

policy *express*

The endless variety of choices Americans enjoy daily is extraordinary—and yet so common it can be easily taken for granted. What are the economics of choice, and why is consumer choice a fundamental indicator of individual liberty and the condition of democratic societies?

The Freedom and Economics of Choice

About the Author

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From the moment our morning alarms wake us to the moment our heads hit the pillow at night, each of us is confronted by an incalculable number of choices: what to wear, what kind of shampoo to use, what flavor of coffee or tea to drink, what kind of music to listen to, whether to see a movie or watch cable.

And these are just the mundane choices. We are also free to make essential life choices: should I be an anesthesiologist, an anthropologist, or an artist?

Your great-grandmother would marvel at the fact that you can fly halfway around the world in a day; that you have over 50,000 items to choose from in a typical American supermarket, and that you not only watch television but can choose from hundreds of channels that cater to many different tastes and interests. And amazingly, it's a pretty good bet that your grandchildren will have choices that you can't begin to imagine.

While not everyone has exactly the same choices, we *all* enjoy more choice than our grandmothers. Two generations

ago, people could not imagine—let alone choose—a laptop or a cellphone, nor could they 'google' for information.

More importantly, our grandparents didn't have the medical choices available today. If my grandmother had been able to get a CT scan or an MRI, for example, her throat cancer might have been detected earlier and she might have lived longer. And each year, researchers develop new technological innovations that will save countless lives in the future.

The wonderful world of choice we enjoy today is made possible by the capitalist free-market economic system, which has proven over time to be the strongest engine of innovation and prosperity.

Choice and self-interest

Choice over so many aspects of our lives is both extraordinarily special and yet so common that we tend to take it for granted. Each day millions of people you will never meet are making shoes, manufacturing cars, assembling iPods, and creating countless other things to give *you*, the consumer, a choice of products to buy. Through a

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vastly complex *worldwide marketplace*, these people choose to engage with you and others in a peaceful and mutually beneficial manner.

Is it because they want you, a complete stranger, to be happy? The answer is yes, and no. One of the oldest insights of economics is that the people who make things are not driven by altruistic motives: they do it because they hope to make a profit and earn a living. They do it out of *self-interest*.

Their self-interest, at the same time, helps you. The people who make and sell you things do so (in the vast majority of cases) because they choose to cater to *your* needs and *your* desires. In fact, they must provide you with something that you value, otherwise you won't buy it and they won't make a living. As a result of the exchange, both you and the producer are better off (otherwise you wouldn't trade, would you?) and that insight—that trade benefits all parties to the trade—is at the heart of free-market economics.

Choice and innovation

It also means that producers are always looking for ways to improve what they make or do and how they make or do it. They innovate—making things cheaper, faster, better or more unique—because they want you to buy from them rather than their competitors.

A world of choice is a world of competition directed at satisfying the desires of customers. In most cases, companies that do not make consumers happy do not survive.

A notable exception to this general rule occurs when producers of goods and services receive special protection from competition, which often happens in government-controlled or regulated services.

The Department of Motor Vehicles, for example, has a reputation for slow

service and unhelpful workers. The DMV doesn't need to be particularly 'customer friendly' or 'service oriented' since it has no competitors. Yet even the DMV experience is improving; many services are now offered online so you can avoid the long wait and grumpy service.

Why the improvement? Although the DMV still has no direct competition, it exists in a world where online transactions are common and increasingly preferred by customers. People accustomed to online transactions in the private sector are likely to demand this user-friendly

Mutual self-interest

The *self-interest* of each party, in the voluntary exchange of goods and services, mutually benefits both parties in the trade. The seller (producer) earns a profit and a living, and the buyer (consumer) receives a product or service that she values. This mutual *self-interest* in the capitalist economic system acts as a check against greed and selfishness.

Competing world economic systems

Autocratic or socialist system (*centralized economic power*)—A central government or military authority makes decisions about (or regulates) resource and asset distribution, production, and consumption for citizens

Free-market or capitalist system (*decentralized economic power*)— Authority over resources and assets, production, and consumption is diffused to millions of individual citizens, who make decisions for themselves.

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option from protected government services as well.

Or consider Microsoft. Many complain that the software giant is so big and powerful that it unfairly controls the market for some types of computer software. Consumers get an inferior product, they say, because Microsoft has a monopoly and is thus no longer accountable to consumer demands.

But *big* doesn't equal *monopoly*. As long as Apple is free to compete with Microsoft, it can—and increasingly does—draw consumers by offering an attractive quality product at a competitive price.

Interestingly, Microsoft's enormous success has another benefit to consumers. Because Bill Gates and his colleagues have succeeded so splendidly, they inspire other entrepreneurs to take risks and create new innovative products, such as Google, eBay, MySpace, and Facebook.

While we tend to take our choices for granted, a world with so much choice is not the normal state of affairs. Most people throughout history lived with far fewer choices. And today in much of the modern developing world, people have far fewer choices than those living in the

United States. What makes a world of choice possible?

A world of choice requires freedom

Our choice-saturated world is the result of a centuries-long process to expand *freedom* for ordinary people. Choice happens because of freedom and the institutions that support freedom.

For most of this history, power was centralized among a powerful few cultural, religious, or military elites. Typically, social status was unchangeable: the poor remained poor; women remained in the background; and outsiders (ethnic, religious, or cultural outsiders) were shunted to one side or victimized. Who you were and who you were related to was more important than what you could do.

In the European experience, the emphasis on one's "place" or status in society began to change centuries ago when some people fled the countryside and feudal manors for the freedom of cities.

In medieval cities two important things happened. First, people congregated together and were thus better able to make use of their individual talents and to trade with others with

Institutions necessary to a capitalist economic system

Rule of Law—adherence to rules protecting inalienable rights of life, liberty, and property

Clear Contracts in Open Markets—clear rules for voluntary agreements between producers and consumers

Individual Property Rights—the individual's right to own—and profit from—his or her assets: material resources, land and natural resources, skills and talents

Individual Responsibility—the duty to respect the life, liberty and property of others

Democracy & Capitalism

Developed over centuries, democracy and free-market capitalism go hand-in-hand, each one the guarantor of the other.

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different talents. More people with diverse talents—some of whom could bake, some of whom could brew beer, some of whom could build furniture, etc.—meant more could be produced. Economists call this a “division of labor,” and a bigger division of labor means more consumer choice for everyone.

Second, as division of labor and trade expanded, some people—typically merchants—recognized the need for better trading rules and a more secure environment in which to trade. So they developed the framework and institutions to meet their needs.

The process was slow, and many fought and died for what they believed in, the core of which is this: that people have inalienable rights to life, liberty, and property, and that coupled with these rights is the duty to respect the life,

liberty, and property of others, regardless of their status.

Put simply, the framework for a world of choice is *freedom*. But what are the rules that people need to trade with each other and that tend to keep societies peaceful?

Simple rules for a complex capitalist economic system

Richard Epstein, a well-known law professor at the University of Chicago, published a book more than a decade ago entitled *Simple Rules for a Complex World*. He argues that the modern world is over-full of laws and regulations and that society would be better off with fewer rules that are clearly understood by all.

The “simple rules” he suggests we adopt, or return to, are largely the rules that developed in early-modern Europe to promote trade and protect people’s

Examples of threats to capitalist free-market economies

Government confiscation of property:

Eminent domain—i.e., government’s power to seize private property without the owner’s consent—has traditionally been used to appropriate land for public projects such as highways and public utility lines. In the 2005 Kelo case, the U.S. Supreme Court ruled that governments could also use *eminent domain* to take private property from one citizen and give it to another for private projects. Responding to public outrage, 42 states thus far have passed some type of reform to limit government’s use of *eminent domain* and restrict the seizure of private property.

Nationalization—This occurs when a government takes control of a business and operates the business in place of a private owner. Nationalizations are a form of “taking” and owners rarely receive compensation for their losses. Companies that extract minerals from the earth and that have the potential to generate large profits, such as mining or oil companies, are often targets of nationalization.

Government regulation—In the 1970s the price of gasoline shot up. The U.S. government responded by capping the price gasoline retailers could charge per gallon. Although the dollar/gallon price was fixed, people “paid” with their time, routinely waiting hours in line for a few gallons of gas.

Tariffs and other trade barriers—Tariffs are a tax on imports that make it more expensive for consumers to buy foreign goods. They also raise costs for businesses that use imported products.

liberty—namely Rule of Law, clear contract rules and norms, secure rights to private property, and rules that hold people responsible if they harm others.

A *Rule of Law* means that people are equal before the law, that no one person or group is above the law. A Rule of Law requires an impartial judiciary and police force; it also requires that government respect and enforce the rights of its citizens and not behave in an arbitrary manner. A functioning Rule of Law makes citizens more secure in their person and in their property.

Contract rules help people trade in ways that are mutually beneficial and allow them to plan their actions with greater certainty. All parties know what to expect and what to do if one party breaches the contract. When contracting rules are clear, well-known, and enforced, it is easier and less costly for people to trade and, in turn, it is easier for economies to grow.

But people cannot trade unless they have secure *rights to property*. Property rights give an owner freedom to use the property in ways that she finds valuable so long as she does not harm others. Property rights are a basic human right. They are the foundation for trade, for decentralizing power, and for peace and prosperity. Markets exist because people have rights over the property they hold (i.e., land, natural resources, intellectual property, information, and skills), and they have the freedom to trade their property with others who value them more than they do.

Finally, rules are needed to hold people responsible for the harm they

cause to others, whether these harms are unintentional or intentional. Rules against injury to people and their property—damage, fraud, and theft—are all essential to keep the bad or careless inclinations of some from harming others.

If these rules exist, and if they are enforced impartially, a world of choice can develop. But if these rules are absent—or if they are poorly or arbitrarily enforced, or limited by a maze of government regulation—then choice and the freedom that makes choice possible will suffer.

Protecting our world of choice

Let me emphasize that these rules are not important just because they allow us to choose from six different kinds of orange juice at the grocery store. These rules are necessary to keep power from being concentrated in the hands of a few people to the harm of many ordinary people.

Ultimately our world of choice—which is simply a capitalist free-market world of people trading voluntarily in markets—is a world of decentralized power where individuals can decide what is best for them and their families and where people face less predation, less oppression, and where most people interact peacefully.

Protecting and expanding an environment in which people are free—free to trade with others, to seek their paths in life, to flourish as they see fit—can be difficult, but it is the path that holds the greatest promise for us as well as the billion people in this world who still live in desperate poverty. ■

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