, because it becomes easier to raise capital on the capital market due to the increased supply. This is at the expense of the return for capital providers.[72] Here, we encounter a potentially tricky issue. Capital providers want their capital to be used for companies that meet ESG standards. At the same time, those same providers want a return on the capital they invest. If the cost of capital of green bonds and similar equity instruments goes down, this results in lower returns for capital providers. A paradox occurs here that involves a trade-off between profitability and sustainability.[73]

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70. Andrew McAfee, More from Less: The Surprising Story of How We Learned to Prosper Using Fewer Resources—and What Happens Next, New York, 2019.

71. Cost of capital is the return that providers of capital receive on the capital provided. If a company sells a green bond to a capital provider and the cost of capital is lower than before, it means that the company pays a lower interest cost to the capital provider who buys the *green bond* from the company.

72. Rising demand for certain investments lowers returns because higher demand enables a company to lower its cost of capital. Shareholder return is one of the components of the cost of capital.

73. Robert Armstrong, 'The dubious appeal of ESG investing is for dupes only', *The Financial Times*, 23 August 2020, (https://www.ft.com/content/e9f00cb2-3cd8-499e-9e8a-dd837f94657e).

A first solution is to ensure that companies with an ESG label actually 'deserve' it. There are still many companies that benefit from an ESG label, but in reality do not meet any of the criteria.[74] An independent body that assesses whether companies meet the criteria could be set up. Or the jurisdiction could be assigned to an existing independent institution. The label is then assigned based on diligent information.

The government also has a role to play here. Market and state can complement each other. Some projects and studies are simply not for private parties. For example, when major long-term investments are required, combined with a great uncertainty regarding outcomes, if there are any at all. Large, long-term investment sums with an uncertain payback model may be attractive from an idealistic perspective. But investments must also be profitable to some degree of certainty. The government can get on board here, by investing in fundamental research that is too risky for private parties. Fundamental research contributes to the development of public goods and prosperity. It is precisely for the development of these public goods that we have a government and pay taxes.[75] Investing in fundamental research, from which technologies can be developed, is a task for the government if this is not done by private actors. In wartime, the smartest minds are used to develop efficient and heavy weapons. If we follow Joseph Stiglitz' reasoning and consider climate change to be our generation's world war[76], those smart minds can be engaged to research technologies that make sustainable production possible, that intervene in the process of climate change in other ways, or that enable us to adapt to change.[77] In addition, we have already specified the role of the government in enforcing CO_2 pricing, as well as setting

74. Billy Nauman, 'How to separate the good from the bad and ugly ESG funds', *The Financial Times*, 8 September 2020, (https://www.ft.com/content/a0dcaf41-cc2e-401c-9742-24544fd97524).
75. Mariana Mazzacuto, *The Entrepreneurial State*, London, 2013.
76. Marike Stellinga and Wouter van Noort, Topeconoom Joseph Stiglitz: 'Klimaatverandering is onze wereldoorlog', *NRC Handelsblad,* 22 November 2019, (https://www. nrc.nl/nieuws/2019/11/22/stiglitz-duurzame-transformatie-is-als-mobilisatie-tweede-wereldoorlog-a3981289).
77. Larry Elliot, 'Capitalism can crack climate change. But only if it takes risks.', *The Guardian*, 16 August 2018, (https://www.theguardian.com/commentisfree/2018/aug/16/capitalism-climate-change-risks-profits-china).

rules based on the damage principle, to prevent serious damage to the living environment.

A final important point is that externalities do indeed occur within capitalism. This doesn't mean that switching to a different system will solve these issues. As we discussed in chapter 1, socialist systems have proven ineffective in terms of wealth creation, while capitalist systems have succeeded in this. To be able to cope with externalities, resources are needed to achieve effective measures. Major investments are necessary, and only possible if the financial resources are available. The market has proven to offer room for social provisions due to the expanded possibilities brought on by economic growth.[78] In that sense, the economy plays an important role in pursuing climate and environmental goals. Slowing down the economy in order to function within the ecological boundaries of our planet would hinder a certain progress that could well lead to the effective functioning of the free market within those same ecological boundaries.

The Way Forward

The corona pandemic has shown us that we're capable of taking collective action in the event of a direct health threat. Damage to the earth, however, is sometimes the result of a slow, not immediately perceptible development, as is the case with climate change. But that doesn't mean we can look the other way.[79]

In the past decades, we have seen that attempts to limit consumption and the conclusion of unenforceable international treaties have not contributed, or not sufficiently contributed, to mitigating climate change and limiting the extraction of finite raw materials. There is still plenty of reason for optimism, but action is required. Effective action. Mass recycling and the signing of treaties that fuel free-lifting issues have not

78. Peter Berkowitz, 'Capitalism, Socialism, and Freedom', *Essay Series Socialism and Free-Market Capitalism: the Human Prosperity Project*, Hoover Institution, 2020.
79. Gideon Rose, 'The fire next time: what's inside', May/June 2020, (https://www.foreign-affairs.com/issue-packages/2020-04-14/fire-next-time).

proven to be sufficiently effective.[80] Flawed measures that have failed to suppress harmful externalities have led to a growing criticism of the market's role in this. Although this criticism arises from a noble idealism aimed at improving everyone's living environment, it is more useful to look for solutions that actually work.

Binding international regulations and a focus on innovation and geo-engineering appear to be more effective. The market is a great place for innovation, especially if effective transnational CO_2 pricing creates an incentive to find efficient ways to produce and buy more sustainably. In this way, the trend of dematerialisation can be continued and technologies can be developed that have a positive impact on the climate. The government and the market can complement each other by linking fundamental research to innovation in companies. The government must step up when it comes to sufficient investment in fundamental studies with uncertain outcomes. Research that creates more opportunities for the development of successful technologies that can contribute to combating depletion of the earth. International cooperation—the exchanging of knowledge and joining of forces—can also contribute to this.

Climate club

It is time to give proper shape to the 'polluter must pay' principle. A geopolitical solution to climate change could be the creation of what the American economist and Nobel laureate William Nordhaus calls a Climate club.[81] Setting emission limits and trading emission rights still allow for the relocation of production to countries with less stringent regulations. This results in symptom management with a counterproductive effect. Production proceeds without effective pricing of harmful effects and associated emissions. The idea of a Climate club is that countries voluntarily form a bloc; a coalition whose members must put a price on emissions, but also on imports. A so-called carbon price. Climate action must be collectively regulated in order to be effective, therefore, the EU emerges as the right institution.

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80. Andrew McAfee, *More from Less: The Surprising Story of How We Learned to Prosper Using Fewer Resources—and What Happens Next*, New York, 2019.
81. William Nordhaus, 'The climate club. How to fix a failing global effort', May/June 2020, (https://www.foreignaffairs.com/articles/united-states/2020-04-10/climate-club).

Implementation at Union level is also beneficial in connection with scale effects. A snowball effect is created by countries wanting to become part of the bloc. In order to become a member, they must meet all criteria with regard to true carbon pricing. The major advantage is that a homogenous emission reduction policy is created.[82]

A possible disadvantage of such a plan is that national sovereignty is at stake. It could pave the way for a growing number of European taxes. In this regard, we argue in favour of safeguarding the principle of subsidiarity: only organise that what cannot be regulated at a lower political level at the transnational level. In our view, the transboundary climate issue must be tackled at the international level. After all, we now know that individual (national) action is not sufficiently effective. In the process of outlining the regulations, it would be wise to define the area of supranational legislation and limit it to climate (and where relevant) the environment. These regulations should not result in the European Union drawing in more and more power in a general sense. Harmonised regulations, combined with national enforcement and collection of taxes, can guarantee the sovereignty of states.

In addition, there are still some issues to tackle: pricing, data collection and dealing with less developed countries that may not have the capabilities to meet the requirements.[83] However, all these barriers are no reason to refrain from taking action. In recent years, new regulations have also been introduced in the financial sector (Basel III and Basel 3.5). These regulations are the result of thorough analyses and transparent step-by-step plans, but without the proof that all measures are effective. They are being implemented nevertheless, because there is a need to intervene. Where necessary, adjustments are made that prove more effective and fit within the institutional framework.[84] The same could be true for an EU carbon tax. This could also be adjusted in the meantime if necessary.

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82. Ibidem.
83. Péter Balás, Cándido García Molyneux and Paul Mertenskötter, *Climate change: the EU moves toward a carbon border adjustment mechanism*, 11 March 2020, (https://www.lexology.com/library/detail.aspx?g=0ab3c5b5-5adf-41f5-9885-decbbf21e8b1).
84. Aerdt Houben, Remco van der Molen and Peter Wierts, 'Making Macroprudential Policy Operational. Revue de Stabilité Financière', *Banque Centrale Du Luxembourg*, 2012.

Brussels has already taken the first steps: the European Commission has developed concrete plans for a European plastic tax and a carbon border adjustment mechanism.[85] The market will adapt to the new frontiers of regulation and find a new equilibrium, with prices rising or other production methods being found. Such taxes are not only instrumental to foster innovation, but also influence consumer behaviour.

Two things are crucial to the success of such a project. The first has already been mentioned: homogeneous emission reduction. A harmonised policy ensures clarity and transparency. In addition, measures must be binding in law. When a conflict with established rules occurs, the consequences must be determined in advance and these must be legally enforceable. Creating incentives for countries to join the Climate Club, such as higher import duties for non-members, is also important. In this way, factors of ignorance, free-riding behaviour, anti-environmental interests and short-term thinking can be overcome.[86]

Depletion of finite resources

While the Climate Club can potentially play a role in reducing CO_2emissions, there is also the problem of global depletion. Think of tree felling and the mining of finite resources. Here too, the market and government can play an important role in the process of dematerialisation. Stimulating dematerialisation through innovation to reduce costs and meet more sustainable consumer needs can lead to better methods: techniques that are capable of producing the same result with less input. Less finite raw materials will then be needed for the production process. Raw materials could also be taxed. In line with the Climate Club, which focuses on emission reduction, a similar initiative would enable government action to curb the use of finite resources and encourage dematerialisation.

85. Sam Fleming and Jim Brunsden, 'Brussels looks to new taxes to pay off pandemic recovery debt', *The Financial Times*, 25 May 2020, (https://www.ft.com/content/e4ca5b01-9b26-413a-bbb9-960db6b5914a).
86. William Nordhaus, 'The climate club. How to fix a failing global effort', May/June 2020, (https://www.foreignaffairs.com/articles/united-states/2020-04-10/climate-club).

Spontaneous Sustainability

In addition to the foregoing regulation propositions, it is also good to mention the phenomenon of spontaneous sustainability. Companies conform to the values that consumers deem important. Consider, for example, the great amount of attention that companies recently paid to the Black Lives Matter movement. With regard to sustainability, there is an increasingly louder and broader call to combat damage to the earth. Ecological values are becoming increasingly central to consumer choices. This sense of urgency from the demand side of the economy forces companies to adapt. At this very moment, the market itself is already doing some of the work.

The government can support this process through sustainable labelling. Stricter standards for sustainability labels would enable citizens to opt for products that are truly sustainable. After all, too much greenwashing still occurs, where a sustainable label is used to attract consumers to a product that is actually not as sustainable as the label makes out.[87] The same applies to the capital market, as described earlier with regard to ESG investing. This type of deception must be eliminated. Only then can a real choice for sustainability be made.

87. Richard Dahl, 'Green Washing: Do You Know What You're Buying?', *Environmental Health Perspectives* 118(6), June 2010.

CHAPTER 3.

Concentration of Power

> 'Competition is the essence of capitalism, yet it is dying.'
>
> Jonathan Tepper and Denise Hearn in *The Myth of Capitalism: Monopolies and The Death of Competition,* New Jersey, 2019

The Critiques

Two years ago, Jonathan Tepper and Denise Hearn presented a serious diagnosis of the state of capitalism. In a nutshell: in various (American) industries, there is an excessive concentration of power. That is to say: there are a few major players on the market that call the shots. There is little real competition. And that's serious, because, as they write in *The Myth of Capitalism: Monopolies and The Death of Competition*, capitalism without competition is not capitalism.

According to them, the lack of competition leads to all kinds of negative consequences. This results in less freedom of choice for consumers and employees. It leads to growing inequality, with a lot of money ending up with the monopolist. Prices increase. Wages decrease. There is less innovation and less investment. The economy's productivity decreases. There is less momentum in the economy, with more giants and fewer start-ups. Where competition normally provides clear price signals in markets that stimulate supply and demand, that mechanism is now disrupted by a lack of competition. All in all, there is less economic development, and above all, a weaker democracy, because the power is held by a handful of companies.

Others reached similar diagnoses. In his book *Gigantism*, the Belgian economist Geert Noels opposes the idea that big, bigger, biggest is

desirable.[88] He watches with dismay, as companies and organisations are getting bigger and more powerful, with terrible consequences for healthy competition within the economy, sustainable growth and ultimately also for people, who are marginalised in the process. In *The Financial Times,* renowned economics editor Martin Wolf warns of damage to liberal democracy due to declining competition and growing dominance of a number of players.[89] In *People, Power, and Profits*, Joseph Stiglitz writes that economic power is concentrated in fewer and fewer actors and also results in political power. A trend of growing inequality is manifesting itself, whereby the power of large corporations is increasing at the expense of the—already limited—power of the middle class.[90] In a competitive market, companies are *price-takers* and *wage-takers*, but growing market power is turning them into *price-setters* and *wage-setters*.[91] Critics say that companies are taking advantage of this on a large scale by exploiting workers and consumers with low salaries and high prices. Companies swallow the excess profits without benefiting workers and consumers.[92]

In Europe and the United States, the conversation regarding concentration of power focuses on Big Tech. The four tech giants—Amazon, Apple, Facebook and Google—recently appeared in the US Senate to answer for their enormous market power. Their dominant position is alleged to cause stagnant innovation, a lack of newcomers and (potential) abuse of consumer privacy.[93] Over the past decade, the five largest tech companies have made 400 acquisitions, with hardly any intervention

88. Geert Noels, *Gigantisme. Van too big to fail naar trager, kleiner en menselijker*, Tielt, 2019.
89. Martin Wolf, 'Why rigged capitalism is damaging liberal democracy', *The Financial Times*, 18 September 2019, (https://www.ft.com/content/5a8ab27e-d470-11e9-8367-807ebd53ab77).
90. Joseph Stiglitz, *People, Power, and Profits*, New York City, 2019.
91. Jason Furman and Peter Orszag, 'A firm-level perspective on the role of rents in the rise in inequality', in: *Toward a Just Society: Joseph Stiglitz and Twenty-First Century Economics*, New York, 2018.
92. Joseph Stiglitz, *People, Power, and Profits*, New York City, 2019.
93. Eva Schram, 'Een groot bedrijf is niet tegen de wet, een monopolie wel', *Het Financieele Dagblad*, 28 July 2020, (https://fd.nl/achtergrond/1351799/een-groot-bedrijf-is-niet-tegen-de-wet-een-monopolie-wel).

or active control by regulators.[94] Moreover, they largely determine the rules of the game and therefore, also the boundaries of the online public debate. Critics increasingly wonder how desirable this is for our democracy.

In short, by letting the market system run wild, critics say we are left with a few large companies that do not serve—or even harm—the public interest. In their view, this increased power has led to a decrease in competition and with it, the incentive to innovate. In addition, in order to eliminate competition, large companies are buying up smaller start-ups before they develop into serious contenders. Companies with dominant positions are benefitting from employees and consumers who have no other options. Critics are therefore calling for the protection of the public interest—and the protection of privacy—through more active government intervention and by restriction of the market power of large companies.[95]

Reflection

Where liberals have an intuitive distrust of great government power, this also applies to concentrated market power. Any form of power concentration must arouse scepticism on the basis of liberal ideology. In our view, Jonathan Tepper and Denise Hearn, the authors of the quote at the beginning of this chapter, are right in saying that competition is crucial. Businesses affect the lives of many. Consumers buy from companies, employees earn their wages there, and companies buy from suppliers. Companies influence the quality of the product or service at the price consumers pay, the wages and working conditions of employees, and the compensation paid to suppliers. That power is limited by competitors. Rivals in the market offer comparable products or services at competitive prices. Companies also need employees to whom wages are paid. Good conditions for employees are created by means of competition.

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94. *The Economist*, 'What more should antitrust be doing?', 8 August 2020, (https://www.economist.com/schools-brief/2020/08/08/what-more-should-antitrust-be-doing).
95. Mariana Mazzucato, 'The COVID-19 crisis is a chance to do capitalism differently', *The Guardian*, 18 March 2020, (https://www.theguardian.com/commentisfree/2020/mar/18/the-covid-19-crisis-is-a-chance-to-do-capitalism-differently).

Competition also provides the incentive for innovation. In a competitive market, investments that lead to innovations are key in order to stay afloat. A competitive market is thus a system that generates higher standards for all.

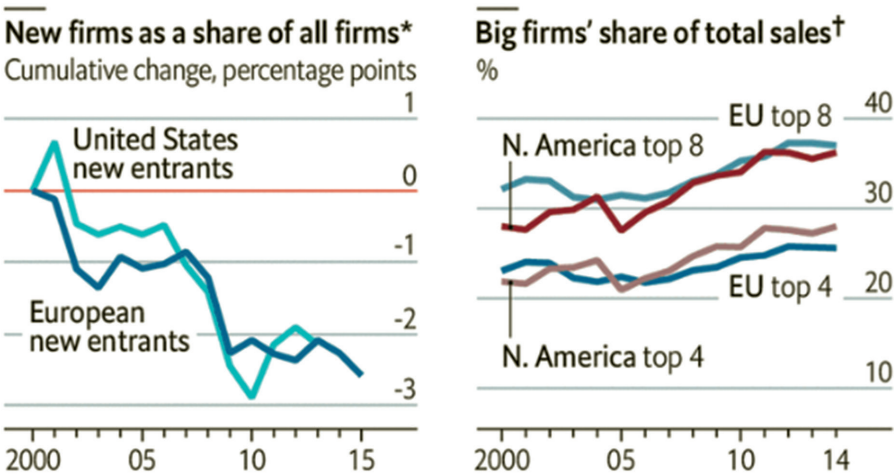

Figure 9. **Indicators of increasing market concentration in Europe and North America***

Source: *The Economist* ('Competition is withering on both sides of the Atlantic', 20 November 2018)

*The first graph shows the number of *new firms as a share of all firms* as an average of countries and industries. The number of new entrants demonstrates a downward trend as a percentage of the total number of companies. The second chart shows the percentage market share measured in revenue of the largest four and largest eight companies (= *big firms' share of total sales*) as an average of all industries. The market share percentage of the largest companies shows an increasing trend. Both trends apply to both Europe and the United States.

If there is limited (potential) competition, companies can bend the market to their will. Figure 9 illustrates the existence of indicators of increasing market concentration in the western market economy. Large companies have larger market shares and there are fewer market entrants. These trends of increasing market concentration are an indication of declining competition. Several aspects associated with the growing market concentration and (potentially) adverse effects for those involved are discussed below.

Consumers and surplus profits

One of the major criticisms of capitalism in relation to large corporations revolves around the withdrawal of surplus profits from the economy. In a free market, prices are established through the interaction between supply and demand. Ultimately, this leads to a balance in the market between the number of suppliers and consumer demand. When this equilibrium is reached, the price covers the costs and the profit necessary for the company to reinvest for continuity and to pay returns to capital providers. This process does not allow for the generation of additional profits.

If suppliers were to try to make extra profits through higher prices, the price would eventually have to go down again. After all, this situation would offer opportunities for (potential) competition to offer the same product or service at a lower price. This increase of suppliers then leads to a price drop (more supply while demand remains the same). The supplier with the higher price is then competed out of the market or has to lower the price. At least, that's what standard economic theory prescribes.

In practice, however, we see that certain companies are able to make excess profits. A lack of competition may result in companies being able to influence prices in a way that is not possible in a well-functioning market.[96] In that case, a company can make more profit without a complete loss of demand.

Usually, when a company charges a higher price than the competition, demand falls away. The company in question has to lower the price in order to remain competitive. However, due to increased market power, companies are sometimes able to attract such surplus profits for a longer period of time. Their market position is strengthened by raising barriers to entry and buying up (potential) competitors. This form of power concentration enables companies to keep competitors out of the market.[97] The concern is that the consumer receives less value for money than they would in a competitive market, or in other words: the same value

96. As standard economic theory prescribes
97. Joseph Stiglitz, *People, Power and Profits*, New York City, 2019, chapter 3.

for more money. The victim of this lack of competition is the consumer, while companies have the advantage of higher profits.

There are two sides to the surplus profit story. On the one hand, these are earned by entrepreneurs who correctly assess the needs of consumers. The entrepreneur is apparently able to offer something for which the consumer is willing to pay. If the consumer is willing to pay more for a product or service because they value this product more, the surplus profits of companies need not be a problem. In theory, surplus profits should be temporary, because they attract new competition. Surplus profits should eventually erode completely. This process can take a long time however, and can therefore be quite painful for the consumer. When companies become overly powerful, we must be wary that they do not abuse their market power to eliminate potential competition in advance, for example by blocking market entrants.

Employees and surplus profits

Low costs are the second source of surplus profits. For a company, expenses can be divided into labour, land and capital. Entrepreneurs actively look for investments where they estimate that these factors are undervalued. This is the case, for example, when the wage is lower than the turnover that a worker can add to the company. Once again, we can label the profit made as surplus profit. Thus, in the case of labour—which is the main focus of the criticasters' argument—profit is made, in a sense, by the deployment of workers. Wages are therefore disproportionate to the work, because working yields more for employers than the wages reflect. In both North America[98] and Europe[99], we see a trend of a decreasing share of profits for employees. The share of capital, on the other hand, has increased. If this were to lead to increased investment, this could lead to economic growth and the associated prosperity.

98. Anna Stansbury and Lawrence H. Summers, 'The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy', *National Bureau of Economic Research* [Working Paper Series], 2020.
99. Dilyana Dimova, 'The structural determinants of the labor share in Europe', *International Monetary Fund*, 2019.

However, investment has not increased but stagnated[100], indicating surplus profits benefiting the capitalists without a proportional increase in the employee share. Again, the cause can be found in the lack of alternatives (in this case, for the worker). And here too, it is—theoretically—up to other entrepreneurs to recognise undervaluation and attract workers by offering better working conditions. The surplus profits are the signal for these potential entrants that undervaluation exists. The logic that applies to consumers, applies to employees as well.[101]

While everyone is free to enter into agreements as they see fit, growing inequality is undesirable if it is largely the result of increased corporate power and diminished worker power. If companies are *wage-setters* and use this power to skim wages in favour of surplus profits, the market process does not function optimally. An additional problem is that capital is becoming increasingly global and detached from local markets, while labour remains local.[102] A Chinese investor could care less about the wages of a Dutch employee. If that employee does not have the power to influence wages, this allows the investor to take advantage of it. In addition, research indicates that low-skilled workers are particularly affected by globalisation and increased market concentration. In combination with low labour mobility, this poses a threat to well-being within society.[103] If this narrows the possibilities of a large group of individuals, equality of opportunity within society is in danger. Liberals are not against unequal outcomes, but they are, if these are the result of unequal opportunities.

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100. See, for example: Anna Stansbury and Lawrence H. Summers, 'The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy', *National Bureau of Economic Research* [Working Paper Series], 2020. It must be said, however, that the stagnation of investments has various causes, such as the low return on investments and the lack of good investment opportunities. So it's not just the result of capitalists taking a greater share of the returns at the expense of others; in this case, at the expense of employees.

101. Market power through a lack of competition resulting in the ability to set prices is monopolistic power. Market power from a lack of potential employers (either geographically or within sectors) resulting in the ability to determine employee wages is monopsonic power.

102. Eric Lonergan and Mark Blyth, *Angrynomics*, Newcastle, 2020.

103. See, for example Anna Stansbury and Lawrence H. Summers, 'The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy', *National Bureau of Economic Research*, [Working Paper Series], 2020.

The conclusion with regard to surplus profits is that, in theory, they can stimulate competition, but that reality sometimes proves otherwise. One solution lies in counteracting barriers to entry, giving new companies the opportunity to challenge established companies and thus reintroducing a strong competitive stimulus into the market. As a result, companies will have to sacrifice surplus profits in order to remain competitive.

Barriers to Entry

When it comes to market concentration, in our view, the entry barriers that stand in the way of lively competition are an area of major concern. Intervention is by all means necessary when the exercise of market power leads to the erection of artificial barriers to entry. As far as we're concerned, the fact that companies have other means of competing and therefore succeed in varying degrees is not in itself problematic. But, wherever the basic right to compete is not a given but must be obtained, an undesirable barrier exists.

We are critical, for example, of the Big Pharma-industry, where profits are not necessarily made by implementing ideas for the benefit of consumers, but also by obstructing other parties through patents. In the pharmaceutical industry, large companies use complex regulations regarding intellectual property and patents. As a result, generic, cheaper alternatives are sometimes kept off the market by legal tricks.[104] The consumer then has no choice but to buy medication at a high price, assuming they want to live as healthily as possible. Exploiting these regulations, while perhaps within legal limits, is detrimental to the market process. Potential competition is barred and citizens suffer the consequences in the form of unnecessarily high prices.

This doesn't mean that patents and intellectual property should be abolished. The musician whose songs are protected by copyright; the writer whose novella may not be published by another person; the game designer whose game may not be copied and distributed. All examples of the desirable role of intellectual property. After all, it offers a market

104. For a detailed analysis, see for example: Mark S. Levy, 'Big Pharma Monopoly: Why Consumers Keep Landing on Park Place and How the Game Is Rigged', *American University Law Review* 66(1), 2016, pp. 247-303.

party the necessary protection of the outcome of its efforts and creativity. This type of regulation also offers a degree of certainty to recoup investments and risks. This is of great importance to be able to undertake risky long-term projects, for example when it comes to drug development. Patents serve as protection for the developer, in order to recover the costs incurred, without anyone being able to take advantage of their developments without having to incur costs themselves.

The public interest is not served by legal tricks that exclude parties from the market and that ensure exploitation long after the costs have been recovered. It is therefore necessary to strike the right balance between intellectual property protection and competition. Just as with international tax rules (see Chapter 1), the solution lies in less complexity and more clarity within the regulatory framework. This way, every player in the market will know where they stand, there will be less opportunity for clever legal interpretation or abuse, and rules are easier to enforce.

Market failure

As discussed, the market process gives rise to monopolies (high prices) and monopsonies (low wages). While this generally resolves itself in the long run, in some cases, the market adjustment process requires time to reach a new equilibrium. For example, due to the time competitors need to respond to the market process. Where the process is slowed down, either intentionally or due to specific circumstances, economists speak of market failure. Companies can apply a variety of tactics that lead to market failure.

The first is cartel formation. In a cartel, agreements are established between independent market participants. Agreements can be about the amount of production, the price or the geographical distribution of the market. The result is lower production at a higher price and thus a reduction in mutual competition. As Adam Smith put it in 1776: 'People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.'[105]

105. Adam Smith, *The Wealth of Nations,* London, 1776, book 1, chapter 10.

A second tactic is *predatory pricing* ('cut-throat competition'). This involves a dominant player in the market. Due to its deep pockets, it can suffer inefficiencies (and losses) when a competitor enters the market and drive the rival away. Once the playing field has been cleared, monopoly gains can compensate for losses incurred. As a bonus, or as part of the strategy, the established reputation of 'fighter' can cause potential competitors to shy away from entering the market at all.

The final mechanism we'll discuss is that of network effects, a very topical concern in economic theory. Network effects occur when the value of a company's products or services increases with the number of users. This is the case, for example, with social media platforms that are attractive because others also use them. Network effects also apply to platforms that bring companies and consumers together, such as holiday accommodation, food delivery and (online) shopping centres. A *winner-takes-all* dynamic takes place here. Due to network effects, consumers are not likely to switch to another product or service, even if this would benefit them as a group. New competitors experience an inherent disadvantage when entering the market. The concern here is that natural monopolies exist that can impose unfair terms on their customers, without being restrained by competitors. For example, by ranking search results for a certain product higher if this provider has used another service from the platform. The customer will not see the best offer, but the offer from which the platform administrator has made the most money.

Big Tech

In relation to market power concentration and network effects of platform companies, there much public debate surrounding the so-called Big Tech companies. This particularly concerns Amazon, Apple, Facebook and Google (with Alphabet as the parent company that often has to account for itself). Together, these companies are worth over 4,000 billion euros (!).[106]Where, a few decades ago, these companies brought

106. Nando Kasteleijn, 'Is 'big tech' te machtig? Kopstukken moeten zich verdedigen in het Congres', *NOS*, 29 July 2020, (https://nos.nl/artikel/2342188-is-big-tech-te-machtig-kopstukken-moeten-zich-verdedigen-in-het-congres.html). .

about *creative destruction* as innovative new entrants—as Schumpeter would have wanted—today, they inhibit innovation and the entry of newcomers into their markets. Not only do they acquire large companies within the sector—Google took over YouTube, Facebook took over Instagram and WhatsApp—they also procure numerous small businesses that pose a potential threat. For start-ups, it has become standard practice to be occupied with one's exit from the very start: being bought up for a large sum by the big tech companies.[107] In this way, they never grow into full-fledged competitors who can actually give the tech giants a hard time.

One issue regarding unfair competition conditions manifested itself in the Amazon case, with the European Commissioner for Competition Margrethe Vestager concluding that the company plays an undesirable double role.[108] Amazon is both retailer—selling its own products online—and manager of the platform for third parties. Vestager ruled that non-public information regarding these third party sales is used by Amazon to promote its own products. *Elsevier Weekblad* offered a nice comparison with a county fair, where the market manager stands at a booth among the customers and suddenly turns out to be a competitor. 'You wanted oranges? Try mine first.'[109] The market manager can also set up his own booth at the best place of the fair; another undesirable effect of the dual role of managing the fair (the network) and offering products (the booth).

Many concerns also exist regarding the privacy of citizens. The privacy of individuals is often poorly protected by Big Tech. A critical look at Big Tech is vital. Any liberal would have agreed with Jeff Bezos when he stated in the US Senate on July 28: 'Let me close by saying that I believe Amazon should be scrutinised. We should scrutinise all large institutions, whether they're companies, government agencies, or non-profits. Our responsibility is to make sure we pass such scrutiny

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107. Eva Schram, 'Een groot bedrijf is niet tegen de wet, een monopolie wel', *Het Financieele Dagblad*, 28 July 2020, (https://fd.nl/achtergrond/1351799/een-groot-bedrijf-is-niet-tegen-de-wet-een-monopolie-wel). .

108. For the statement of the European Commission on this case, see: https://ec.eu- ropa.eu/commission/presscorner/detail/en/IP_20_2077.

109. See for the complete opinion piece: https://www.ewmagazine.nl/opinie/opinie/2020/11/ brussel-voert-terecht-strijd-tegen-amazon-787752/. .

with flying colours.'[110] As stated earlier in this chapter, liberals should always remain critical of powerful institutions.

Supervision

Market failure gives rise to market intervention. If it were up to us, the ultimate goal of supervision would be consumer protection. This can be achieved by guaranteeing fair and lively competition in the market through the establishment of rules aimed at counteracting market failures. However, enforcing those rules of the game is somewhat arbitrary. The question is, which limits can be applied by a regulator to identify and counteract market failure? And how would a regulator be able to determine that market failure is taking place?

When discussing market concentration, competition is often referred to as a *quantity* of which we can have more or less. In reality, competition is a continuous *dynamic process*, which is intrinsic to a free market. This was the central message of Friedrich von Hayek's essay 'The Meaning of Competition', at a time when that message was as relevant as it is today.[111] In this process, the estimates made by entrepreneurs are subject to the profit and loss mechanism, which leads to a better distribution of scarce resources. Within a static framework, it is easier to talk about and recognise market failures. But the dynamic market process is inherently unpredictable to a certain extent, making it difficult to draw clear conclusions.

Does this mean that supervision is not necessary or possible? No. If market concentration leads to abuse of dominant positions and loss of prosperity, intervention is imperative. Concentration of power inherently provides the opportunity for profiteering behaviour. It is up to the regulatory authority to apply the rules in such a way that the market functions as effectively and efficiently as possible. However, this doesn't mean the supervisor should be granted absolute power. Just as too much

110. Statement by Jeff Bezos to the *U.S. House Committee on the Judiciary*: *Testimony before the Subcommittee on Antitrust, Commercial, and Administrative Law*, 28 July 2020, (https://www.aboutamazon.com/news/policy-news-views/statement-by-jeff-bezos-to-the-u-s-house-committee-on-the-judiciary). .

111. Friedrich von Hayek, 'The Meaning of Competition', in: *Individualism and Economic Order*, Chicago, 1948, pp. 92-106.

power in a small group of companies can lead to market disruption, so can too much power in the supervisory body.

The Way Forward

Liberals will always be suspicious of major forms of power concentration. Classically, this manifested itself in distrust of an overly powerful government. After all, the freedom of the individual may be oppressed as a result. At present, we also observe the added risk of the concentration of power of a shrinking group of large companies in the market. Individuals benefit from spreading and limiting power. Any form of power must be held in check by counter-power.

Competition (existing competition and (potential) entrants) is especially important and must be properly safeguarded. Competition creates freedom of choice. Consumers are free to choose from different services and products, employees can choose from different employers and companies continue to develop through innovation. In the economic sphere, buyer protection and consumer interests should always be paramount.

Within the market, there is always the possibility that companies will grow and acquire profits. As long as this attracts competitors who also wish to tap into these opportunities, market forces will remain. This doesn't mean that every form of profit-making by one or a few players on the market should be restricted immediately. As long as the consumer has a choice or (potential) competition exists, market forces are at play. However, if that power has become too extreme or is abused, resulting in a disadvantage for the consumer or the employee, intervention is imperative.

The issue of power abuse must be tackled at its roots. Stimulating competition seems to be the most effective way to combat forms of power exploitation in the free market. If there are opportunities for competition, there is (potential) choice for the consumer. Market suppliers are then forced to act in the interests of the consumer to avoid losing them to another market party. If market concentration leads to abuse of dominant positions and loss of prosperity, intervention is necessary in order to maintain or restore the competitive incentive.

We need strong regulators that dare to intervene, for example when unfair competition exists. European Commissioner Margrethe Vestager appears to be a good role model in this regard. The regulator could also focus more on the phenomenon of early acquisitions. In our view, prevention is better than cure (breaking them up). For example, the American regulator should not have allowed the takeover of Instagram and WhatsApp by Facebook at the time. It was foreseeable that these acquisitions would lead to a monopoly in the social media market. Now, the regulator is demanding that Facebook should shed its two subsidiaries, with all the technical difficulties and costs this entails. One idea could be to let companies themselves prove that an acquisition does not have an anti-competitive effect and is for the benefit of the consumer, instead of the other way around.[112] In this way, disruptive innovation is not nipped in the bud by the companies in order to maintain their own dominant position. When it comes to keeping global tech giants in check, a transnational—or at least Europe-wide—approach, is required. This is the only way to guarantee fair competition and secure values such as privacy.

Besides this, measures that can promote the openness and neutrality of platforms are also beneficial. When it comes to online platform companies that currently have a dual role, good market functioning may involve separating ownership of infrastructure from its use. To make a few comparisons: this means not owning both the track and the trains, not supplying the power as well as managing the network, not operating both the airport and the airline that uses it. In short, this is a well-known problem at its core and proven methods exist to mitigate its drawbacks for consumers.

One final note. The fact that the power of a few large companies must be subject to control doesn't mean the government should continuously intervene actively in sectors or companies. The idea remains that, in the free market, individuals and suppliers should be able to interact freely with one another. These transfers must take place in an open and competitive atmosphere. Otherwise, they are not truly free. This open and competitive atmosphere must therefore be actively monitored.

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112. *The Economist*, 'What more should antitrust be doing?', 8 August 2020, (https://www.economist.com/schools-brief/2020/08/08/what-more-should-antitrust-be-doing)..

CHAPTER 4.

Shareholders in the Doghouse

> 'A company is more than an economic unit generating wealth. It fulfils human and societal aspirations as part of the broader social system.'
>
> A quote from the *Davos Manifesto*, 2020

The Critiques

Prominent among critiques of capitalism is the accusation that capitalism is overly focused on short-term profit. 'More, more, more'. According to the critics, shareholders have too much power and shareholder capitalism leads to a culture of excess. There should be a stronger focus on social goals and public values—such as our living environment and the climate—and an even distribution of income. The gap between the shareholder's share, the manager's share and the share for the benefit of employees' wage growth is said to be too big. Large multinationals, in particular, are criticised for not paying taxes, taking advantage of public facilities and not giving back to society (see also chapter 1).

In the Dutch Parliament, 'shareholder capitalism' is criticised regularly by SP leader Lilian Marijnissen, GroenLinks leader Jesse Klaver and the rest of the left-wing opposition. They say it's high time to put an end to shareholder capitalism—which in their view, only focuses on profit distribution to shareholders—once and for all. 'My big concern is shareholder capitalism gone too far', Klaver said in an interview with Dutch newspaper *Trouw*.[113]

113. Bart Zuidervaart, 'Jesse Klaver: we moeten nu debatteren over leven na de coronacrisis', *Trouw*, 28 April 2020, (https://www.trouw.nl/nieuws/jesse-klaver-we-moeten-nu-debatteren-over-leven-na-de-coronacrisis~b29a0423/). .

He sees the corona crisis as grounds for a fundamental debate about the future of the economy.

A number of incidents have failed to improve the image of shareholder capitalism in the public debate. For example, the Booking.com incident. What happened there? The company appealed to the support scheme that the government set up to deal with the consequences of the corona crisis. Companies that lost more than twenty percent of their turnover could be reimbursed up to ninety percent of the wage costs of their employees. Booking invoked this arrangement, while its parent company paid out five billion euros to its shareholders. In addition, eight billion euros in treasury shares were bought. Couldn't the company have continued to pay its own staff, if the company had held on to its resources? Now the ordinary taxpayer had to pay up, instead of the shareholders. For those already annoyed by 'shareholder capitalism', this was the ultimate confirmation of their position.

Critics of shareholder capitalism often propose different governance models. The concept of stakeholder capitalism is a much-loved example: the idea that a company focuses on meeting the desires of all its stakeholders, such as customers, employees, partners, the community and even society as a whole. This stakeholder capitalism is currently being discussed by business leaders around the globe. The concerns regarding the governance model of shareholder capitalism thus reach beyond the scope of left-wing politics.

Stakeholder capitalism was, for example, the central theme of the Davos Manifesto 2020, which presents the perspective of the World Economic Forum: the forum where leaders in politics and business meet once a year. The manifest states: 'The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders—employees, customers, suppliers, local communities and society at large. The best way to understand and harmonise the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company.' Another notable passage from this manifesto is this: 'A company is more than an economic unit generating wealth. It fulfils human and societal aspirations as part of the broader social system. Performance must be measured not only on the return to shareholders, but also on how it

achieves its environmental, social and good governance objectives. Executive remuneration should reflect stakeholder responsibility.'

The idea that a company simply has a right to exist if it focuses on making a profit is thus explicitly renounced. With regard to the perspective of the corporate sector on shareholder capitalism, the preliminary end of the trend of 'the business of business is business' (loosely based on Milton Friedman) by means of 'long term value creation for shareholders' (from the mid-80s to the 2008 financial crisis) to 'value creation for all stakeholders', is also well summarised in the declaration of the American Corporate Roundtable 2019, the largest employers' organisation in the United States. It states:

> 'While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:
> – Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.
> – Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
> – Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.
> – Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
> – Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.
> – Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.'

Some thinkers even go a step further than these business leaders. During the Marchant lecture on September 4, 2020, the American economist Glen Weyl stated that capitalism should be democratised. 'We need to turn corporations into democracies. Forcing them to become democracies of their stakeholders', he said during the annual lecture of the scientific bureau of Dutch political party D66. Weyl apparently believes that companies should be forced to become democracies for their stakeholders.

Reflection

Milton Friedman would probably have been shocked by the foregoing idea. After all, it was the classical liberal economist Friedman who, some fifty years ago, wrote in an essay for *The New York Times* that 'the social responsibility of business is to increase its profits'.[114] In the article, he strongly criticises managers claiming to behave in a socially responsible manner. For example, if they claim to be aware of the wishes of all kinds of random stakeholders. In his view, corporate social responsibility is a socialist doctrine that transforms managers from private employees into public officials, who realise their social intentions at the expense of shareholders, employees and customers.

Friedman touches on a justified point of principle here: people in the business world are not democratically elected to pursue political-social goals. If collective goals are to be pursued within society, we must arrange this through elected politics. Every taxpayer has been able to cast a vote for this, which is not the case when merely a random group of stakeholders is taken into account.

Moreover, if we start forcing companies to act as mini-governments, as Glen Weyl apparently suggests, then almost all activity in a society is relegated to a collective and social goal. As Friedman wrote in his *New York Times* essay: 'The doctrine of social responsibility taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly

114. Milton Friedman, 'A Friedman doctrine. The social responsibility of business is to increase its profits', *The New York Times*, 1970, (https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html)..

collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means.' As liberals, we find that undesirable. Not just for the democratic reason just offered. But especially because we value a clearly defined and broad private domain, where companies and individuals can make their own choices and considerations. We do believe that companies have a social responsibility not to cause damage, in accordance with the damage principle of the British liberal philosopher John Stuart Mill. Milton Friedman's ideas are also in line with this. Everyone remembers the first part of the well-known Friedman quote about the purpose of companies ('to increase its profits'), but many forget that in the second part of the quote, he wrote that companies must operate within the rules of the game in their pursuit of profit ('which is to say, engages in open and free competition without deception or fraud').[115]

In an opinion piece, Robert Armstrong, editor at *The Financial Times*, sums up our position with regard to shareholder capitalism and the relationship to social goals quite nicely: 'Shareholder capitalism is an excellent way to manage our corporate economy and we should stick with it. We also have a very good, if presently neglected, set of tools to ensure that everyone shares in the fruits of economic progress. They are democratic action and the rule of law, which allow us to, for example, set minimum wages, tax carbon emissions and change campaign finance laws. Let's use the right tools for the right purposes.'[116]

This does not mean that shareholder capitalism is opposed to all kinds of social goals. We will explain in depth that, in many cases, this actually coincides. But, where necessary, we have the government as an instrument to set the right preconditions for companies and to achieve certain public goals.

115. Ibidem.
116. Robert Armstrong, 'The dubious appeal of ESG investing is for dupes only', *The Financial Times*, 23 August 2020, (https://www.ft.com/content/e9f00cb2-3cd8-499e-9e8a-dd837f94657e).

Who is the shareholder anyway?

Before we refine our positions further in this chapter, it is good to clearly define a number of aspects. What do we mean exactly, when we talk about companies, shareholders and profits?

Essentially, a business (or enterprise) is nothing more than a way of organising labour and capital in order to make a particular product or to provide a service. It can take many different legal forms.[117] The great advantage of the company is that risks are shared. In this chapter, we focus on companies where ownership and management are separated. In the Netherlands, these are the private limited liability company (bv) and the public limited company (nv).

Alternative governance models, such as cooperatives, also exist. A cooperative has no shareholders. It concerns an association with members. The cooperative, however, has generally proved less successful. Canadian professor of philosophy Joseph Heath offers an explanation for this: 'Internal fighting within a cooperative often becomes so corrosive, or the place becomes so badly run, that it becomes in everyone's interest to hand ownership over to a group of relative outsiders, who will be able to make business decisions in a more impartial manner and to impose them more effectively. That group is the shareholders.'[118] So let's leave the cooperatives for what they are.

We'll focus on companies where ownership and management are separate entities. The mechanism for this is quite simple: if a company makes a product that's in demand, the company will prosper, otherwise it will not. Shareholders are at the bottom of the capital structure. They take the most risk and only receive compensation (dividend) once everyone else has had their share. If loan capital (debts) has been raised for financing, this must first be reimbursed.

With the foregoing business economic example in mind, it makes sense that the (expected) return on equities should be higher than less risky alternatives. This is where investment theory meets the macroeconomic

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117. The simplest legal form is the sole proprietorship, where the owner is also the director. There are also partnerships, general partnerships and cooperatives. In our argumentation, we will focus on private/public limited companies where ownership and management are separate entities.
118. Joseph Heath, *Economics without Illusions*, New York, 2010, p. 83.

context. If you had the choice between consuming in the here and now or delaying that purchase into the future, you would demand compensation for the latter option. The further into the future and the more uncertain you are about that future, the greater the compensation should be. The debate about how high the compensation should be, how high it has been, and how high it will be in the future has been the subject of debate among economists and investors for decades. The fact is that a risk premium exists. Fact is also that it is not stable.

Much of the criticism we discuss here is aimed at shareholders. Who are they really? The answer is not so clear-cut. It concerns a mix of different entities and persons. Especially in those large companies that are the subject of so much criticism.[119] A shareholder is, for example, the pension fund that is investing your future pension on your behalf. The insurance company trying to achieve a return with the premium you invest each month, so that it can make a payment to you if necessary. The bank that invests for wealthy individuals, but also ensures that the less wealthy have access to the capital market. The housing association and the foundation to which you transfer money for charity. The shareholder is the private investor who has opened an account to save for later. The foreign investor, the hedge fund with a more speculative character. And the private equity investment fund, often featured negatively in the press. It's true that sometimes, there are parties who drain a company for the purpose of their own gain, with the attitude: *'après moi le déluge'* ('after me, the flood'). A company is loaded with debt and dividends are quickly paid out. If a company then goes bankrupt, the state steps in and the taxpayer ultimately bears the costs.[120] These are unwelcome excesses.

For our discussion here, it's especially important to realise that there's not just one type of shareholder, that most shareholders are not so drastically different from you, are good-natured and have a long-term horizon. More on that later.

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119. Standard governance is that managers are appointed to keep the company going. In a small company, this is often the director and major shareholder. In a large company, it is more widely distributed. With a supervisory board responsible for monitoring and more distant shareholders.

120. The nuance is missing in the debate and even if the heavily exaggerated image were correct, it can sometimes even be good and healthy. The *shortsellers* exposed scandals at Enron, WorldCom and recently Wirecard. They warned against the imploding of Lehman Brothers.

False contradictions

In other chapters, we have already discussed tax morality and externalities. The next chapter is about inequality. Here, we'll explain that the discussion between shareholders on the one hand, and social values on the other, is a false contradiction. We will clarify that many shareholders are committed to long-term value creation.

The main point is that, in the current era, it's of course far from true that you would create value *either* for your shareholders *or* for your customers, employees, suppliers or locations. The first cannot do without the second (any longer), so it is understood to be in a company's own interest to comply with the ESG principles and standards. Economic value creation—and the survival of a company—depend on it. After all, in their role as consumer, employee or resident, most citizens are becoming more reluctant to deal with unsustainable, exploiting and polluting companies. Companies that don't take good care of their employees will lose them. Companies that don't treat their customers well, will see those customers buying products elsewhere. And companies that fail to comply with ESG standards are increasingly having a hard time with shareholders. These companies experience more difficulty in attracting funding.

The truly committed institutional investor invests in a better world. A recent study by the World Economic Forum makes it clear that negative externalities of business activities are expressed in prices of goods and services.[121] This is particularly evident among institutional investors. They take these matters into account when considering which companies to invest in and which issues to discuss with management. Companies that do not take into account the major social challenges of the future will be confronted with higher costs for raising capital. These companies will have to offer investors a higher expected return. Companies that come up with innovative solutions to mitigate those effects will actually benefit. Are companies coming round as a result? Of course.

Today, not one company exists that is not pressured by its shareholders to pay attention to its economic, social and governance (ESG)

121. World Economic Forum (in cooperation with Mercer), 'Transformational investment: Converting Global Systemic Risks into Sustainable Returns', *White paper*, May 2020.

objectives. Corporate social responsibility has really taken off. Gone are the days when investors merely had a simple exclusion policy where they did not wish to invest in companies that manufacture cluster bombs, use child labour and where employees are exploited, and that was it.

Not only do pension funds pursue financial return, they also expect future pensioners to be able to enjoy their pension in fifty years' time, in a world where climate goals have been factored in. ESG objectives are increasingly taken into account. The instruction given by pension fund boards is that, at the very least, discussions must be held in order to bring about behavioural change. In some cases, the possibility of companies and investors contributing to the UN Sustainable Development Goals (SDGs) is being explored. What's promising is that this shift has taken place without it requiring a leading role from the government.

Another common criticism is that, in recent decades, both listed companies and investors have shifted their focus from the long term to the increasingly shorter term. What's the real story here? The matter is more nuanced than the public debate sometimes suggests. We have just observed that shareholders are steering towards adherence to major social objectives, and are thus concerned with long-term value creation. In addition, various large institutional investors in the Netherlands and abroad are increasingly urging pension funds, asset managers and companies to adopt a longer-term horizon.[122]

Still, there are some concerns. One worry is that listed companies are under increasing pressure to show results in the short term.[123] CEOs hold their positions for a shorter amount of time and have to show results faster. Investors hold onto their shares for a shorter period of time. The IMF indicates that, even among institutional investors, who typically have a long horizon, short-term behaviour is still too often facilitated.[124] Moreover, non-listed family businesses seem to have a more long-term focus than listed companies.

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122. Marcel Andringa a.o., 'Korte-termijn winst of lange-termijn waardecreatie? Beleggen met focus op de lange termijn', *VBA Journaal* 123, 2015, pp. 19-23. Pieter Couwenbergh, 'Blackrock eist concrete langetermijnvisie van bestuurders', *Het Financieele Dagblad*, 2 February 2016.

123. Dominic Barton and Mark Wiseman, 'Focusing Capital on the Long-Term', *Harvard Business Review*, January 2014.

124. Bradley A. Jones, 'Institutionalizing Countercyclical Investment. A Framework for Long-Term Asset Owners', *IMF Working Paper*, February 2016.

Should we draw the conclusion that it's better not to list companies on the stock exchange? To keep shares private instead of public? No, that would mean putting the cart before the horse. The great advantage of listed companies is that a larger part of society can share in the profits that companies generate. Access to private markets is highly limited and is often only possible for institutions and the extremely wealthy. Another concern is that, on average, companies are investing less than they did decades ago. The crucial question here, is whether companies are not making profitable investments because they are afraid to put their quarterly figures at risk? Would they choose to invest if they weren't listed? That would be alarming.[125] But above all, it seems that companies do not see any profitable opportunities for investment. Interest rates are this low for a reason. On a macro-economic scale, there is less demand for, than supply of, capital. In addition, overcapacity exists in many industries. There is a reason why inflation has been on a downward trend for decades. These are all signs that it makes sense for companies to invest less. Much criticism on the short-term behaviour of companies ignores this observation.

More research must be done before any firm conclusions can be drawn. In doing so, attention must be paid to sound financial foundations. It is very possible that a company operates in a part of the economy with little opportunity for value creation.

If we then zoom in to the type of investments that companies are making, we see a trend towards long-term value creation. The economy is undergoing a disruptive transition from labour and physical investment, to technology and less physical investment. To be more specific: in recent decades, there has been a shift from investment in *tangible assets* (physical assets such as working capital and factories) towards *intangible*

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125. Graham, Harvey and Rajgopal, show that 55 percent of the financial directors of listed companies did not want to invest in (long-term) investment projects with a positive NPV if doing so would cause them to fail to meet their (short-term) profit expectations (John R. Graham, Campbell R. Harvey and Shiva Rajgopal, 'The Economic Implications of Corporate Financial Reporting', *Journal of Accounting and Economics* 40, 2005, pp. 3-73). Asker, Farre-Mensa and Ljungqvist look into the growth in *assets* of listed public companies versus private companies. Adjusting for size of the company and the stage in life cycle, the average growth in private companies is almost twice as high (6.8 versus 3.7 percent). See: John Asker, Joan Farre-Mensa and Alexander Ljungqvist, 'Corporate Investment and Stock Market Listing: A Puzzle?', *Review of Financial Studies* 28(2), 2015, pp. 342-390.

assets (such as intellectual property and patents). These are less visible investments that require less labour. They are, however, high-risk and include high expected returns. Companies that are part of this disruptive trend are making big investments and are currently operating at a loss. Shareholders accept this with the 'promise' that these investments will add value and they will be paid out in the (distant) future.[126] Successful examples within this trend are Netflix and Tesla. The value investors 'attach' to these companies is therefore far from short-term driven.

Low interest rates, influenced by central bank policy, among other things, also play a role. Interest rates namely affect the value of assets. The lower the discount rate, the less it 'matters' that the cash flows are expected to be further in the future. This is probably one of the reasons shareholders embrace 'groeibriljanten' (growing diamonds). However, low interest rates and other support measures can also have negative macroeconomic effects. For example, they uphold overcapacity.

In brief, shareholders already have quite a long-term view for various reasons. In order to give further substance to the desire to take the long term into closer consideration, the interests of investors and companies must be aligned. In classic academic literature regarding *governance*, it has already been stated that if the interests of managers and shareholders are not aligned, this leads to problems. Consider the situation where a company manager receives a huge bonus when things go well, while the shareholders are supposed to pick up the pieces when things turn sour. In these cases, economists speak of principal/agency issues.[127]

Sometimes, the gap between the shareholder and the company in which they invest is too big. This is the case, for example, when many intermediaries are involved who all have different interests. Responsibilities then become too fragmented and the shareholder is often less involved. In this respect, a family business has the advantage of shorter lines and a clear responsibility structure.

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126. Hannes Mohrschladt and Sven Nolte, 'A New Risk Factor Based on Equity Duration', *Journal of Banking and Finance* 96, 2018, pp. 126-135.

127. Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', *Journal of Financial Economics* 3(4), 1976, pp. 305-360.

The Way Forward

In this chapter, we have tried to paint a nuanced picture of the role of shareholders. Shareholders are the subject of much criticism. Critics say they are overly focused on the short term and demonstrate very little commitment. The 'shareholder capitalism versus stakeholder capitalism' frame is usually a false contradiction. On the basis of (business) economic theory and several social examples, we have shown that shareholders are mindful of all stakeholders. This is also in their own interest.

At the same time, we mustn't go too far in stakeholder thinking. After all, according to liberals, companies belong to the private, free domain and therefore have a different character than democratically elected governments. We are of the opinion that companies have a responsibility not to cause damage to their environment. We should not, however, force them to behave like mini-governments, having to realise all kinds of public goals. If we would do so, everything would become a collective goal and soon even the (unelected) business community will be a public sphere. To liberals, an undesirable scenario. We value a free, private atmosphere where companies and individuals can make their own choices. Private companies are the beating heart of the market economy.

There are, however, practical aspects that could be improved when it comes to the behaviour of shareholders. We'll mention a few. Sometimes, excesses occur: shareholders who have little connection with the company, who mainly profit from short-term benefits and do not share in the risks. In other words: financial vultures. This leads to undesirable circumstances. It is, therefore, a good thing that these excesses are critically addressed in the press. It keeps everyone on their toes. But we mustn't forget that it concerns an extremely small minority of shareholders. Most shareholders are properly committed and have a long-term horizon.

In order to give further substance to the desire to adopt a more long-term focus, the interests of investors and companies must be aligned. Shareholders should demand that managers be rewarded on the basis of long-term value creation and not short-term objectives. That is not a task for the government, but a responsibility of the shareholders. The 'contracts' between the parties must be clear and must have the same

horizon.[128] It helps if not too many intermediaries are involved. These often give rise to diffuse responsibilities, causing the shareholder to be less involved.

128. Here, we refer to the aforementioned *principal-agency* issue. Within *corporate finance* literature (see previous footnote about Jensen and Meckling), this is an issue between managers and shareholders. Investment theory focuses on the interests of the asset manager and the client. Martijn Cremers, Joost Driessen, Pascal Maenhout and David Weinbaum demonstrate that asset managers perform better when the portfolio managers invest in the same fund as their (pension fund) clients. Having 'skin in the game' helps to realise aligned interests. See their article: 'Does Skin in the Game Matter? Director Incentives and Governance in the Mutual Fund Industry', *Journal of Financial and Quantitative Analysis* 44(6), 2009.

CHAPTER 5.

Inequality

> 'You need some inequality to grow… but extreme inequality is not only useless but can be harmful to growth because it reduces mobility and can lead to political capture of our democratic institutions.'
>
> Thomas Piketty, *Capital and Ideology*, Cambridge (Mass.) and London, 2020

The Critiques

Whether the free market leads to inequality is a major point of discussion in the public debate. The best-known critic of inequality is Thomas Piketty, who argues—in two voluminous publications—that inequality is a self-reinforcing problem, slowing economic growth and leading to social disruption.[129]

In his first work (2014), Piketty explains that the return on capital (r) is higher than the growth of the economy (g), and that inequality increases as a result. The wealthy become wealthier, and that growth cannot be matched with income. He refers to Simon Kuznets, who stated that income inequality increases in the early phase of industrialisation and then decreases again.[130] In his database, Piketty only saw this phenomenon in the period 1910-1970, and he states that, ever since the liberalisations of the 1980s, inequality has returned to feudal times. With no adjustment of the tax system, there's no telling where it'll stop.

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129. *Capital in the Twenty-First Century* in 2014 and *Capital and Ideology* in 2020.
130. Simon Kuznets, 'Economic Growth and Income Inequality', *The American Economic Review* 45, 1955, pp. 1-28.

In his follow-up work, published in 2020, Piketty explores this theme further. In over 1000 pages of economic history, statistics and especially politics, he argues that inequality is a political choice. It's not technology and the economy that determine inequality, ideology does. Piketty wants to combat the new inequality by tackling the underlying ideology. He wants to tax property, income and inheritances, and limit shareholder power.

Although Piketty is the best-known figure to combat inequality, he is not alone. Branko Milanovic is widely known for the 'elephant curve', which shows that the middle class in the developing world has experienced significant income growth in recent decades. The other group that benefited was the 'global elite': the richest one percent.[131] The middle class in developed countries, however, has lagged behind. Milanovic establishes a clear link with globalisation. Broadly speaking, his work is based in earlier observations by Joseph Stiglitz, who was one of the first to argue that globalisation also generates losers.[132] Inequality between countries has decreased, but has increased within countries.

Reflection

Inequality in income and wealth has increased in recent decades. In earlier work by the TeldersStichting, it has been argued that the increase in inequality in the Netherlands is not as significant as it is sometimes perceived to be,[133] especially when taxes and benefits are taken into account. Furthermore, in the case of wealth inequality in the Dutch context, pension accumulation is often disregarded. This reflex—'it's not as bad as it seems'—is often the first response of liberal politicians and scientists when confronted with wealth inequality. This nuance is relevant, but it doesn't help the discussion any further. We must ask ourselves: What does it matter if one earns much more than the other?

131. Christoph Lakner and Milanovic's elephant curve can be found in the article 'Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession', *The World Bank Economic Review* 30(2), 2016, pp. 203–232.
132. Joseph Stiglitz, *Globalization and its Discontents*, New York, 2002.
133. Roelof Salomons a.o., *Groeien naar vermogen*, TeldersStichting, The Hague, 2015.

Is inequality in itself problematic or is the real problem that some have too little, instead of less?

Let us be clear: for liberals, inequality in income and wealth is not problematic if it's the result of a fair process where everyone has a chance. In other words: when there's no connection between income and wealth inequality and a lack of social mobility. Low social mobility leads to the fear that inequality exists not only in outcomes, but also in opportunities. The concern that the fate is sealed by the place of the cradle. If that is the case, liberals should start to feel restless.

In order to properly position the criticism of inequality, it's crucial to make a distinction between income inequality on the one hand, and wealth inequality on the other. Next, we need to take a critical look at the causes of inequality. If this is a result of globalisation and technological development, then the question is whether this is a bad thing. After all, in economic terms, society is improving on balance. Rather, the question is whether we, as a society, want to slow down progress or mitigate the adverse effects. Finally, liberals must also honestly admit that some policies perpetuate inequality. Monetary policy has certainly worked positively for wealthy people. Perverse incentives from the government, that make taking on (mortgage) debt attractive, lead to unequal outcomes. And finally, we argue that the system around inheritance and donation must be overhauled if we aspire equal opportunities. Although the debate surrounding financial inequality has been raging for years, surprisingly little attention is paid to a theme on which different political-philosophical movements could well find each other, namely the reform of inheritance tax. As a side effect of classical liberal values, such as freedom and equality before the law, wealth inequality can be reduced.

The extent of income inequality depends on the moment it is measured, namely before or after equalising measures are applied. These measures have far-reaching consequences for the distribution of income: over the past decade, the commonly used Gini coefficient[134] has been about 0.55 for inequality in primary incomes (market incomes) and, after taking into account taxes, premiums, benefits and allowances, 0.29 for

134. At the value 0, incomes are distributed exactly equally and at the value 1, all the income belongs to one person.

inequality in disposable income.[135] The progressive tax system plays a minor role in this, as the old age pension (AOW), social benefits and supplementary pensions account for three quarters of this levelling. Thus, government intervention has reduced income inequality almost by half.

As the Gini coefficient is sensitive to changes in the middle of the distribution, critics say it obscures developments at the extremes of the distribution (the very rich and very poor). Indeed, a lower coefficient is not good news for the bottom quarter of the income distribution. Measures aimed specifically at the extremities of the distribution, however, do not provide substantially different insights into the trend in inequality or the degree of redistribution.

In recent decades, The Gini coefficient has not changed much in the Netherlands. Inequality in primary incomes has risen slightly, but the larger differences disappear after the big circulation machine (redistribution through taxes and benefits) is switched on. The ratio between the poorest and richest twenty percent (the 80/20 ratio) has also not changed appreciably in the last two decades: the disposable income of the richest twenty percent is consistently 4 to 4.5 times greater than that of the poorest twenty percent.

Where the Netherlands is as flat as the proverbial pancake when it comes to the distribution of incomes, we see a different picture when it comes to the distribution of wealth. Wealth inequality is much more extreme. Although these figures have long been known, and Piketty pays no attention to the Netherlands in his work, Piketty's *Capital in the Twenty-First Century* and the WRR report *Hoe ongelijk is Nederland?* have greatly fuelled the interest in this issue. The richest one percent own about a quarter of the total wealth, while the poorest eighty percent have less than a fifth. The richest 0.1 percent even own more than the poorest 70 percent.

As we stated earlier, we want to be careful with nuances that sidetrack the debate. However, some points should be mentioned here. The distribution of wealth is by definition more skewed than the distribution of income. While the latter shows the state of affairs in a single year, the wealth distribution is a snapshot of people at various stages of their lives.

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135. CBS, *Welvaart in Nederland*, 2019, (https://longreads.cbs.nl/welvaartinneder- land-2019).

One is about to retire, while another has just graduated with student loan debt. Wealth accumulation takes time, and forty percent (0.33 of the Gini coefficient of 0.80) of inequality can be explained by wealth differences between age groups.[136] Specifically for the Netherlands, the owner-occupied home (accounting for 67 percent of the assets, 86 percent of the debts) and pensions are of great importance (if pensions are included, the wealth share of the richest one percent shrinks by roughly a third and the number of households with negative wealth is reduced by half).

When economists talk about growth, the focus is often on the average. The extremes and the shape of the income and wealth distribution should, however, also be considered. Especially in the political arena. If we look at the economic trends of the past decades, we see that:

- So far, technological development has not significantly boosted growth, but has pushed inflation down and widened inequality (winner-takes-all, see also chapter 3).
- Globalisation is good for the world, but while inequality between countries has decreased, it has increased within countries. Harvard economics professor Dani Rodrik argues that the 'gains' of hyperglobalisation are shrinking and the redistributive effects are getting bigger.[137] The pace at which work shifts and transforms is becoming increasingly difficult for the middle class to keep up with.
- The division between capital and labour has grown more skewed. Rising economic growth combined with low inflation and low interest rates have led to rising share prices, which have mainly benefited capital providers.
- The unconventional monetary policy of central banks has thrown the skewed wealth distribution even further off balance. The depression has been prevented. However, growth and inflation are slightly higher, while financial assets have increased in value.
- The pain of the recession in the western world due to tight budgetary policies (sour comes first) has mainly been felt by the middle class, without them having the sense that it has benefited them so far (the sweetness is yet to come).

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136. René Schulenberg, 'Vermogensongelijkheid: het is de demografie!?', *TPE digitaal* 13(3), 2019, pp. 70-90, p. 75.
137. Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy*, New York and London, 2011.

Many trends have been underway for some time. Since the early 1980s, power has slowly shifted from labour to capital. The government has focused on privatisation (supply-side economics) and curbing inflation. Business has created jobs, increased production and reduced inflation. Lower interest rates led to rising prices on the financial markets, and to greater prosperity.

Stiglitz, however, has demonstrated the cracks in market thinking.[138] Over the past ten to fifteen years, prosperity (in terms of GDP) has increased, but debts have piled up, while real wage growth has stagnated. Rising inequality becomes a problem if the middle class—as in recent years—no longer progresses. In their book *Angrynomics*, Eric Lonergan and Mark Blyth show that anger is then lurking.[139]

The aspects related to income inequality, and its effects that play a role on a global scale, are interesting for economists, but less relevant for local policy makers. As a small and open economy, the Netherlands cannot afford to tamper with the limits of globalisation. Our business climate must remain attractive and we must continue to trade with other countries. We can, however, reduce the negative redistribution effects by, for example, continuing to invest in education/training and a socially fair safety net. All other measures will always have to be taken together with other countries and thus call for more globalisation. Not less.

One of the areas of attention when talking about inequality is the role of taxes. This poses a major challenge. The main tax challenge concerns the local tax remittance by companies in a globalised world. And because technology makes many tangible assets redundant, it increasingly revolves around indirect taxes (such as VAT), which are very easy to collect and trace, but can hardly be used by governments as a redistribution mechanism.

In the previous chapter, we addressed the role of the shareholder. In chapter 2, we addressed the perception that companies (especially the big ones) pay a lot less tax than citizens do. If, under the influence of the changing social discourse, the profit tax is increased, it should be taken into account that shareholders (including pension funds) will have lower returns. Everything has a price. The most important question

138. Joseph Stiglitz, *Globalization and its Discontents*, New York, 2002.
139. Eric Lonergan and Mark Blyth, *Angrynomics*, Newcastle, 2020.

is, however, whether higher taxes for the corporate sector are feasible. The existing system assumes that companies pay local tax on profits. In chapter 2, we talked about various companies. As companies are increasingly operating internationally, a multitude of tax rates and agreements between countries have arisen to prevent double taxation. Only a universal tax rate will make it easier for governments to increase their tax revenues. However, global harmonisation is a pipe dream. We might have a chance in Europe, but it's not an easy task.

Technology makes physical assets less important when taxing companies, while intangible assets such as intellectual property gain in importance. Many companies are able to achieve high returns on their invested capital with few assets. Investors find those returns attractive, keeping the cost of capital low and amplifying network effects: a *winner-takes-all* dynamic takes place here.[140] Monopolistic tendencies rightly call for regulation. In Europe, the European Commission wants to introduce a digital tax, a type of source taxation, whereby services are taxed at the place of delivery.

In addition to the influence of technology on tax collection, the sharing economy poses problems for the tax authorities. How can taxes be levied if capital goods are shared or publicly owned? The only logical route is a tax on usage. This discussion also affects indirect taxes: excise duties and VAT. It will certainly lead to tax harmonisation, but raising VAT will lead to additional inequality—after all, everyone pays the same VAT rate, and lower income earners spend a proportionally larger part of their income on consumer goods.

Taxing wealth more heavily is not something liberals are passionate about. Liberalism can look back on a long struggle against the aggregation of power, both in the political and economic domains. But the fear that 'a concentration of economic power among a small group of wealth owners' allows them to single-handedly decide how the financial resources are used, is unfounded.[141] After all, in a market economy,

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140. Jason Furman and Peter Orszag, 'A firm-level perspective on the role of rents in the rise in inequality', *Presentation at "A Just Society" Centennial Event in Honor of Joseph Stiglitz at Columbia University*, 2015.

141. Bas van Bavel, 'Vermogensongelijkheid in Nederland: de vergeten dimensie', in: Monique Kremer a.o. (ed.), *Hoe ongelijk is Nederland? Een verkenning van de ontwikkeling en gevolgen van economische ongelijkheid*, Amsterdam, 2014, pp. 79-100, p. 91.

consumer demand drives the use of means of production. Nearly all the super-rich have acquired wealth and created jobs by making products for the masses. In the battle against economic concentration of power, free trade, unimpeded market access and a strict competition policy are better weapons than a generic tax increase.

This also applies to the political domain. The political influence of the business community and wealthy Dutch people seems to be limited—let alone that they form an ideologically homogeneous group—but vigilance is still required. We spoke earlier about the influence of lobbies. It is good to be critical of politicians who end up in business after their political career with the purpose of 'opening doors'. Transparency is crucial. The same applies to party financing, in order to combat conflicts of interest. And finally, the widest possible access to Parliament: the electoral threshold that is preferred by some is simply the political equivalent of an import tariff that gives companies an unfair competitive advantage. It is a very plausible assumption that, as the level of competition in politics decreases, the importance of money increases.

Inheritance and donation

According to Piketty, as long as inheritances are treated with a velvet glove by the tax authorities, wealth inequality will increase. Research by the Central Planning Bureau does not yet indicate this.[142] The CPB study does demonstrate an increasing interest in the link between inheritances and inequality, but (unfortunately) there is little talk of inheritance tax reform.

When it comes to inheritance and gift tax, liberals are divided to the core. As a liberal, you can look at this issue in roughly two ways. Inheriting and donating can be seen through the lens of the 'giver': as an inheritance or gift from one person to another. That's why some liberals characterise the inheritance and gift tax as 'double taxation'. After all, tax has to be paid on money that has already been taxed by the tax authorities before. Why should someone have to go through the tax authorities again to bequeath or donate, this group wonders. Isn't it

142. Stefan Groot, Marcel Lever and Jan Möhlmann, 'Effect van erfenissen en schenkingen op vermogensongelijkheid en de rol van belastingen', *CPB Notitie*, December 2019.

simply someone's right to decide for themselves what happens to that money? Not such a crazy thought. But there is also another perspective.

Namely, that inheritances and gifts can be regarded as a source of income for the recipient. And while liberals will never be a fan of high taxes, it is generally accepted that a certain amount of tax should be paid on income, in favour of the public good. In this case, the argument is that it's better to tax the income someone has received without effort than the income someone has worked for. By counteracting the generational transmission of wealth through an inheritance tax, and then investing that collected money in the wider young generation, you also contribute to equality of opportunity.

The contrast between liberalism as a political philosophy and liberalism as a party political movement is huge on this matter. Politicians and the electorate are critical of the inheritance tax, while many political philosophers have traditionally endorsed taxing inheritances. According to Friedrich von Hayek, inheritance was one of the most dubious institutional causes of inequality. 'Inheritance taxes could, of course, be made an instrument toward greater social mobility and greater dispersion of property and, consequently, may have to be regarded as important tools of a truly liberal policy', said Hayek. Adam Smith and John Stuart Mill were also supporters of high inheritance taxes.[143] As Mill wrote: 'I should prefer to restrict, not what any one might bequeath, but what any one should be permitted to acquire, by bequest or inheritance.'[144] In other words: someone is free to donate or bequeath (as part of one's property right), but that same right does not apply to the receiver's side. There is a right to give, but not to receive. For this reason, Mill wanted a restriction on 'what any one may acquire by the mere favour of others, without any exercise of his faculties, and in requiring that if he desires any further accession of fortune, he shall work for it'.[145] We agree with the idea that inheritances and gifts should generally be regarded as income of the recipient, which they acquired just like that. They should therefore not be

143. Adam Smith, *The Wealth of Nations*, London, 1776; John Stuart Mill, *Principles of Political Economy*, London, 1848; Friedrich von Hayek, *Individualism and Economic Order*, Chicago and London, 1948 and *The Constitution of Liberty*, Chicago, 1960.
144. This quote comes from the above *Principles of Political Economy*.
145. Ibidem.

taxed less than other income. Own merit, such as work, should actually pay more than it does now.

During the most recent revision of the Succession Act, the idea that 'it is justified to levy tax on wealth that someone has accrued without making any effort' was also designated by the then Minister De Jager as its main legal basis.[146] In that light, it's a bitter irony that precisely the category of heirs who may still have some right to claim to have 'deserved' the inheritance[147], namely the non-relatives, is dealt with the hardest by the tax authorities.

Equal tax treatment of all heirs removes the incentive to leave an inheritance mainly to the children and offers the testator greater freedom of choice. It should be possible for the political left and right to find each other on this point.

The Way Forward

In this chapter, we've taken a closer look at inequality. When inequality is the outcome of a fair competition, there is no problem. The government then only has to fulfil the role of regulator (see chapter 3) and not the role of tax official to level out the differences. It can, however, remove perverse incentives from the system that perpetuate, exacerbate or even lead to inequality of opportunity. The abolition of the mortgage interest deduction is a politically charged measure, but should be implemented more quickly. And, if you ask us, inheritance tax needs to be overhauled. Another obvious choice is to equalise the difference between return on labour (wage) and return on capital (investment). Piketty certainly has a point when he states that there is a difference between working for money and making money work for you (return). The return on labour is far too low compared to that of capital. It would be extremely liberal to view inheritances and gifts as income for the recipient and to treat it like any other means of income. The realised return on capital can also be taxed in this way. We can't make it any easier.

146. Tweede Kamer/Dutch Parliament, Parliamentary year 2008-2009, Parliamentary document 31930, no. 9, p. 6.
147. Because the testator has explicitly determined that those non-relatives become heirs, while children are automatically heirs by birth.

In this chapter, we've paid little attention to the role of governments as social safety net providers or as drivers of economic growth. We'll discuss the role of government in the next chapter. It goes without saying that if people don't earn enough to afford housing, medical care or education, liberals see this as grounds for government intervention. After all, to be able to function (later) as a free, full, equal and responsible citizen, it is necessary to have certain basic goods and services at one's disposal. As the liberal philosopher Ralf Dahrendorf envisioned: a common ground for all citizens must be provided by offering a number of life chances.[148] It is unacceptable, for example, if parents have to deny their children further education for financial reasons. The appropriate solution then lies in guaranteeing the accessibility of secondary vocational training (mbo) and higher education, not in reducing statistical inequality. In light of this, it makes sense to reintroduce a basic grant system. Although there is still some uncertainty regarding the extent to which the current loan system restricts access, it does burden more students with high debts, reducing their buffers and obstructing their access to the housing market.

Socio-economic problems can rarely be traced directly to inequality. Sometimes, the underlying mechanism is more vicious. Research indicates that children from less educated and/or low income families more frequently receive a (secondary) school recommendation from their teacher that is below the level of their final (primary school) test than children from well-educated/high income families. In other cases, the underlying mechanism is highly complex. This applies, for example, to the housing market. In order to bring owner-occupied houses within the reach of people with lower incomes and smaller assets, a larger and more varied supply of housing is needed. This requires spatial planning policy reform, more professionals and innovation in construction, and the gradual abolition—as is currently taking place—of mortgage interest deduction, which drives up prices and mainly benefits those with higher incomes. We support the government's plan to abolish the so-called 'jubelton'—a tax-free monetary gift from parents that is used to bid for homes. Because currently, those who don't have rich parents

148. Fleur de Beaufort, 'Een claustrofobische drang naar vrijheid. Ralf Dahrendorf (1929– 2009)', *Liberaal Reveil*, 2009, no. 3, pp. 160-161.

are at a disadvantage in the overheated housing market: they have to bid against someone who can outbid them using a gift. So this scheme, too, drives up prices.[149] With regard to the possible connection between the housing market and wealth inequality, we should also bear in mind that the monetary easing by the ECB, combined with the Dutch capital gains tax, contribute to this inequality: due to the negative real savings interest rate, wealth owners have started investing in real estate and shares on a large scale.

Financial inequality does not so much cause problems as expose them, and those who remain stuck in a discourse about rich versus poor are fighting symptoms, while the problems that hinder people in their life path (such as inequality of opportunity in education and an overstrained housing market) should be tackled at the root.

Furthermore, we would like to conclude this chapter by saying that anyone who considers equality before the law to be important must accept that economic inequality will arise. Equality before the law and economic equality can only coexist if everyone has the same talents, if they receive exactly the same social appreciation (money) for those talents, and if everyone then behaves identically as a consumer and saver. This is not just impossible, but also a recipe for a crushingly dull, colourless and conformist society.

149. Tax-free gifts from parents only make houses more expensive, economists conclude. See this article in Dutch newspaper *Trouw* by Jochem van Staalduine on 22 July 2020, (https://www.trouw.nl/economie/belastingvrije-schenkingen-van-ouders-maken-de-huizen-alleen-maar-duurder~b573145f/).

CHAPTER 6.

Market Versus Government

> 'Radical reforms — reversing the prevailing policy direction of the last four decades — will need to be put on the table. Governments will have to accept a more active role in the economy.'
>
> *The Financial Times*, 3 April 2020

The Critiques

The corona pandemic shook the world in 2020. And not just in medical terms. The consequences reach much further. The corona crisis has also reopened the debate on the relationship between market and state. In order to contain the crisis, the government seized all kinds of power. There was huge intervention in business, and suddenly, a lot of money was available to be handed out to the affected people and companies. To left-wing publicists, such as Rutger Bregman, this crisis is the perfect opportunity to give this temporary, increased role of the state a more permanent character. In *Time Magazine*, he wrote 'the moment to change the world is right now'.[150]

But the call for a greater role for the state does not only come from the left. *The Financial Times* stated that the corona crisis exposes the fragility of our social contract. According to the influential liberal business daily, the economic policy of the past decades is in need of a fundamental

150. Rutger Bregman, 'The moment to change the world is right now', *Time Magazine*, 7 May 2020, (https://time.com/5833427/coronavirus-hope/).

revision, the main point being that the state should take a more active role (see also the quote at the beginning of this chapter).[151]

The importance of a strong government has also been widely emphasised in Dutch politics since the pandemic. The stronger, orbigger, government is mentioned in almost every election manifesto for the Dutch national elections of March 2021. The call for more appreciation for the public sector has grown louder. The crisis is said to expose what really matters in society. For the political left in the Netherlands, this coincides closely with what the public sector does. Left-wing politicians are therefore pushing for a larger public sector and demand more money and resources for this. Perhaps indicative of this tipping point regarding the valuation of the public sector: care workers have become 'care heroes', who, according to left-wing parties, should be rewarded more in terms of salary, in line with their heroic status. A similar call for more structural pay for schoolteachers and other public sector workers has been heard for some time.

Even before the pandemic, there was growing criticism of the relationship between government and the market. Critics say the market has run its course too much. In the 1980s, when Ronald Reagan and Margaret Thatcher were at the helm in the US and the UK respectively, an unsustainable form of capitalism is said to have emerged. According to the critics, we now find ourselves in a 'neoliberal' era, where market forces, competition, profit and self-interest have free rein. In this view, public values have become underappreciated. Our society has supposedly been 'marketed', leaving too much room for private parties to do as they please.

In recent years, several economists have called for more government intervention. On the one hand, they say, to tame the excesses of capitalism. Growing inequality (more on this in chapter 5) and market power (more on this in chapter 3) should be tackled. Nobel Prize winner Joseph Stiglitz calls for stronger anti-trust legislation and for containment of the abuse of corporate (political) power.[152] Thomas Piketty calls for high

151. *The Financial Times*, 'Virus lays bare the frailty of the social contract', 3 April 2020, (https://www.ft.com/content/7eff769a-74dd-11ea-95fe-fcd274e920ca).
152. Joseph Stiglitz, *People, Power, and Profits*, New York City, 2019.

wealth taxes to create a 'less unequal' society.[153] On the other hand, many economists argued that the three percent fetishism[154]—the narrow focus on keeping government deficits down in times of private savings surpluses—is nonsensical. Deficits should be allowed to rise, especially if this can stimulate growth.[155]

Another important point of criticism is that more is needed for a well-functioning market than a government that merely keeps an eye on the rules of the game. Critics say, for example, that the government should play a more active role in investments that would serve the general interest. Economist Mariana Mazzucato argued in *The Entrepreneurial State* that the government and the private sector can support each other well when it comes to innovation. Without public investment, a lot of ground-breaking innovations by companies would never have come about, she says.[156] In her most recent publication *The Value of Everything*, she states that this model of public-private partnership should be a blueprint for the future, where social goals should be the starting point for value creation.[157] In *People, Power, and Profits*, Joseph Stiglitz emphasises that the government must invest in things like basic research, because the market will not organise this itself.

According to these critics, the market should thus be downsized for the benefit of the government, in order to reduce undesirable social outcomes of the market. The government could expand its role to promote certain social goals.

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153. Thomas Piketty, *Capital in the Twenty-First Century*, Cambridge (Mass.) and London, 2014.
154. Referring to the European rule that the budget deficit should not exceed three percent of GDP.
155. Coen Teulings describes this process well in the *ESB*, 10 July 2020, (https://esb.nu/ esb/20060094/de-private-sector-verlangt-een-hogere-staatsschuld-en-dat-levert-ook-nog-wat-op).
156. Mariana Mazzacuto, *The Entrepreneurial State*, London, 2013.
157. Mariana Mazzucato, *The Value of Everything*: *Making and Taking in the Global Economy*, London, 2018.

Reflection

In this part, we will consider why a delicate balance between market and government is in the interest of free individuals in a society. In addition, we will explain that, at present, we're not dealing with unbridled market forces and minimal government, and that an (even) bigger government is not in the interest of freedom, nor does it serve public purposes. On the contrary, increasing the size of the government may result in an unwieldy state that hinders efficient and effective action. A big government is also costly and it's often the ordinary citizen who pays the price. There is, however, room for a decisive government that performs its core tasks well and also invests in our future growth potential. This is how we see it: the government must stake out the field and establish the most important markers. These are the preconditions for the functioning of the free market. The markers should be as far apart as possible, creating a large playing field.

Before we go into this further, it is worth noting that so-called unbridled market forces never actually existed. As discussed in earlier chapters, there has never been a situation of *laissez-faire*. This doctrine, which is often so closely linked to the free market, has never been practiced with full consistency. The market has always functioned within a framework created by the state. Liberals like to see it that way. As our namesake Professor Ben Telders once spoke at a conference lecture: 'The myth that the homage of "laissez-faire" belongs to the essence and tradition of liberalism has been repeated so often that people have gradually come to consider themselves liberated from the duty to properly justify claims in this regard.'[158] The state has always had a role in speeding up economic processes and combating social injustice. As we've described before, liberals have played a decisive role in this history.

In addition to the existing regulations which market players must navigate, the government has also grown in size in recent decades. Currently (pre-corona), government revenue and expenditure accounts for over 40 percent of the Dutch GDP.[159] One hundred and fifty years ago,

158. Benjamin M. Telders, 'De legende laissez faire, laissez aller', in: *Verzamelde geschriften*, part IV, The Hague, 1947, pp. 384–387.
159. CBS Statline, 'Overheidsfinanciën: kerncijfers', (https://opendata.cbs.nl/statline/#/CBS/nl/dataset/84114NED/table?ts=1594648371006).

this was a mere 14 percent.[160] In addition, the number of jobs in the public sector—already over 500,000 today—continues to increase (not even counting education and healthcare). The number of laws in force has doubled in the last 40 years.[161] Thus, it's safe to say, the role of the government within society has not decreased in size. The question that arises is whether the relationship between the market and government is still well balanced and whether the functioning of government is efficient. Liberals should be vigilant when there's a greater call for more government. A government is generally not the best actor to manage all matters in society.

The market is much better able to deal with complexity. The outcome of trade is the result of numerous individual plans, and not of central planning through a government scheme. It's an evolutionary process of spontaneous order. As Friedrich von Hayek stated in 1944, the state is not able to collect all individual knowledge centrally and use it efficiently and effectively through central planning.[162] The market serves this purpose. The increasing complexity in the form of globalisation and technological development makes market forces even more important. Globalised chains cause an increase in complexity, with many actors in different places forming a link in the chain. The only way to run a complex process of trading efficiently and effectively is through market forces that are framed by certain rules of the game.[163] We shouldn't put our hopes in a government to efficiently direct all our lives. Something liberals would find undesirable from the point of view of freedom anyway. Thus, the private, free sphere must be extensive.

This doesn't mean that liberals don't see a role for the government. Liberals prefer to see a clear separation between the private and public domain. Matters should, as much as possible or in their entirety, belong

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160. Frits Bos, 'De Nederlandse collectieve uitgaven in historisch perspectief', *CPB*, 2006, (https://www.cpb.nl/sites/default/files/publicaties/download/de-nederlandse-collectieve-uitgaven-historisch-perspectief.pdf).
161. Mathijs Bouman, 'Niks neoliberalisme. Onze overheid bleef altijd groot en corona is geen reden voor nieuw elan', 28 August 2020, *Het Financieele Dagblad*, (https://fd.nl/opinie/1355486/niks-neoliberalisme-onze-overheid-bleef-altijd-groot-en-corona-is-geen-reden-voor-nieuw-elan).
162. Friedrich von Hayek, 'The Use of Knowledge in Society', *The American Economic Review* 35(4), 1945, pp. 519–30.
163. Frans de Graaf a.o., *Vertrouwen in de markt*, TeldersStichting, The Hague, 2007.

either to the public domain or to the market. Situations in between should be avoided as much as possible. More often than not, a mixture of public and private leads to half-hearted situations and the worst of both worlds. No real competition, but performance agreements that lead to extra bureaucracy, for example. Also consider the 'housing market', where the market is often blamed for its failure. What is often forgotten, is that the situation actually entails a mixture of government and market, where the government—with the aim of pursuing a social income policy—has introduced all kinds of market-distorting elements by imposing requirements and regulations. The result being that people either end up in the social rental sector (with long waiting lists), or have to deal with an expensive private sector as a result of little competition in that sector.

That said, there is room for a public sphere in which the government has an important role to play. Within liberal democracies, there are various tasks that primarily belong to the government. Some of them will not be subject to discussion. Defence, security and justice, primary education and infrastructure have all been regarded as government domain since the time of Adam Smith.[164] Healthcare has been the subject of much debate in recent years. We could fill a whole book on the workings of the healthcare system. We'll limit ourselves here, by stating that a government must at least guarantee a good basic level of care for everyone. Kenneth Arrow, one of the greatest economists of the twentieth century, has already demonstrated the importance of this.[165] This doesn't mean that there's no room for private parties and market forces in these areas. In essence, we also classify education as a government task (not just primary education). In the chapter about inequality, we argued that income and wealth inequality do not pose a problem as long as there is equality of opportunity. In *Deaths of Despair and the Future of Capitalism*, Anne Case and Angus Deaton clearly demonstrate that an interplay between healthcare, education and economic progress exists.[166] In order to offer everyone life opportunities, and to give everyone the ability to climb the

164. Adam Smith, *The Wealth of Nations*, London, 1776.
165. Kenneth Arrow, 'Uncertainty and the Welfare Economics of Medical Care', *American Economic Review*, 1963.
166. Anne Case and Angus Deaton, *Deaths of Despair and the Future of Capitalism*, Princeton, 2020

social ladder, it is necessary for a government to guarantee, among other things, good education and proper healthcare.

Liberals do appreciate that people subsequently take control and responsibility for their own lives. In other words: the government does not have to ensure that those life opportunities are actually utilised. That is ultimately up to the individual. If people don't grasp the opportunities available, that's their choice and therefore their responsibility. What we do need, is for the government to guarantee a social safety net for those who temporarily fall by the way side or for those excluded from the labour process due to circumstances beyond their control. Furthermore, in a rapidly changing world, where some sectors become less relevant, the government may also help people move from one job to another. The detour of a social benefit is preferably avoided in this process. People can be made more resilient by promoting, for example, skills training, retraining, upskilling and traineeships. At present, education focuses mainly on the first phase of life. More should be invested, however, in lifelong learning. The government can allocate resources for this, but companies also have a role to play.

Also relevant—and perhaps traditionally less mentioned from a liberal point of view—is that the government could play a role in our future earning potential by investing in our growth potential. This is why public funds may well be used for good (higher) education and (fundamental) research. This leads to a strong knowledge-based economy and ultimately to innovation. On this particular point, liberals could follow the thoughts of, say, Joseph Stiglitz to a certain extent.

A paternalistic government is undesirable

Although—as we have noted—liberals believe that the state has a number of tasks to perform, they are generally not keen on a paternalistic government that supposedly knows what is good for the public and therefore interferes in the market process at all times. Individual freedom is the foundation of our constitution and our society. We would like to hold onto that foundation: individuals who are given the space to determine what is good for them. Excessive government intervention in the market limits this freedom of choice and is therefore undesirable.

Although liberals are not eager for a paternalistic state, some paternalism from the government can sometimes be justified. For example, paternalism can be just if there's a risk of damage. Wearing a seat belt was made compulsory, because otherwise, accidents would entail a lot of extra medical costs, which are borne by others as well. Other examples are pension reforms and insurances for the self-employed. In essence, these must be well regulated (provided by the government), so that short-term actions do not cause long-term damage. However, that doesn´t mean that the government should regulate these matters down to the very last detail. There should be space left for individual decision making.

Interference in what individuals choose to consume is, in most cases, unjustifiable. This jeopardises individual freedom of choice. That is where liberals become restless. A government may make regulations that are paternalistic to a limited extent, in order to protect the individual and the collective from potential harm. As soon as the fundamental freedom of the individual is at stake, the government should refrain from interfering. To a liberal, the point where a government becomes (too) paternalistic is quickly reached. The government should create a framework wherein the individual is enabled to make their own choices without outside (government) interference, insofar as the harm principle is met.

The government as regulator

When should a government actively intervene in the market? Liberals would like to see the government create a clear and level playing field wherein one can navigate the market. By establishing preconditions and rules, the government ensures that the market process can function efficiently. Free trade is crucial for price formation that results in signals of profit and loss. This involves ensuring fair competition and the individual freedom of choice for consumers. The government does this by drawing up and applying a legal framework. Just as the market evolves on the basis of the spontaneous order that develops continuously, the rules of the game and regulations have to move with it. Clear, non-complex regulations are important. In that way, everyone is aware of the boundaries within which one can trade freely. In a sense, a comparison can be

made to the referee on a football field. The lines of the field and the game rules form the boundaries and guidelines of the game, so that everyone on the field knows what is—and what is not—allowed. The game should be played fairly. Once the playing field and rules of the game have been established, everyone is free to try to achieve their goals in their own way without being subject to arbitrariness on the part of the referee.

The question that naturally follows: at which moments should the government—as a referee—intervene? In any case, action is not required when there's sufficient competition. In that case, the consumer has enough freedom of choice. In the event of lacking competition, for example due to monopolisation, the government (or the competition authority) is legitimised to decide to interfere. The government must also ensure that certain rights are safeguarded. Think of a set of guaranteed minimum labour rights and the protection of property rights. If these rights are violated by companies, they should be subject to sanctions.

The government as market player

Not only does the government manifest itself as a regulator of the market. The government itself is also a market player. Besides the provision of employment with the associated economic consequences (civil servants who receive salary and spend it on the market), the government also participates in economic activity itself. Think of infrastructure development through private government tenders. In such cases, the government enters the market as a purchaser and must abide by its own rules to safeguard the functioning of the market.

State intervention must be temporary

Earlier in this book, we outlined what—within the liberal view—the relationship between the state and the market should generally look like. During the corona pandemic, the role of the state intensified for the duration of the crisis. What is our reflection on this? Firstly, it's good to start by saying that what may be necessary for exceptional times is not necessarily the best recipe for ordinary times. The liberal weekly magazine *The Economist* put it nicely: 'Big government is

needed to fight the pandemic. What matters is how it shrinks back again afterwards.'[167]

The government intervened in the market and provided huge support measures to preserve companies and jobs. As liberals, we are in favour of aid as compensation for governmental restrictions on, or the elimination of, opportunities for entrepreneurs and employees. For example, when restaurants and cafes were closed down. The restrictions imposed by the government on companies can be justified on grounds of health and safety, which belong to the core tasks of the government. However, the lost revenues for entrepreneurs do not come from ordinary business risks. Therefore, compensation and support is justifiable while taking such measures.

However, as soon as the restrictions are removed, the aid must stop. The measures must be temporary. Certain risks are simply a part of entrepreneurial risk, where government intervention can be harmful. If companies are no longer viable due to developments that occur, the government should refrain from intervening. Otherwise, it removes the market incentive.

For market forces to work, it is important that companies bear not only upside risk, but also downside risk. This means that those negative consequences of the pandemic that do not directly arise from restrictions imposed by the government should be borne by the company itself and not be covered by state aid. Otherwise, a crucial factor of market functioning will cease to exist. This is, in fact, not a situation of market failure, but of government failure. A company that knows it will be kept alive by the government in the absence of the required cash flows and profits will lack the incentive to sustain itself in the market. In addition, companies that were already unviable before the crisis should not be kept alive due to the crisis. After all—as the old saying goes—capitalism without bankruptcy, equals religion without hell.

Moreover, the choice of who is—and who isn't—salvageable poses a diabolical dilemma and is not a task for governments and central banks. To this day, the market remains to be the best system to allocate resources and create wealth. There is a crucial lesson here for economists

167. *The Economist*, 'Everything's under control. The state in the time of covid-19', maart 26 2020, (https://www.economist.com/leaders/2020/03/26/the-state-in-the-time-of-covid-19).

who are calling for even more government policy. Namely, the accompanying risk of lower growth when no Schumpeterian *creative destruction* can take place. This means, emerging, small, creative companies don't get the chance to bring about innovation by knocking the established order out of the field, because these sluggish, big giants are artificially kept alive on government aid. Economists have long pointed to the consequences of low interest rates and excessive state support. With each recession, fewer companies go bankrupt. With each recession, the support package expands. Great for now. Bad for the economy later. Fighting a crisis over and over with 'free money' and more debt is a recipe for low growth. Private sector economists draw attention to the *moral hazard*: you can buy corporate bonds fairly safely if the company will be saved no matter what.[168]

Claudio Borio, head economist at the Bank for International Settlements (BIS)—the central bank of central banks—has established a connection between low productivity growth, 'free money' and the fact that even less creditworthy companies can continue to finance themselves. If interest rates stay too low for too long, zombies emerge: companies that exist by the grace of 'free money'. Since 1980, the percentage of zombies has grown from zero to ten percent. Zombies also stay zombies for longer.[169]Before the year 2000, there was a clear difference visible in the behaviour of healthy versus unhealthy companies. In the past, action would be taken as a result of pressure exerted by high interest charges. Debts were reduced, companies cleaned up their balance sheets and cut investments. The market ran its course.

Now, there are hardly any differences to be found. The result: misallocation of capital and labour.

Looking back, we can say that we should have done things differently in the past. That is of no use to us now. The lesson, however, is that we must enable the market to run its course as soon as possible. Interest rates that are too low for too long lead to an ever-growing mountain of debt. In a market where companies are kept afloat by low interest rates and government support, no downside risk of bankruptcy exists. There

168. Deutsche Bank, *Annual Default Study*, 2018

169. Claudio Borio, 'A blindspot in today's macroeconomics', *Bank for International Settlement*, Presented at the BIS-IMF-OECD conference *Weak productivity: the role of financial factors and policies*, 2018.

is merely upside potential. This creates perverse incentives, which are then sustained by government support.

A brief critique of Modern Monetary Theory

Times of crisis often give rise to new theories. One such theory is that government deficits may be allowed to grow further without objection. Not just because the government has to keep the economy going as the private sector has come to a standstill. No. Free money as a solution to climate issues, inequality and everything else that's wrong in the world. Stephanie Kelton is the standard-bearer of this movement: Modern Monetary Theory, also called MMT.[170] In her most recent book, she gives the impression that, in order to finance matters of public interest, governments can allow debt and deficits to build up without risks or consequences.[171]

Before we discuss the ultimate risk (inflation) this entails, it's worth pointing out that MMT is right to criticise the idea that a government should strive for a balanced budget. The comparison made with the household book is, however, flawed. The government has two resources at its disposal that companies and citizens do not have: the money press and the possibility of levying tax. Naturally, it is important that these resources are not used lightly. If the government incurs debt, it must be aimed at an investment that benefits the future. In addition, structural deficits must be avoided. The government should have a financial buffer for less prosperous times. The importance of this is underlined by the corona pandemic. This crisis made it possible to take firm measures in the interest of healthcare and to compensate people and companies in a difficult period.

Running up deficits is not free either. Debts are deferred taxes. In fact, you're borrowing from future generations. In the hope that growth will be higher in the future and this debt won't be a chip on their shoulder. Or that part of the debt evaporates due to inflation. Even then, it's still a burden, but packaged as a loss of purchasing power. The inflation risk particularly, is hardly dealt with seriously by MMT supporters.

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170. Stephanie Kelton, *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Money*, New York, 2020.
171. Ibidem.

Ultimately, investors in government bonds will expect higher interest rates. As a result, companies and consumers will have to pay more and will be able to spend less. This will have a negative impact on the economy. Another side effect is that private parties will be pushed out of the market if the government imposes too great a claim on the capital market. Again, this means that companies will pay higher interest rates, making capital needed for investments more expensive. In the long run, this has a negative effect on the functioning of the market and therefore on our welfare.

The Way Forward

How should we liberals proceed in this discussion about the role between state and market? Some see the corona pandemic as the perfect opportunity to give the temporary market interventions by the government a permanent character. This is a scenario we deem undesirable. The corona pandemic is an exceptional situation, and what is needed for the exception is not sensible policy for ordinary times. First and foremost, more government is undesirable when it comes to preserving our freedom. After all, the more control the government has over the private sphere, the less free space there is for individuals and their companies to make choices. More government is not the solution to every problem. The market is much better able to deal with complexity than a government as a central planner.

Moreover, the government does not have the same incentive that market providers do. In a market with healthy competition, there is a risk that the customer will go to another company if a certain product or service at a certain price doesn't suit them. A well-functioning market is thus characterised by a significant risk of failure, ultimately resulting in bankruptcy. A government will never have to deal with that. Meaning it is not punished in the same way if the 'service' provided is not as desired. After all, the welfare state will not go bankrupt if it functions moderately or poorly, nor does a new welfare state emerge to force the old one out of the market by offering better services.

There's no question that free-market systems generate economic growth and prosperity that central planning systems do not. We must

therefore be careful not to throw out the good with the bad, despite the current criticisms of the market. In addition, we must evaluate the market on the basis of fundamental market characteristics. If market failure occurs due to unnecessary government intervention or due to an inadequate institutional framework, the market doesn't have to be abolished or curtailed as a whole. Instead, we must examine it closely, in order to discover what it is lacking in terms of preconditions in order to function properly.

A market must continue to function as a real market. A clear division between public and private is of vital importance here. The government has a number of important and distinct core tasks, such as in the field of security and education. In addition, the government has the role of regulator and must create a playing field where the market mechanism can work effectively. These rules serve to ensure a smooth and fair functioning of the market, whereby individuals can freely choose what they spend their money on. How can the government go about this? First of all, by ensuring fair and sufficient competition. Transparency is also important. Both from the government and on the market. For the government, this means that the rules formulated—which constitute the preconditions—are clear and not too complex. As a result, they provide a frame of reference for trading in the market, which makes it clear for everyone what to expect from one another on the basis of the legal framework. Preventing complexity and ambiguous interpretation is crucial here. Transparency in the market means that information is easily obtained and reliable. This allows individuals to do comparative commodity research and make informed choices.

There are a few other things a government can do to enhance market functioning. Investing in our growth potential, for example. This can be done by investing extensively in education and (fundamental) research, which leads to innovation and the creation of a knowledge-based economy. The government can also provide a temporary incentive, for example, by offering guarantees for loans that are used for innovations that are still uncertain but socially valuable. In addition, the government can take the lead with large infrastructure projects. Overall, it's too easy to turn against either the market or the government. Ultimately, the market cannot do without the government and vice versa. The market needs the government to create institutions that allow the market

to function, such as property, education and security. And without the value created by the market, the public sector cannot exist.[172] After all, it bears the cost of the public sector.

For liberals, the freedom of individuals comes first. This is best served by a government that performs a number of tasks well, so that everyone has a healthy and safe basis and is given plenty of opportunities in life. A government that also invests in our future opportunities. This leaves no room for a huge, sluggish, almighty government.[173] The liberal's ideal image looks like this: an effective government that also leaves as much room as possible for individuals and companies to make free choices and bear the accompanying responsibility.

172. Paul de Grauwe, *De limieten van de markt*, Tielt, 2014.
173. The 'toeslagenaffaire' (child benefits scandal), which stems from a complex circulating machine, has demonstrated to us what government power is capable of.

CHAPTER 7.

Free Market Versus Vital Interests

> 'When the sun's out and you feel the wind in your back, the global economy works fantastically. But it is highly vulnerable. We've witnessed a single virus shutting everything down. We want to avoid that next time. You simply cannot buy everything, some things you have to make yourself.'
>
> Klaas Dijkhoff, 13 June 2020 on *WNL op Zaterdag*

The Critiques

The above statement was made by the then party leader of the VVD, during a radio interview for *WNL op Zaterdag*. Due to the corona pandemic, there seems to be a renewed awareness that, in times of crisis or when things get geopolitically tense, it often becomes every country for itself. Klaas Dijkhoff had the idea to organise a number of core matters, for example medication and energy sources, together with a few friendly countries.

Dijkhoff was far from the only influential person in the Netherlands who—in the wake of the pandemic—pointed out the vulnerabilities of far-reaching globalisation in the field of trade. For example, GroenLinks frontman Jesse Klaver stated that it would be wise if we conducted more of our own production, for example in the case of face masks. The temporary corona envoy Feike Sijbesma, who was involved in the purchase of medical supplies, also deems it wise to depend less on other countries, such as China and India, when it comes to the production of medication, medical equipment and protective equipment. In that same context, professor of corporate law Claartje Bulten stated in *Het Financieele*

Dagblad: 'The pandemic is exposing the vulnerability of global supply chains. For example, when it comes to medical protective equipment. In times of crisis, you don't want to depend on unfriendly countries.'[174] It might be more expensive, but at least we'll be in control, critics say. More domestic (or European) production is thus called for when it comes to matters of vital national importance.

Contemplating this vulnerability that might accompany far-reaching international dependence is, of course, not limited to the Netherlands. The now former US President Donald Trump was already known for not shying away from protectionist measures and trade disputes, under the guise of what he calls 'fair trade'. In the US, this tendency has only been pursued further. As Peter Navarro, one of Trump's key advisors, stated in a press conference on 3 April 2020 about lessons learned when it comes to the corona crisis:

> 'One of the things that this crisis has taught us, sir, is that we are dangerously overdependent on a global supply chain. [...] What we are learning from that is that no matter how many treaties you have, alliances, or phone calls. When push comes to shove, you run the risk, as a nation, of not having what you need [...] Never again should we have to depend on the rest of the world for our essential medicines and countermeasures.'

Similar words were heard from Jared Kushner, Trump's son-in-law and senior advisor. During the corona pandemic, Kushner told TV station *Fox News* that the US is busy making sure never to depend on foreign supplies again. According to him, 'to control your own manufacturing' was a 'national security issue'. Not only when it comes to the healthcare industry. According to Kushner, the US needs to become a global leader in advanced manufacturing.

The arrival of Joe Biden as Donald Trump's successor will lead to a somewhat less aggressive attitude towards multilateral institutions. However, as Clingendael's senior researcher Hugo Klijn, writes: 'The

174. Bas Knoop, 'Van vrije markt naar sturende staat: industriepolitiek is weer in', *Het Financieele Dagblad*, 11 July 2020.

clouds hanging over international trade will not suddenly disappear.'[175] French President Emmanuel Macron also seems unconvinced that we can lean on the United States again. For example, in an interview with French magazine *Le Grand Continent* (12 November, 2020), he stated that the US government change 'is an opportunity to pursue, in a completely peaceful and calm manner, that what allies understand among each other: we must continue to build our independence for ourselves, as the United States is doing for itself, and as China is doing for itself.' In the interview, Macron indicated that it's essential for Europe to find the ways and means to stand on its own, technologically and in terms of health and geopolitics. Earlier, Macron told *The Financial Times* that the EU should regain industrial sovereignty.

The tension between the free market and national security is thus broader than the issue of health alone. There are also dilemmas in the field of energy supply and in the field of digital infrastructure, for example. During the construction of the 5G network, critics wondered whether it's wise, for national security reasons, to let the Chinese company Huawei play a role in it. In an interview with *Elsevier Weekblad*, the American ambassador in the Netherlands, Pete Hoekstra, spoke of his astonishment regarding the Dutch attitude towards China when it comes to the construction of the 5G network. According to him, this Chinese influence carries 'unacceptable risks'.[176] In a broader sense, people are asking the question whether we, as the West, shouldn't invest more in the development of strategic technology. In both a European and Dutch context, consideration is being given to how unwanted takeovers of companies in strategically important sectors such as healthcare, infrastructure and technology can be prevented. In addition, there are, for example, questions concerning Russia and gas. Do we, as the Netherlands (or as Europe), want to be heavily dependent on Russian gas? These questions regarding dependence on other countries when it comes

175. For the opinion piece, see: https://spectator.clingendael.org/en/publication/disaster-relief-europe-should-keep-calm-and-carry.

176. Eric Vrijsen, 'Interview Pete Hoekstra: Gebruik apparatuur Huawei brengt onacceptabele risico's met zich mee', *Elsevier Weekblad*, 22 March 2019, (https://www.ewmagazine.nl/domein/americandreamers/economie/achtergrond/2019/03/678829-678829/).

to vital industries were already being asked, and are expected to receive renewed attention due to the corona crisis.

In short, criticism is coming from many directions, stating that the (international) free market—so beloved by liberals—sometimes takes too little account of the protection of vital interests. In light of the corona crisis, this idea may take flight. This could lead to a greater emphasis on national security in the near future, at the expense of international trade. Elizabeth Economy, senior fellow with the US Council on Foreign Relations, assumes, for example: 'I don't think fundamentally this is the end of globalization. But this does accelerate the type of thinking that has been going on in the Trump administration, that there are critical technologies, critical resources, reserve manufacturing capacity that we want here in the U.S. in case of crisis.'[177] She is certainly not the only one who foresees this trend. The British opinion weekly, *The Economist*, for example, made a similar prediction by writing: 'More countries may seek to become self-sufficient in the production of "strategic" commodities such as medicines, medical equipment and even toilet roll, contributing to a further rollback of globalization.'[178]

Reflection

The question is how liberals should deal with the criticism that too rigid a hold on the liberal value of free trade sometimes comes at the expense of national security. This criticism comes from all kinds of political angles. Even from the liberal wing, as can be deduced from the quote at the beginning of this chapter by former VVD party leader Klaas Dijkhoff. As liberals, we must rethink the relationship between free trade and security. We offer an attempt below. We start with a warning for the initial—understandable, but also convulsive—reflex following the corona crisis: to want to take matters into our own hands as much as possible. Next, we will continue by explaining that, for

177. Neil Irwin, 'It's the end of the world economy as we know it', *The New York Times*, 16 April 2020, (https://www.nytimes.com/2020/04/16/upshot/world-economy-restructuring-coronavirus.html).
178. *The Economist*, 'Building up the pillars of the state', edition of 26 March 2020.

liberals, not only free trade, but national security is also of importance. If you ask a liberal, they'll say both values and interests will have to be safeguarded.

Protectionist reflex

It is not surprising that countries have a somewhat nationalistic reflex and intend to keep more strategic industries in their own country. Due to the corona crisis, we've all witnessed that, in challenging times, countries focus on their own survival and sometimes abandon the principles of free trade. Everyone saw how, in an acute situation, even 'European solidarity' could disappear like snow before the sun. How Schengen could suddenly be nullified when inconvenient. Countries unilaterally decided to close their borders. France and Germany soon introduced an export ban on face masks, respirators and other medical goods. On a global scale, there was also great competition for obtaining test material.

This is certainly a reality to be reckoned with in the future. To ignore it and simply hope that it won't happen again in the future would be a bit naive. Making even more international agreements can also never fully prevent that part of international trade will come to a standstill during a crisis. But the liberal response should not be to therefore disentangle international trade and produce as much as possible ourselves. A protectionist reflex is not the solution. It's not just unrealistic. It is also undesirable from the liberal point of view.

It is unrealistic, first of all, because we cannot bring entire production chains—from raw material to end product—to the Netherlands. Today's global economy means that trade is increasingly cross-border. Not only do individuals and companies trade heavily internationally. More and more chains have also become more complex because many links in the chain are located in different places. Production chains of high-tech products, for example, are so complex that no country can single-handedly manufacture everything. iPhone parts are made all over the world. iPhone distribution and sales are also taking place on a global scale. Another example is large car manufacturer Volkswagen. The Volkswagen Group has 40,000 suppliers worldwide. If we also include suppliers of suppliers, this figure may exceed a million. According to renowned journalist Martin Wolff of *The Financial Times*, only the largest and

most advanced countries can aspire to some degree of self-sufficiency. He writes: 'For all others, this would be a dead end.'[179]

Besides the fact that it's impossible for a country—especially a small country—to produce everything domestically, we should not have the illusion to be able to perfectly prepare ourselves for any crisis. The very nature of a crisis is that it cannot be immediately controlled and requires a certain degree of improvisation. Moreover, in the wake of the corona pandemic, we may consider it useful to be better prepared for the next medical crisis, and focus all our arrows on that. But perhaps the next crisis will be of a completely different nature. We must be wary of the tendency to want to fight the previous war too much.

Of course, we can never know for sure what the next crisis will be. If we knew that, there would be no real crises. Many conceivable crisis scenarios are possible: volcanic eruptions, solar flares, a food crisis, biological weapons, cyber-attacks. If we want to be optimally prepared for all possible scenarios, this takes time and a great deal of money. It is good to realise that resources for crisis prevention and preparation are limited, and—at the very least—choices have to be made when it comes to the risks faced by society: what is truly vital?

Although we believe that we should not prepare too much for the previous 'war' (a pandemic), there's plenty to learn from this crisis for the future. For example, the fact that the market system does not always automatically create sufficient buffers. This is costly and doesn't benefit us in ordinary times. It led to a worldwide shortage of adequate face masks during the corona crisis. A buffer was also lacking in terms of healthcare staff, to be deployed flexibly and temporarily, when necessary. It must be made possible to rapidly scale up ICU capacity when a crisis occurs. The corona crisis exposes the importance of a certain amount of spare capacity and a plan for rapid, temporary upscaling. Think of it as—in economic terms—an insurance premium for bad times.

179. Martin Wolf, 'The dangerous war on supply chains', *The Financial Times*, 23 June 2020, (https://www.ft.com/content/e27b0c0c-1893-479b-9ea3-27a81c2506c9).

Wealth

Besides the difficulty (some would say impossibility) of disentangling an advanced global economy, it is also undesirable. International trade and global cooperation bring us wealth and products that we cannot create ourselves. If we become less dependent on other countries, products will simply become a lot more expensive, we'll have less to choose from, and we cannot maintain the standard of living we enjoy today.

It is not without reason that liberals throughout history have championed international free trade, believing that it leads to mutual benefit and prosperity. As Adam Smith wrote in *The Wealth of Nations*: 'Between whatever places foreign trade is carried on, they all of them derive two distinct benefits from it. It carries out that surplus part of the produce of their land and labour for which there is no demand among them, and brings back in return for it something else for which there is a demand.'[180]

Also consider liberal British political economist David Ricardo's theory of comparative advantage. In a chapter on foreign trade from his work *The Principles of Political Economy and Taxation* (1817), he outlines the idea of comparative advantages. The bottom line of his theory is that international trade enables countries to specialise by benefiting from the global division of labour. A country focuses on what it is relatively best at and imports the rest. Hence the term 'comparative advantages'.

Ricardo outlines a situation where Portugal is more efficient than England, both in the production of wine and in the production of clothing. Furthermore, Portugal's wine production is more efficient than its own clothing production. If Portugal commits to the production of wine and England to the production of clothing, both countries can benefit from mutual trade. Together, the Portuguese and the English achieve higher production and prosperity when compared to the situation without free trade. However, England will not be inclined to produce its own clothes if these can be imported cheaper from Portugal. But this problem, Ricardo shows, will resolve itself. The money flowing from England to Portugal results in prices falling in the former and rising in the latter. As a result, prices reach a point where it is beneficial for both countries to trade with each other.

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180. Adam Smith, *The Wealth of Nations,* London, 1776, book 4, chapter 1.

In an article in *Het Financieele Dagblad*, Economics professors Steven Brakman and Arjen van Witteloostuijn explained Ricardo's theory with a slightly more appealing example: 'Lionel Messi is a brilliant football player. Besides, he can probably mow the lawn much faster than FC Barcelona's groundskeeper, who—by the way—is a mediocre football player. Still, it is beneficial to let the groundskeeper mow, so that Messi can fully focus on football and become even better. The same principle applies between countries. It's not about absolute differences in skills and incompetence, but relative ones.'[181]

In short, pursuing an autarkic industrial policy, and thus counteracting specialisation spread over countries, has disadvantages in terms of efficiency. Government intervention ensures that companies, whose production is actually taking place more efficiently and effectively in other countries, are upheld. This reduces the incentive of specialisation and innovation within companies.

The complexity of chains also means that government intervention can damage their functioning, including that of crucial food chains and the supply of health products. The fact that a product is crucial for society and the economy should not be an immediate reason to have it produced by the government.[182] The market is generally better able to deal with complexity. For that reason, our food—which is of vital importance—is not produced by the government, but is, to some extent, left to the market.

In addition, once countries start thinking in protectionist terms, a sliding scale may develop. A vicious circle, where countries start withdrawing further and further when it comes to important, strategic sectors. 'Panic changes politics in a nationalist direction, such as with bans on the export of drugs and medical equipment. And while that seems like a way to protect citizens, it forces other countries to do the same and results in shortages for everybody', writes the liberal thinker Johan Norberg in the aforementioned book *Open: The Story of Human*

181. Steven Brakman and Arjen van Witteloostuijn, 'Populisten begrijpen niks van Ricardo's theorie van comparatieve voordelen, en dat is gevaarlijk', *Het Financieele Dagblad,* 15 October 2018.
182. See also the poster about the division of roles between government and the market by the TeldersStichting.

Progress.[183] Moreover, during the corona crisis, it was about medical facilities, but who knows, maybe the next step is a tendency towards self-sufficiency in food production. For this reason, *The Economist* made an appeal in May 2020 to preserve food chains: 'Markets, open borders and ingenuity have kept the world fed. Don't take that for granted.' *The Economist* was concerned about the autarkic tendencies that might arise in countries after the pandemic: 'This evening, when you pick up your chopsticks or your knife and fork, remember both those who are hungry and also the system feeding the world. It should be left free to work its magic not just during the pandemic, but after it too.'[184]

Besides the argument that free trade leads to more prosperity, there are also theories in the doctrine of international relations which argue that economic interdependence between countries even leads to more peace and stability in the world. One reason for this being that the economic costs of conflicts increase as a result of this interdependence. Some liberals have also argued that trade leads to positive interaction between nations. In his 1795 essay on eternal peace, the German eighteenth-century Enlightenment philosopher Immanuel Kant assumed that every nation would eventually become captivated by the 'spirit of commerce'. And because, in his view, this cannot coexist with war, this would ultimately guide countries to 'towards peace'. In his 1819 essay, *The Liberty of Ancients Compared with that of Moderns*, liberal politician and writer Benjamin Constant wrote in a similar tone that 'commerce has brought nations closer, it has given them customs and habits which are almost identical; the heads of states may be enemies: the peoples are compatriots'. British-born liberal activist Thomas Paine (1737-1809) also believed in the conciliatory nature of international trade. In his work from 1791, *Rights of Man*, he writes: 'It is a pacific system, operating to cordialize mankind, by rendering nations, as well as individuals, useful to each other.' More recent political theories also exist which state that more economic free trade will ultimately lead to more cultural and/or political integration.

However, all these theories also give rise to doubts. There are plenty of examples where possible damage to trade did not stand in the way of

183. Johan Norberg, *Open: The Story of Human Progress,* London, 2020, p. 11.
184. *The Economist*, 'Supply chains and the pandemic. The food miracle', 9 May 2020 edition.

a war; or where a war arose precisely because of trade conflicts.[185] Scientific literature is also not unequivocal about the relationship between economic free trade and peace. According to political science professor Erik Gartzke, other achievements of capitalism, such as economic development, financial markets, and monetary policy coordination, arguably play a more crucial role in promoting peace than international trade itself.[186]

In any case, the point remains that liberals have historically viewed international free trade as a positive phenomenon worth pursuing. Both in terms of efficiency and prosperity, as an instrument for allowing people to interact freely across national borders.

Security is a core task

At the same time, it is important not to lose sight of security. Also when it comes to issues in the market; we don't necessarily always have to strive for maximum efficiency. Security may well cost a little. For liberals, security is pre-eminently a core task of the government. When it comes down to it, the night watchman takes precedence over the economy. Even Adam Smith, who is best known for his theories about the market, ultimately found the importance of national defence more significant than that of free trade, as can be concluded from what he wrote on the subject in *The Wealth of Nations*. To him, 'defence' was more important than 'opulence'. Furthermore, prosperity of a neighbouring country could also be dangerous, from a perspective of politics and war. Moreover, according to Smith, the main task of the sovereign was 'that of protecting the society from the violence and invasion of other independent societies'.[187] So, for liberals, free trade—although an important ideal—is never an absolute ideal.

Consequently, when it comes to international trade, it's sensible to keep an eye on geopolitics as well. Additionally, in terms of dependence

185. Edwin van de Haar, 'Free Trade Does Not Foster Peace', *Economic Affairs* 40(2), 2020, pp. 281–286.
186. Eric Gartzke, 'The Capitalist Peace', *American Journal of Political Science* 51(1), 2007, pp. 166-191.
187. Daniël Turk, 'Liberalisme en economisch nationalisme. Zijn er liberale rechtvaardigingsgronden voor het toepassen van nationaal economisch beleid?', *Liberale Reflecties*, July 2017, pp. 61-74.

on other countries, it's also of importance *which product or service* is at stake and *with which type of country* you're dealing. Being completely dependent on kiwis from New Zealand is a different story than being completely dependent on Russian gas. It also seems obviously unwise to put our entire digital infrastructure in the hands of Chinese companies, for example. The latter also has to do with the close relationship between the Chinese business community and the Chinese state. Chinese companies are often either directly controlled or owned by the state. This entails risks. Chinese companies, for example, (have to) pass on crucial information to political leaders, whether those companies want to or not. Europe must invest in strategic areas, such as digital technology, in order to be able to counterbalance Made in China 2025. The America First trend also urges Europe to realise that it cannot rely entirely on others.

In addition, concerns exist within the EU regarding outside companies taking over European companies. The Dutch Parliament is also appealing for more protection against unwanted foreign company takeovers. Measures, such as an investment test that creates the possibility of stopping a foreign takeover if national security is at stake, are being considered. Liberals should be wary of a government acting as the pope of industry, wanting to protect all kinds of companies and industries in the Netherlands at all costs. There may, however, be two exceptions to this rule. Firstly, when it concerns our vital infrastructure. After all, liberals usually consider infrastructure to be a government task. When it comes to crucial infrastructure, such as ports, railways, airports and nowadays also digital infrastructure, the government has a protective role. This doesn't mean airlines should be kept afloat at all costs, but can mean, for example, that a well-functioning airport is guaranteed.

Another point to consider is unfair competition in takeovers by foreign companies. On the one hand, banning Chinese companies can be seen as interference in the free market. However, the question is whether you can even speak of a free market if the Chinese state actively and strategically subsidises companies. Fair competition and a level playing field are important to liberals. If an unfair advantage is created through state aid, there may well be grounds for market intervention.

Ultimately, however, our best protection from a security perspective is to maintain a high-quality knowledge-based economy ourselves. In other words: by standing strong. As argued in the chapter on the

relationship between the state and the market, this requires sufficient long-term investment in knowledge, research, innovation and education.

It would also be sensible to think about how we can be better prepared for future crises and less vulnerable when the international system is under pressure. Without thinking that we can do everything ourselves and avoid every risk, as explained earlier. A useful question to examine is: what are the biggest and most realistic threats to our national security, now and in the future (and how does the free market play a role in this)? A guiding principle could be to, in any case, want to avoid disruption of society.

Increased self-sufficiency and detachment from the global economy is not always the best strategy for security. 'We rarely think of it this way, but globalization is actually our best chance to fight pandemics in the first place, since wealth, communication technology and open science have made our response to new diseases faster than ever', says Johan Norberg.[188] We also witnessed this during the corona pandemic: numerous vaccines were rapidly developed as companies and universities around the world searched for a solution.

According to Sébastien Miroudot, senior economist at the OECD, the best way to avoid disruption is to have multiple suppliers spread across various locations. Producing everything yourself entails risks, as any location can be hit by a pandemic, hurricane, unrest or even war. Betting on one horse is not sensible practice, even when it comes to your own country, is his argument. Moreover, international networks, proper *supply chain* managers and flexibility are needed to quickly expand supply in a crisis situation. You simply don't see this kind of experience in local production, where competition from the outside world is shielded. In addition, interdependence could also be a source of stability, because it wouldn't benefit anyone to completely cut off production lines. In other words: free trade, with many different suppliers, ensures reliability in the supply of goods.[189]

188. Johan Norberg, *Open*: *The Story of Human Progress*, London, 2020, p. 11.
189. Sébastien Miroudot, 'Resilience versus robustness in global value chains: Some policy implications', *Centre for Economic Policy Research*, 18 June 2020, (https://voxeu.org/article/resilience-versus-robustness-global-value-chains).

In addition, it's wise to have an emergency plan in place and stock up on essential emergency supplies, in order to absorb the first shock and prevent disruption. In response to the corona crisis, the Brussel-based economic think tank Bruegel comes to the conclusion: 'Looking at the world market of medical goods for the EU, we argue that self-sufficiency is the wrong approach. Global medical markets are to the benefits of the EU and stockpiling and preparation are more effective in preparing for emergencies.'[190] This sounds like a sensible motto, not just for the medical sector but in a general sense.

The Way Forward

The corona crisis has shown us that dependence on other countries in terms of international trade entails a certain vulnerability. Is there enough attention for national security? We've noted that, after a crisis, it's important not to immediately give in to that first understandable reflex: wanting to start organising more domestically. The government should not have the illusion that it can prepare itself perfectly for any possible crisis and that it can defend itself against everything. The solution is not to start producing everything ourselves. That is unrealistic and undesirable. Production chains are too intertwined and countries are unable to disengage without huge welfare losses. Then there's the risk of the sliding scale when countries give in to a tendency towards more protectionism. This is certainly disadvantageous for a small country like the Netherlands, with an international, open economy.

It is, however, necessary to keep tabs on our security interests in addition to our commercial interests. The basic principle here must be for disruption of society to be prevented. Several matters must be considered in order to be better prepared for issues where market and national security intersect.

First, it is recommended that we conduct an up-to-date analysis of our vital interests, identifying our greatest threats and vulnerabilities when it comes to issues that could disrupt society now and in the

190. For the entire blog post on their website, see: https://www.bruegel.org/2020/04/eu-trade-in-medical-goods-why-self-sufficiency-is-the-wrong-approach/.

future.[191] Think of cybersecurity for example, when it comes to shutting down our digital infrastructure.

Second, as a country, it is wise to have a plan B, in case international trade goes sideways. Create buffers and draft a plan that enables fast and flexible upscaling. This will buy us time in a crisis situation, time to absorb the first shock of logistical problems. During the corona crisis, producers indicated that they had no technical difficulty in making face masks that protect against corona, but the certification and approval of the products was time-consuming. In a crisis situation, it is important to remove these bottlenecks as soon as possible, making rapid and flexible upscaling possible. Where strategic (medical) stocks are still missing or insufficient, they must be built up or supplemented.

In addition, make sure that, as a country, you don't become dependent on suppliers from a single country when it comes to vital sectors. If possible, spread risks across different locations. For example, when it comes to gas: you don't want to be solely dependent on Russia. It also matters who you depend on. You could distinguish between countries with a liberal constitutional state and those without one. Doing business with (companies from) countries such as China, as in the field of technology, entails additional risks. However, in times of real crisis and scarcity, countries that are seen as friendly will usually also focus on their own survival. During the corona crisis, we even saw this happening within the EU, where export bans arose. The most important thing, therefore, is to avoid running out of alternatives in the event that a line is cut.

In an earlier chapter, we concluded that investing in a strong knowledge infrastructure and promising technologies is beneficial for our growth potential and future earning capacity. It's also relevant from a geopolitical point of view, in order to prevent us from falling (too far) behind other countries like China. Think of knowledge regarding crucial digital infrastructure such as artificial intelligence. It is also good to take a critical look at whether the takeover game played by foreign

191. In 2001, Dutch Parliament requested that a cross-sectoral plan of action be drawn up for the protection of vital infrastructure. In 2005, this led to the report *Bescherming vitale infrastructuur* (critical infrastructure protection) from the Ministry of the Interior. A similar report could be made.

companies is actually being played fairly, or whether there is undesirable state interference and state support (from a geopolitical point of view), creating an uneven playing field.

CHAPTER 8.

Capitalism and 'the Good'

> 'It seems as if the free market is nothing more than a playing field, driven by self-interest and financial gain, where free-floating individuals enter into transactions with each other and have nothing else to do with each other.'
>
> Ad Verbrugge, Govert Buijs and Jelle van Baardewijk in *Het goede leven & de vrije markt*, Rotterdam, 2018

The Critiques

A number of critical thinkers, both from the left and the (right) conservative angle, argue that 'free market thinking' has gone too far and is thus undermining the good life. For example, the authors of the above quote, Jelle van Baardewijk, Govert Buijs and Ad Verbrugge, in their book *Het goede leven en de vrije markt*, wonder whether the free market—as the pinnacle of modern society—brings the good life closer or stands in the way of it. In doing so, they do not take the individual and its freedom of choice as a point of departure. Instead, they look at five dimensions which they consider important for the good life: relationships, institutions, the body, nature and the spiritual.

In relation to these dimensions, they have a number of concerns regarding the free market. For example, they worry that 'market thinking' is also spreading outside the economic sphere and that people only see each other in terms of utility. Furthermore, they are concerned that the body is becoming the hunting ground of marketers who are trying to manipulate consumption in all sorts of ways ('even if it kills the body, think of smoking, the huge amount of sugar in soft drinks'). They also

claim that people 'are being absorbed into a permanent tidal wave of experiences that keeps them in the "here and now", instead of making them aware of the totality of life'.

The Leiden-based professor of legal philosophy—and self-proclaimed reactionary[192]—Andreas Kinneging also criticises a society that is largely based on the market principle in his extensive book *De onzichtbare maat: Archeologie van goed en kwaad*. Within such a society, he envisions the individual as purely focused on own desire and consumption, guided by ego, and with no concern for the community and the mind; 'the Good, True and Beautiful'.[193]

He writes, 'Even if we assume the market works well, offering riches and the opportunity to satisfy all desires, it nevertheless paints a sad picture. The image of what Nietzsche called "the last man". A being only interested in consuming. And a society entirely focused on consumption, as well as the production required for that consumption.'[194] In short, what's missing in that society, according to Kinneging, is everything that makes life worth living. A disenchantment of society, as the German thinker Max Weber called it. According to Kinneging, people can be quite happy in such a market society, but only in the sense of a 'happy pig'.[195] He writes: 'Man as pig, bent on satisfying as many cravings as possible; and the world as a granary, which must be ever more ingeniously arranged to serve those cravings'.[196]

According to him, the concepts 'freedom' and 'equality', arising from the Enlightenment and Romanticism, have become false ideals in modern times. By staring blindly on freedom and equality, we have lost sight of important lessons from what he calls the Great European Tradition. According to Kinneging, the Great European Tradition includes the Greek philosophy of Plato and Aristotle, as well as the great Christian

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192. He stated this in Jort Kelder's *NPO Radio 1* podcast (from minute 43:50). The 'Jortcast' can be heard via: https://www.nporadio1.nl/pod-casts/de-jortcast/6947-230-in-gesprek-met-andreas-kinneging.
193. Andreas Kinneging, *De onzichtbare maat. Archeologie van goed en kwaad*, Amsterdam, 2020, pp. 128-129.
194. Ibidem, p. 560.
195. In his book *Utilitarianism* (1863) John Stuart Mill wrote: 'It is better to be a human being dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied.'
196. Andreas Kinneging, *De onzichtbare maat. Archeologie van goed en kwaad*, Amsterdam, 2020, p. 213.

thinkers Augustine and Thomas Aquinas. According to this philosophy, there is indeed such a thing as a natural order and hierarchy, a correct measure of things. Some matters are, in essence, regarded as more superior to others. Push-pin is not equal to poetry[197], says Kinneging. Translated to the present: the flower parade is not of the same value as a Beethoven piano concert in the Amsterdam Concertgebouw.

Kinneging's reasoning is that if we let everything take its course, under the guise of everyone being free and doing whatever they like, we'll end up with a world of entertainment parks, shopping malls and outlets, ubiquitous highways and cars, gaming havens, wellness centres, a tourist industry all over the world, and an abundance of sweets, drinks, fatty food, drugs and screens'.[198] After all, that's the choice of the masses. In contrast, Kinneging says people should learn to temper themselves and look for the right balance. Towards the Good, the True and the Beautiful. In doing so, he emphasises, among other things, the importance of community and values such as security, peace, wisdom and kindness.

This type of criticism—the free market leads to excessive consumerism, egotism and greed—is often heard in recent publications. Philosopher Jeroen Linssen even devoted an entire book to the theme of greed, in which he observed that, as an individual in a market society, it is hard not to become greedy.[199] Linssen writes:

> 'In the current neoliberal climate, greed has been normalised more than ever. By this, I do not mean that we consider it 'normal' for someone to be extraordinarily greedy, but that 'greed as a motive' has become part of a powerful regime of subjectivation. If someone asks me whether greed is good or bad, should or should not be a motive for people, my answer is: there is little or no choice. In today's society, where individuals become a subject

197. Kinneging refers to a statement by the thinker Jeremy Bentham. Bentham argued that all that matters is how much fun someone gets out of something. Whether it is poetry or the simple game of push-pin, makes no difference to his happiness calculus.
198. Andreas Kinneging, *De onzichtbare maat. Archeologie van goed en kwaad,* Amsterdam, 2020, p. 22.
199. Jeroen Linssen, *Hebzucht. Een filosofische geschiedenis van de inhaligheid*, Nijmegen, 2019.

> by taking on the entrepreneurial form, self-interest and greed are naturally a part of the subject.'[200]

This idea that today's capitalist society entails a moral force that brings out the worst in people, is deeply rooted in much capitalism critique. In *The Enchantments of Mammon: How Capitalism Became the Religion of Modernity*, Eugene McCarraher portrays capitalism as a perverse religion that has a hold on us, in which we regard money as being sacred.[201] According to sociologist Gabriel van den Brink, neoliberalism undermines our human natural tendency towards community and togetherness.[202] In his book, *Ik, wij, zij*, the Leuven-based sociologist Rudi Laermans points to excessive individuality and the pressure to perform, which would lead to depression.[203] In a book review in Dutch newspaper *NRC*, Willem Schinkel—again a sociologist—praises Laermans for putting 'the fragmented neoliberal individual', as a consequence of this society, back on the agenda with his book.[204] Economist Noreena Hertz argues that neoliberalism has resulted in the loneliest century ever.[205]

So, the idea exists that the market has become an end in itself, that 'the economy' dominates and determines our human lives, with damaging consequences for both people and planet. These views emerge in a wide variety of essays and books, usually accompanied by the terms 'neoliberalism', 'economism[206]', 'predatory capitalism' and the idea that the Homo sapiens has become the 'homo economicus'[207].

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200. Ibidem, p. 269
201. Eugene McCarraher, *The Enchantments of Mammon: How Capitalism Became the Religion of Modernity,* Cambridge (Mass.), 2018.
202. Gabriël van den Brink, *Ruw ontwaken uit een neoliberale droom,* Amsterdam, 2020.
203. Rudi Laermans, *Ik, wij, zij*, Ghent, 2020.
204. Willem Schinkel, 'Het versplinterde neoliberale individu', *NRC Handelsblad*, 12 June 2020, (https://www.nrc.nl/nieuws/2020/06/12/het-versplinterde-neoliberale-individu-a4002545).
205. Karolien Knols, 'Dit is de eenzaamste eeuw ooit, en dat is de schuld van het neoliberalisme', *de Volkskrant*, 2 October 2020, (https://www.volkskrant.nl/nieuws-achtergrond/dit-is-de-eenzaamste-eeuw-ooit-en-dat-is-de-schuld-van-het-neoliberalisme~bc279812/).
206. In 2015, GroenLinks leader Jesse Klaver released his book *De mythe van het economisme*.
207. This entails a type of rational, calculating human being who, as much as possible, works towards optimally pursuing self-interest.

Reflection

We will reflect on two main points from a liberal perspective. First, we'll consider how a free market relates to the good life. And secondly, we'll deal with the question to what extent the free market makes people or companies greedy, or more broadly, makes them immoral.

The good life

It is important, first of all, to mention that most liberals will have difficulty with someone else choosing the five dimensions of the good life for them, thus dictating what the good life entails. One of the great things about liberalism is the freedom it offers to find out for yourself what the good life means to you. Moreover, these five dimensions leave room for discussion. Take the spiritual dimension, for example. Why do people have to become aware of 'the totality of life'? And is it really such a problem if someone chooses to focus primarily on experiences? After all, this doesn't prevent someone else from occupying themselves with 'the totality of life'—whatever that may mean—and from abstaining from all opportunities for short-term experiences. In a free society, of which a free market is part, both ways of living are possible. If there is a certain demand for something, a supply will usually emerge in the long run. Our society certainly has enough to offer for those people who want to focus on so-called superficial experiences, but also for people wanting to pursue meaning and 'the totality of life'. If your desire is to go to church, if you want to contribute to the community, or only prefer to read philosophical books in your free time, you can do just that. And if something is lacking within the free market system, there's always the possibility to create it yourself. In that respect, the market is a fairly inclusive system, with a diverse range for all kinds of lifestyles. It is up to individuals to make their own choices.

Liberals are therefore not so fond of the general diagnoses that are sometimes made, of an atomic society where people supposedly feel no connection with one another. In a free society, liberals see many opportunities to establish connections with others. This does presuppose a somewhat proactive individual, willing to make some effort to find out what they would like to join. In order to join a sports club,

reading club or other association of your own preference, you must take the first step.

Opposite this liberal ideal of freedom of choice is a society where the 'good life' would be defined in a general sense, the life to which society—and therefore the free market—must subsequently conform. As a citizen, you should never want to accept such an invocation of the 'good life'. Even if you were lucky enough that your conception of the ultimate good life happens to prevail within a society, there's always the risk that, some day, with that same invocation of the 'good life', a lifestyle becomes enforced that you detest. Then the 'good life' suddenly sounds a lot less appealing. It's better to let people determine their own preferences and allow them to make their own choices to the greatest extent possible.

That doesn't mean that it is in itself wrong if people form judgments about what the good life is and express themselves in this regard. For example, we might personally agree that poetry has higher value than push-pin. We could also try to convince other people that a healthy lifestyle is better than an unhealthy one. For liberals, that's not the issue. In fact, it's good to exchange ideas, wishes and moral convictions with one another. By interacting with others and by gaining knowledge and experience in a free society, each person develops gradually, also in terms of preferences and lifestyle.

In *The Theory of Moral Sentiments*, Adam Smith argued that our sense of good and evil does not come from above (or: consists of what churches teach and try to impose on us), but that it's a result of our human interaction. By living together and reflecting on this life, we determine what we consider to be 'good' and 'bad'. This is based on our capacity for what Smith calls sympathy (i.e. empathy). As explained earlier in this writing, the market is a great place for normative development as it facilitates free exchange.

In addition, such a thing as chance also plays a role in moral development. For some people, the corona crisis may spark a new appreciation for values such as peace, security and family life, and they may attach less value to consumption and short-lived experiences. Liberals welcome this if it develops spontaneously. But when moral 'progress' is enforced and there is no room for a different view, a line is crossed. For example, if all kinds of opportunities for experiences become prohibited. Or if

you ban shops from opening on Sundays. In other words: To liberals, it's no problem if someone chooses not to shop on Sundays and tries to convince others not to, but we mustn't deny others the *opportunity* to do so. After all, there may be just as many people who have noticed just how nice their lives were pre-corona: being able to go out for a drink, getting a haircut or going to a concert. They discovered they really enjoyed their lifestyle. In the sense of: you don't know what you've got until it's gone.

Furthermore, the free market is sometimes conveniently lumped together with the pursuit of utility maximisation and excessive consumption. For the sake of clarity: the maximum pursuit of desires is not an objective of liberalism. In a liberal society, there is room to pursue one's own values and goals, and this doesn't necessarily result in a maximum pursuit of personal desires. The movement that does encourage this lifestyle is utilitarianism: a moral theory promoting the maximisation of happiness for the greatest amount of people. Jeremy Bentham is the most famous thinker of this movement. According to Bentham, the natural goal of people is to maximise pleasure and minimise pain. This type of thinking, aimed at the pursuit of desires, should mainly be classified under the tradition of utilitarianism and not be regarded as the main element of liberalism.

It is also important not to consider liberalism and the free market as one and the same thing. In short, the free market is an efficient system that allows various players to make choices freely. A market that is free to a certain extent is a precondition for a liberal society. If the government would have full control over the job you must perform and what you must buy or sell, then you cannot control your own life and you are therefore not truly free. This doesn't mean, however, that the free market itself is declared a life goal for liberals. For example, in *Capitalism and Freedom* (1962), Milton Friedman argued that a free market is a necessary condition for a free society. He did not claim, however, that the concept of freedom is limited to the idea of a free market.

In a free and prosperous society, with the associated free market, you don't have to be concerned merely with production and consumption. According to liberal values, you don't have to be a cold, calculating, materialistic 'homo economicus' at all; if such a human type even exists

in the real world.[208] Nothing stands in the way of you living a life that is not centred around these matters. In fact, many people are not focused on this at all in life. It goes without saying that most people want to have an adequate income, but people also attach great value to social contacts and family life. The fact that people voluntarily choose to devote their attention to such matters strengthens their social character. The fact that someone chooses to volunteer for the elderly for a number of hours a week makes the act all the more valuable. For liberals, the connections that people establish with one another on a voluntary basis are many times stronger than those imposed on people from above.

Individual freedom of choice is therefore not opposite to community spirit. Within the liberal view, there is no great vacuum between the individual and the state with nothing in between. Liberals assume that people are social beings by nature, who freely seek each other out and become connected. The fact that one of the great liberal predecessors in the Netherlands, Johan Rudolph Thorbecke, laid down the freedom of association and assembly in our Constitution in the 19th century is illustrative of the importance liberals attach to living together with others.

Not only *can* people in a free-market society engage in things other than production and consumption; this system also made it *possible* to do so. Due to our prosperity, we don't have to work every day of the week to provide for our livelihood. Studies by the International Labour Organisation indicate that people in low- and middle-income countries tend to work more hours than people from richer countries. This is partly because, if you are wealthy, a few extra hours of work will not outweigh the free time you lose. While, if you are poor, money is of vital importance to you, and you'll therefore have to work more.

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208. For example, Adam Smith wrote in his *The Theory of Moral Sentiments* (1759) that people are not only concerned with their own self-interest, but are also very attached to the well-being of others. The opening sentence of *The Theory of Moral Sentiments* is: 'How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.' The rational, calculating aspect of *the homo economicus* is also questioned by liberals. Hayek, for example, certainly did not assume that the human being was perfectly rational. On the contrary, individual errors are gradually corrected in the free, spontaneous social process in a society.

So, you'll have less time to read poetry, volunteer for the local sports club, organise a demonstration or care about a vegan lifestyle. Be careful what you wish for, if you thought it possible to accomplish intangible, 'higher' things by setting aside a generally successful economic system. At the end of the nineteenth century, workers knew nothing but work. In those days, fulltime jobs in industrialised economies meant working 60 to 70 hours a week. In the century after that, with incomes rising, the average number of working hours dropped to 40 a week in 1970, writes *The Economist*. Their conclusion: 'Declines in hours worked per person are among the least-sung benefits of economic development.'[209]

From this, we can conclude that it would be unwise to overthrow the foundation that led to this excellent starting position—economic growth—to achieve a better life. Or you shouldn't mind sacrificing a high standard of living, which would include degradation of healthcare and education, while that good education also leads to a more open, promising, tolerant and committed society.

Greed

A second important critique is that the free market leads to greed. First of all, it should be noted that this kind of criticism sometimes caricatures capitalism as a system of all kinds of greedy types, possibly including the image of round-bellied men in striped suits smoking cigars. That seems a bit exaggerated.

Still, it would be crazy to deny there's such a thing as greed. Or to deny that greed occurs in a free market system. It does. But it's another thing to automatically conclude that capitalism leads to greed. After all, under any economic system, you'll find both good and bad—greedy—types. Greed is just as prevalent in other systems, such as communism. There are countless examples. In fact, in all communist countries, party leadership members grew richer and richer. During the Cold War, they were called the nomenklatura. Your party membership, and accompanying rank, gave rise to all kinds of privileges, making party membership attractive. Ironically, one of the benefits was access to shops selling

209. *The Economist*, 'Why do some countries work longer hours than others?', 28 December 2018, (https://www.economist.com/graphic-detail/2018/12/28/why-do-some-countries-work-longer-hours-than-others).

western luxury items. Communist leaders like Leonid Brezhnev, Erich Honecker, Nicolae Ceaușescu all had expensive houses, often more than one. Brezhnev collected expensive Western cars—a hobby shared by Kim Jong-un, among others. This may sound rather comical, but these comments are not to be taken lightly. The point is: greed cannot be linked one-on-one with capitalism. It occurs in humans and is expressed in various ways in all kinds of systems.

In addition, greed is not a typical modern society phenomenon. Concerns about greed have been raised long before the market took effect. The ancient Greeks (Aristotle, for example) were already concerning themselves with the concept of greed. The Roman Catholic Church

Lucas Vorsterman, *Gierigheid (Avaritia)*, naar Adriaen Brouwer, 1619-1675, gravure op papier, 189x141mm, Rijksmuseum Amsterdam, CC0 1.0, http://hdl.handle.net/10934/RM0001.COLLECT.192297.

uses the term 'Seven Deadly Sins'. Pope Gregory I (590-604) officially established the sins (vices) in the sixth century. Greed, called *avaritia*, was one of those so-called capital sins.[210] In short: greed can be found in (some) people, not in the market.

The market should not be seen as a system that, by definition, leads to immoral or moral behaviour. On this point, we refer to document 103 of the TeldersStichting (2007), with the title *Vertrouwen in de markt*, in which, among other things, the relationship between the free market and morality is explained. It says: 'The market is an amoral means of weighing values; it is as moral or immoral as its users. The market itself cannot therefore be judged in a moral sense. We're in favour of markets, but not because we rely on people to make the right moral decision.' Based on the work of liberal thinker Friedrich von Hayek, the authors of this publication came to the conclusion that 'the most fundamental reason for choosing the market is that it leaves room for individual freedom, and individuals are free to behave and develop morally'.[211] We, the authors of this new publication on the market, are happy to agree with that.

Throughout history, there are also liberal thinkers who have promoted greed as something positive, under the guise of 'greed is good'. The argument being that greed isn't bad because it ultimately leads to a good net result for people. For example, Bernard Mandeville, in his satirical poem from *Fable of the Bees*, praised the proposition that private sin ultimately leads to general benefit. Later, various classical liberal thinkers would build on Mandeville's bee hive, where the selfishness of the bees does not lead to chaos: 'Every part was full of vice, yet the whole mass a paradise.'[212] Although there is a certain logic in this, it must be stated that promoting greed is not the most elegant defence of capitalism. Although there's nothing wrong with pursuing self-interest, especially if it also serves the benefit of others, glorification of greed goes a bit far.

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210. The other six capital sins are *superbia* (pride), *luxuria* (welllust), *invidia* (jealousy), *gula* (gluttony), *ira* (rage) and *acedia* (laziness/indifference).
211. Frans de Graaf a.o., *Vertrouwen in de markt*, TeldersStichting, The Hague, 2007, p. 26.
212. Bernard Mandeville, *The Fable of the Bees: Or Private Vices, Publick Benefits*, London, 1714.

With his famous quote from *The Wealth of Nations*, Adam Smith indicated the relevance of self-interest: '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.' But in his other work *The Theory of Moral Sentiments*, Smith also made it clear that money and fame are insignificant, and happiness consists of 'tranquillity and enjoyment'. He also wrote: 'How many people ruin themselves by laying out money on trinkets of frivolous utility?'[213] The liberal thinker Smith was well aware that greed and decadence do not necessarily lead to happiness.

It is, of course, true that in a society with a market economy, companies try to be financially healthy—if you don't concern yourself with that at all, you simply won't survive. But that is quite different from being greedy or blinded by profit. In a well-functioning, competitive market, profit is primarily an expression that a product or service is valued by consumers. This doesn't change the fact that there are companies that go overboard in their desire for profit. If, as a result, companies start to exhibit unacceptable behaviour, for example deception, fraud or tax evasion, state regulations should be in place that penalise this type of behaviour. Companies should play fairly and stay within the rules of the game.

Liberals also believe in the dispersion and limitation of power. Classically, of course, in terms of government, but also when it comes to business. That is why competition is so important: it ensures that players in the market can't get away with any tendencies towards greed. In addition, it is necessary to organise other types of counterpower. Because, when strong companies are faced with strong and high-quality supervisory authorities, other important liberal principles, such as privacy, but also the harm principle (companies should not harm people by putting unsafe food on the market), are also properly safeguarded. For this reason, we must cherish critical players, such as the free press and consumer organisations.

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213. Adam Smith, *The Theory of Moral Sentiments,* Cambridge, [1759] 2002, part 4, chapter 1, p. 211.

The Way Forward

It has just been explained that the free market does not equal selfishness, unlimited consumerism, greed and disregard for human relations, as is sometimes suggested. As far as we're concerned, the way forward is primarily for liberals to tell a different story about the free market. Not the story of the free market as a leeway for free-floating individuals driven by financial gain, but a free market as a leeway to organise your own life. The free market that, when it works well, offers you the opportunity to make choices. Choices about the work you do, what you buy, sell, how you conduct yourself morally and how you spend your time. It leaves room for your own interpretation of what the 'good life' is.

In concrete terms, what can we do with this? This chapter on culture and morality is less suited for a list of policy options. Still, there are three lessons to be learned from this section. First: As a liberal, prefer to stay away from the frame *greed is good* and the sanctification of production and consumption. Emphasise the free market as a system of free exchange and free choice, where moral development is possible. Moreover, it's good to realise that a liberal society encompasses much more than the principle of the free market.

Second, organise counterpower against companies where necessary, also to protect other important values, such as privacy and food safety. Strong and high-quality supervisory authorities are important. That's why continuous investments must be made in institutions such as the Dutch Data Protection Authority and the Dutch Food and Consumer Product Safety Authority. In addition, cherish the free press and other critical players such as consumer organisations, partly because they ensure companies remain alert.

Finally, it is worth emphasising that a government does not have to solve every moral issue concerning business. In a free, open society, morality develops spontaneously. It is important however, that companies or other players in the free market adhere to the rules. If they don't, they should be bound by law, just like ordinary citizens, with all the consequences that entails.

Conclusion

In our view, the free market performs particularly well when it serves us all. As emphasised in this book, the market has benefitted us greatly throughout history. Never before in history have we known such a high level of prosperity, well-being and freedom. We mustn't forget that much of our wealth is owed to our liberal market economy, which, above all, respects individual freedom of choice. Alternative society systems all underperform in terms of freedom and prosperity.

We must therefore remain vigilant for strong tendencies towards centralism that could arise in the wake of the corona crisis, during which the state has temporarily seized more power over the market in order to combat the virus. This should not become the recipe for (more) ordinary times. In a highly intertwined, complex world, we need the market; not one central planner who believes it can arrange everything.

At the same time, we liberals must be diligent in ensuring that the market really does work for all of us. This publication opened with the statement: the market should serve all of us, not the other way around. After all, the free market was not cherished by liberal thinkers because they had such warm feelings for 'big capital' or a small club of powerful companies, but because it's a system that enables individuals to make their own choices and to build a better life.

In short, the market works well if each person can move forward at their own discretion. To assess whether the market is functioning properly, we must therefore ask questions such as: does it work well for employees, offering them enough choice between various jobs with good working conditions? Does the market also work well for entrepreneurs, who wish to apply an innovative idea to compete with the established companies? And does it work for the young person, who is trying to buy

a house as a starter on the market, and still has some time left on this planet? And, more generally: does it work well for consumers—as we all are—making sure that, through competition in the market, they're paying a reasonable price for a high-quality product? If the answer to these questions is yes, this means the market is doing a proper job.

At this time, we come to the conclusion that the answer to these questions is still not always a resounding 'yes'. Although many things are going well, we do spot a few bottlenecks. For example, we see that not all companies pay their fair share in taxes. There are still companies that benefit from our tax climate, but contribute little to our economy. A lack of reciprocity exists. Furthermore, damage to the climate, nature or living environment, is not always taken into account. We also observe an increase in power concentration, allowing a small group of companies to be in control and sometimes abuse its dominant position, for example by preventing emerging companies from developing into full-fledged competitors. And, although shareholders are becoming increasingly aware of the social context in which they operate, in some cases, they have no real connection with the company and lack regard for the long term. In addition, there are concerns about equality of opportunity. For instance, the issue that young people without wealthy parents hardly have a chance in the housing market. We've also observed that the government sometimes plays an unambitious role in creating our future earning potential (investments in fundamental research, innovative infrastructure and good education specifically come to mind). Finally, the corona crisis has made us more aware of the fact that the free market doesn't always automatically and immediately take into account our vital interests, or matters such as the protection of privacy.

All this does not make us pessimistic about the market, by the way. On the contrary. We see plenty of opportunities to improve market functioning. One very important aspect of this is ensuring competition. Competition is the oxygen of a market economy. There is no free market without competition. That is why it's important that competition legislation is adapted to current times, and that a regulator can take firm action when power concentration gets out of hand. In addition, proper, clear (international) regulations must ensure that every company contributes a fair share when it comes to tax. After all, we cannot expect companies to pay more than necessary of their own accord. We find it important to

retain those companies that are properly embedded in society and that actually contribute. Not 'letterboxes', but jobs. It is also important to work seriously on proper (international) pricing of negative externalities: the polluter must pay. In order to strive for equality of opportunity, we must, among other things, invest in high-quality education that is financially accessible to everyone. Furthermore, good education is the key to a thriving economy and greater happiness for the next generation. Investments in (fundamental) research and innovation also contribute to this. This is also important from a geostrategic point of view. If Europe falls further behind in the field of (digital) technologies, we will become too dependent on, for example, Chinese infrastructure. It's good to realise that free trade and efficiency are important principles, but should not be made absolute. In the interest of security, buffers must be in place in some areas, plans must be made for flexible upscaling, and, in the field of economy and trade, the geopolitical context must—in some cases—be taken into account. This certainly doesn't mean that we should move in the direction of industrial politics. The corona crisis has shown us, once again, that the international free market ensures efficiency and security. A good example is how we managed to develop numerous vaccines at a rapid pace, as companies around the world searched for a solution to the virus.

As far as we're concerned, the government, with its democratic mandate, has the task of staking out the field. They set the preconditions within which the free market can operate. The field markers should be as far apart as possible, creating a large playing field. Our vision, thus, does not come down to *laissez-faire*. We need the government to create clear rules and to enforce them. In addition, the state can invest in our future earning capacity, provide a safety net for those who temporarily fall by the wayside, and help people in a changing labour market in their process of going from one job to another. This helps the market flourish, and allows everyone to participate and benefit from it.

Creating a better market, however, is not just a task for politicians. First of all, everyone is responsible for their own moral compass. In addition, we may trust the social forces that are at play in a free society. There are all sorts of forces in the market (investors, employees, consumers) that continuously express their preferences, to which companies will continuously have to adapt. For instance, there is a clear call from

society to produce more sustainably. Also consider the role of critical (social) media that, for example, publicly resent high bonuses or dividend payments in times of crisis. This contributes to the norm that people who earn a lot at the top must share in the risks and burdens in less favourable times. The pressure that is exerted by all these players in society is great. This is a good thing. It brings about change spontaneously and gradually.

In the opening of this book, we explained why liberals prefer to talk about the free market rather than capitalism. But when asked about the future of capitalism, the response would be: the future of capitalism is one where the market works for all of us. Not because market principles should be central to people's lives, but because they are a precondition for prosperity and freedom. A well-functioning market economy empowers individuals to shape their own lives.

We have drawn up ten policy recommendations to ensure the proper functioning of the market in the Netherlands.

Policy Recommendations

1. An economy stands or falls with the various companies that comprise it. Good jobs are in the interest of us all. Citizens, SMEs and large companies should contribute their fair share to the public facilities that everyone benefits from. It is therefore beneficial to remove the perverse incentives from the tax system that sometimes prevent this. Tax avoidance and evasion must be counteracted more actively. The former by passing better laws, and the latter by proper enforcement. In addition, Dutch parliamentarians must receive more capable supporting staff in order to obtain a strong information position and to be able to withstand the influence of lobbies aimed at privileges.

2. Complicated, overly detailed regulations should be avoided as much as possible. This contributes to a level and clear playing field, and leaves more room for innovation. Legislative twilight zones often enable the larger companies, which have more human resources to navigate more favourable constructions. In addition, complex regulations can also cause problems for the government itself. Consider the 'toeslagenaffaire' (child benefits scandal), for example, where a complicated circulation machine (taxes and benefits) caused a great deal of misery. Simple systems are generally preferred.

3. To continue to lead the way with an innovative economy in the future, it is necessary to invest in our growth potential. Therefore, we want to invest in education and (fundamental) research. This leads to a strong knowledge-based economy and therefore to innovation. We don't believe, however, that the government can navigate innovation directly. A healthy market economy is needed to achieve

innovation. Obstacles to innovation must be removed as much as possible. If it's a matter of public interest, such as energy transition, the government can provide a temporary stimulus by, for example, offering guarantees for loans used for innovations that are still uncertain but of social value. The government can also take the lead with large, innovative infrastructure projects. Time for a new Delta Plan!

4. Liberals believe in competition and distrust power. Competition creates freedom of choice. Consumers are free to choose from different services and products, employees can choose from different employers and companies continue to develop through innovation. To promote competition and prevent abuse of dominant positions, clear rules are needed that are appropriate to the times. In addition, strong, independent supervisory authorities that can match the level of knowledge of large players are crucial. Countervailing power is also needed to protect other liberal values, such as privacy and security. When it comes to Big Tech, good functioning of the market may involve a separation of ownership of the infrastructure from its use. Due to rapid technological developments, it's important to be able to conduct sufficient and proper investigations into malpractice. The Personal Data Authority must be granted sufficient human resources for this. In addition, partly in order to keep companies on their toes, we must cherish our free press, as well as the existence of other critical organisations such as the Consumers' Association.

5. An old economy is making way for a new economy. That's good news. This disruptive transition must be able to go ahead, and must not be slowed down by keeping interest rates too low for too long, or by putting zombie companies on the government drip. Bankruptcies are part of a healthy economy and ensure that there is room for innovation and growth. This does not alter the fact that there must be a socially just safety net, and that we must do all we can to help people transition 'from job to job' in a rapidly changing world. People can be made more resilient, for example, by stimulating skills training, retraining, upskilling and traineeships. At

present, education focuses mainly on the first phase of life. But both government and business should invest more in lifelong learning.

6. Income and wealth inequalities are not a major concern if they result from fair competition, including a reasonable chance for each player. Outcomes may differ, but the place of your cradle should not determine where you end up. Therefore, we propose a uniform rate of return on income from employment and income from capital, based on realised returns. Inheritances and gifts may be treated as income for the recipient. The testator or donor should be free to decide to whom to they wish to bequeath or donate. This doesn't have to be family. It is not up to the government to make a tax distinction between different types of recipients.

7. Economic growth and climate goals don't have to oppose each other. A pleasant living environment and a habitable planet, for now and in the future, is something liberals value as well. A growing number of shareholders and consumers are becoming aware of social consequences, and companies are responding to this. We are a highly innovative country, developing ever-smarter techniques. We must encourage the process of dematerialisation. To the extent unknown, we must make negative externalities transparent—and put a price on them. Wherever possible, this should be done at the international level. Moreover, the democratically legitimised government can set rules to prevent serious harm, and set benchmarks that encourage companies to adapt and become more innovative.

8. The corona crisis has revealed to us how important it is for a country to have its financial check book in order. As a result, firm measures could be taken in the interest of healthcare, and people and companies could be compensated during a difficult time. This was only possible because we built up financial buffers in recent years. However, government intervention in the economy must always be temporary because, as argued earlier, it's not always effective, raises taxes and/or will lead to inflation. The latter also concerns a 'taxation', in the form of loss of purchasing power. The financial

check book must be put back in order by means of higher growth so as not to lay claim on future generations.

9. We also like to see companies and individuals be more resilient. It would be advisable if they build up buffers for bad times and (like the government) refrain from excessive borrowing. Going into debt is currently made too attractive by the government due to the various possibilities available to deduct interest. To solve this issue, debt and equity should be treated equally in terms of taxation. Steps are already being taken to limit the deductibility of interest in business, and mortgage interest deduction is already being phased out. But there is room for improvement.

10. The corona crisis has taught us, among other things, that dependence on other countries entails vulnerability as countries tend to focus on their own survival in crisis situations. That's why it's good to have a plan B, should international trade come to a standstill. It would also be sensible if the Netherlands, in collaboration with the EU, would invest in strategic (technological) sectors such as artificial intelligence, so as not to lag behind other major powers. Where strategic (medical) stocks are still lacking, these must be built up. In addition, when it comes to vital sectors, we should not be dependent on a single player in the market. What also matters is who you depend on: working with (state-supported companies from) countries such as China, for example, entails additional risks.

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Critique of capitalism is making a comeback. It is said to cause inequality, destroy the environment and undermine our sense of community, while CEOs collect high bonuses and multinationals evade taxes. Some critics would like to see capitalism collapse as soon as possible.

A Free Market for All discusses the liberal perspective on the market. It does not echo widespread defeatism, but rather adopts a positive view. It explains why liberals advocate a free market and why they prefer this term to 'capitalism'. The book outlines how the free market has contributed greatly to our wealth and how it aligns with the fundamental liberal value of individual freedom.

Based on this liberal optimism, the most important contemporary critiques are addressed. Some criticisms and misconceptions are disproved, others are taken to heart by the authors. The book concludes with a liberal vision of the future of the free market and recommendations for a market that continues to work for all of us.

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