by Steven Horwitz

Profit: Not Just a Motive

Profits Tell Producers What They Should and Should Not Do

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One of the more common complaints of critics of the market is that "the profit motive" works at cross-purposes with people and firms doing "the right thing." For example, Michael Moore's film *Sicko* was motivated by his desire to take the profit motive out of health care because, in his view, the ways people seek profits do not lead them to provide the level and kind of care he thinks patients should have.

Leaving aside for a moment whether the health-care industry is really dominated by the profit motive (given that almost half of U.S. health-care expenditures are paid for by the federal government, it is not clear which motives dominate) and whether Moore knows better than millions of individuals what their health-care needs are, the claim that a "motive" is a root cause of social pathologies is worthy of some critical reflection. The critics seem to suggest that if people and firms were motivated by something besides profit, they would be better able to provide the things that patients really need.

The overarching problem with blaming a "motive" is that it ignores the distinction between intentions and results. That is, it ignores the possibility of unintended consequences, both beneficial and harmful. Since Adam Smith, economists have understood that the self-interest of producers (of which the profit motive is just one example) can lead to social benefits. As Smith famously put it, it is not the "benevolence" of the baker, butcher, and brewer that leads them to provide us with our dinner but their "self-love." Smith's insight, which was a core idea of the broader Scottish Enlightenment of which he was a part, puts the focus on the consequences of human action, not their motivation.

What we care about is whether the goods get delivered, not the motives of those who provide them. Smith led economists to think about why it is that, or under what circumstances, self-interest leads to beneficial unintended consequences. It is perhaps human nature to assume that intentions equal results, or that self-interest means an absence of social benefit, as was often the case in the small, simple societies in which humanity evolved. However, in the more complex, anonymous world of what Hayek called "the Great Society," the simple equation of intentions and results does not hold.

As Smith recognized, what determines whether the profit motive leads to good results are the institutions through which human action is mediated. Institutions, laws, and policies affect which activities are profitable and which are not. A good economic system is one in which those institutions, laws, and policies are such that the self-interested behavior of producers leads to socially beneficial outcomes. In mixed economies like that of the United States, the institutional framework often rewards profit-seeking behavior that does not produce social benefit or, conversely, prevents profit-seeking behavior that could produce such benefits. For example, if agricultural policy pays farmers not to grow, then the profit motive will lead to lower food supplies. If environmental policy confiscates land with endangered species on it, owners of such land who are driven by the profit motive will "shoot, shovel, and shut up" (that is, kill off and bury any endangered species they find on their land).

The same issues can be raised in the health-care industry. Before blaming the profit motive for the problems in the industry, critics might want to look at the ways in which existing government programs like Medicare and Medicaid, the interpretation of tort laws, and regulations such as those that limit who can practice what sorts of medicine might lead firms and professionals to engage in behavior that is profitable but unbeneficial to consumers. Labeling the profit motive as the source of the problem enables the critics to ignore the really difficult questions about how institutions, policies, and laws affect the profit-seeking incentives of producers and how that profit-seeking behavior translates into outcomes. Placing the blame on the profit motive without qualification simply overlooks the Smithian question of whether better institutions would enable the profit motive to generate better results and whether current policies or regulations are the source of the problem because they guide the profit motive in ways that produce the very problems the critics identify.

For example, high medical costs may well be a result of profit-seeking providers' recognizing that government programs are notoriously bad at pricing services accurately and keeping good track of their expenditures. Ignoring the way institutions might affect what is profitable is often due to a more general blind spot about the possibility of self-interested behavior generating unintended beneficial consequences. Before we attempt to banish the profit motive, shouldn't we see whether we can make it work better?

Placing blame for social problems on the profit motive is also easy if critics offer no alternative. What should be the basis for determining how resources are allocated if not in terms of profit-seeking behavior under the right set of institutions? How should people be motivated if not by profit? Often this question is just ignored, as critics are merely interested in casting blame. When it is not ignored, the answers can vary, but they mostly invoke a significant role for government. The interesting aspect of such answers is that critics do not suggest that we somehow convince producers to act on the basis of something other than profit, but that instead we replace them with presumably other-motivated bureaucrats or have those bureaucrats severely limit the choices open to producers. The implicit assumption, of course, is that the government personnel will not be motivated by profits or self-interest in the same way as the private-sector producers are.

How realistic this assumption is remains highly questionable. Why should we assume that government officials are any less self-interested than private individuals, especially when the door between the two sectors is constantly revolving? And if government officials do act in their self-interest and are motivated by the political analogs of profits (for example, votes, power, budgets), will they produce results that are any better than the private sector's? If blaming the profit motive entails giving government a bigger role in solving problems, what assurance can critics of the profit motive provide that political officials will be any less self-interested and that their self-interest will produce any better results?

One will look in vain in *Sicko*, for example, for any analysis of the failures of state-sponsored health care in Cuba, Canada, Great Britain, or anywhere else. To blame the profit motive without asking whether an alternative will better solve the problems supposedly caused by the profit motive is to bias the case against the private sector.

How Will They Know?

Even this argument, however, does not go far enough. We are still, after all, focused on intentions and motivation. What critics of the profit motive almost never ask is how, in the absence of prices, profits, and other market institutions, producers will be able to know what to produce and how to produce it. The profit motive is a crucial part of a broader system that enables producers and consumers to share knowledge in ways that other systems do not.

Suppose for a moment that we try to take the profit motive out of health care by going to a system in which government pays for and/or directly provides the services. Suppose further that we could, somehow, ensure that the political officials would not be self-interested. For many critics of the profit motive, the problem is solved because public-spirited politicians and bureaucrats have replaced profit-seeking firms.

Well, not so fast. By what method exactly will the officials know how to allocate resources? By what method will they know how much of what kind of health care people want? And more important, by what method will they know how to produce that health care without wasting resources? It's one thing to say that every adult should, for example, have a checkup every year, but should it be provided by an MD, an LPN, or an RN? What kind of equipment should be used? How thorough should it be? And most crucially, how will political decision-makers know if they've answered these questions correctly?

In markets with good institutions, profit-seeking producers can get answers to these questions by observing prices and their own profits and losses in order to determine which uses of resources are more or less valuable to consumers. Rather than having one solution imposed on all producers, based on the best guesses of political officials, an industry populated by profit seekers can try out alternative solutions and learn which ones work most effectively. Competition for profit is a process of learning and discovery. For all the profit-critics' concern—especially but not only in health care—that allocating resources by profits leads to waste, few if any understand how profits and prices signal the efficiency (or lack thereof) of resource use and allow producers to learn from those signals. The most profound waste of resources in the U.S. health-care industry stems from the incentives and market distortions created by government programs such as Medicare and Medicaid.

Thus the real problem with focusing on the profit motive is that it assumes that the primary role of profits is to motivate (or in contemporary language "incentivize") producers. If one takes that view, it might seem relatively easy to find other ways to motivate them or to design a new system where production is taken over by the state. However, if the more important role of profits is to communicate knowledge about the efficiency of resource use and enable producers to learn what they are doing well or poorly, the argument becomes much more complicated. Now the critics must explain what in the absence of profits will tell producers what they should and should not do. Eliminating profit-seeking from an industry doesn't just require that a new incentive be found but that a new way of learning be developed as well. Profit is not just a motive; it is also integral to the irreplaceable social learning process of the market. Critics may consider eliminating the profit motive the equivalent of giving the Tin Man from Oz a heart; in fact it's much more like Oedipus' gouging out his own eyes.

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