

Profits Are Good; Non-Profits Are Questionable

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I am giving this talk because I am concerned that our school systems and present national government do not properly appreciate the important role that profits and the profit motive play in making sure that resources are utilized efficiently in our society and in promoting the economic growth that has served our country so well in the past. As a result, schools do not teach students why profits and profit seeking are valuable and important. Instead, both schools and the federal government tend to encourage students to engage in “non-profit” endeavors that they seem to believe are morally superior to profit seeking activities. Most recently, such beliefs were embodied and funded by federal government policies that would forgive student loans of college graduates that worked for non-profit enterprises for 10 years, while doing nothing for profit seeking students—except for the negative effect of proposing that taxes be increased on productive small business and successful people. These policies are popular with the public because somehow, many people seem to have been brainwashed into thinking that non-profit activities are somehow morally superior to profit seeking activities. These beliefs are often found in the educational system and the media, and these misperceptions need to be corrected. In addition, our children need to learn how to pursue business activities profitably, but schools rarely teach or encourage such learning. Thus, I hope to explain why profits are valuable in our society and why our public institutions need to emphasize the important role that profits play in making us all better off. I will also point out how, while some non-profit activities provide valuable functions that would not be provided by free markets, others tend to waste valuable economic resources because they are not subject to the discipline imposed by profit seeking motivations. First, I will explain why profits are good.

Profits Are Good

People who have been brainwashed to believe profits are bad may intuitively disagree with this statement, so let me explain. Profits are good because the only way a business can earn profits is by first producing a product or service that people value and are willing to buy. People only buy the product or service in a free market if they value that product or service more highly than the money they must give up to pay for it. Thus, profit making businesses must produce products and services that consumers value at least as much as the price they pay to get them. Otherwise, the business could not sell anything and would have no revenues.

However, merely selling a good or service is not sufficient to generate a profit for the selling business. Before a product can be sold it first must be produced. Thus, a business must buy resources and hire employees to produce the products and services that it intends to sell. In order to do that, it must pay its employees and its suppliers a wage or price that is at least as good as the employer or supplier could earn anywhere else in the economy. Otherwise the employee would go to work elsewhere or the supplier would sell his supplies to someone else. Thus, both the suppliers and employees of the business will do at least as well by supplying their goods and services to the producer as they could by selling their goods or services somewhere else.

If the producer does not pay adequately, he would not be able to obtain the goods and services he or she needs to produce his products. However, if he pays too much, he will not be able to produce his products and services for less than he is able to earn by selling them to others. Thus, producers have a strong incentive to use the resources he or she purchases efficiently. He must use employee time and purchased supplies efficiently in order to ensure that the costs he or she incurs in producing the goods and services he sells does not exceed the amount he can earn from selling them. In order to make a profit, the producer must spend less on goods and employee services needed to produce his products than he can earn by selling his or her goods and services.

In short, in order to earn a profit, a producer must produce goods and services that are worth more to the consumer than the value of goods and labor resources used up in producing those goods and services. Thus, the producer must use economic goods and resources efficiently and add value to them or the producer will not be able to earn a profit.

Furthermore, producers of goods and services will have a strong incentive to increase the efficiency with which they use the products and services that they sell to consumers. If they can organize their operations to use their employees more efficiently or use fewer or less expensive supplies in making the goods and services that

they sell, they will be able to earn greater profits. If times are tough and they find that consumers are not willing to pay as much for their goods and services, they must increase their efficiency or they will lose money and will ultimately go out of business. Thus, producers are under constant pressure to increase the efficiency with which they use their employees time and their purchased supplies in order to ensure that they can continue to make profits and survive or, if times are good, increase their profits and prosper.

Profits are also good because they provide valuable signals to actual and potential producers. If a producer provides goods and services that are highly valued by customers, that producer will be able to sell his or her products or services at a greater price than the value of goods and services used up producing them. Thus, that producer will earn good profits. Profit motivated producers will then realize that they could make even greater profits if they expanded their production and produced even more of the goods and services that their customers valued highly. Even if a producer didn't expand, other potential producers would observe that good profits could be made by producing the goods and services that customers valued highly, and they would have an incentive to enter the field and expand production of the highly valued goods and services so they, too, could earn good profits. Thus, profits not only reward producers for producing goods and services efficiently, they also serve as a valuable signal that will encourage greater production of goods and services that are most highly by customers relative to the cost of producing them.

This process works best, of course, when potential producers are not prevented by government regulations from entering new fields or otherwise expanding production of goods and services that are highly valued by potential customers.

Overall, then, profits reward producers for using economic goods and services efficiently to produce goods that are more highly valued by consumers than the value of resources used up in the production of those goods and services. Furthermore, profits provide valuable signals as to where the production of goods and services should be expanded and, if profits cannot be earned, what production activities should be discontinued. That is why I say profits are good.

Non-profits are Questionable

Now, why do I say that non-profit institutions may be questionable, in spite of the fact that they are often treated as being morally superior to profit making business. Non-profit institutions include government activities, certain charities, and various associations, all of which can vary greatly, and many of which engage in doing “good” works.

First, lets look at why non-profit institutions may exist and why they may be held in high regard by many people. Non-profit activities can be useful because not all the values or cost associated with the production of certain activities can be easily embodied in their price.

For instance, if a government provides a court system and police authority to ensure that people honor their contracts and treat other people fairly, those benefits will allow people to engage in trade with each other and count on the fact that other people will honor their contracts. Thus, people can expand their economic relations and engage in more sophisticated and efficient production activities. Thus, when the rule of law is applied and enforced in a society, economic resources are used more efficiently so people in general can become wealthier and better off. These are diffuse benefits that result from a well-developed legal system and benefit all people diffusely and not necessarily any one person particularly. Similarly, an effective national defense benefits all people in the society that no longer have to fear foreign incursions and exploitation.

Other benefits may be focused on improving the welfare of specific people who otherwise would not or could not pay for those benefits. For instance, charities that seek to improve the welfare of the poor so they will not be inclined to steal from others or become repositories of dread diseases that could easily spread to the society as whole. Thus, such activities can provide a benefit that extends beyond the people to whom they provide services. Furthermore, charitable activities may make people in general feel better by letting them feel that they live in a humanitarian society that doesn't let poor people live in a highly distressed state or starve to death.

Also, research undertaken to solve disease problems may benefit society as a whole—such as the research that led to the development of polio vaccines that were funded by the March of Dimes charitable organization. Similarly, university funded research discoveries often lead to new developments that increase the health or welfare of people in general. Since the benefits of research are diffuse and uncertain, people individually might not be able to fund sufficient research to solve important problems, while jointly funded

research might provide benefits to all.

Furthermore, general education may allow people to learn more effectively, be more productive and informed citizens, obtain better jobs because they can be more productive and, in general, perform better in the economy and in society. Yet the costs of general education cannot be easily captured by most potential employers because employers cannot easily earn a return on educational expenditures if an employee can easily take his or her education and find a job with another employer. In previous times, people were allowed to enter into indentured servitude contracts in which they pledged to work for someone for a particular period of time in return for learning a trade, and governmental entities helped enforce such contracts. However, this form of voluntary slavery is no longer legal. Consequently, potential private employers only have an incentive to educate their employees to the extent that their employees' increased skills will directly affect their business in a positive manner. As a result, general education is likely to be inadequately provided unless it is funded either by the individual who seeks to gain from the education or by an entity such as a non-profit oriented government or private entity that is willing to spend more on general education than it expects to receive in direct payments from the newly educated individuals. Because people cannot indenture themselves, capital markets generally will not provide adequate capital to people who need to borrow to advance their education, since it may be difficult to enforce repayment once the education has been received.

Finally, non-profit institutions may be organized by people who share a common interest to ensure that their shared interests are attended to in an efficient manner. This will be the case when there are economies of scale in providing for those interests. For instance, national defense can be better achieved with a standing army for the nation as a whole than by private militias that serve the needs of individual people and cannot be coordinated without incurring great costs. Voluntary associations of industry representatives can standardize formats, for instance, so diverse electronic products can better communicate with each other harmoniously. Trade associations can also obtain expert advice and legal help that is provided to their members jointly, when the private cost of obtaining similar expertise individually might be cost-prohibitive for their individual members.

Consequently, there are a number of functions that can be performed by non-profit institutions that would not be performed at all, would not be performed to a sufficient extent, or would not be performed efficiently by private entities acting in their own best interest. That is the good side of non-profit institutions, but there also may be a bad side.

The bad side of non-profit institutions is that they are often not constrained to use resources efficiently. Too often government entities explain away inferior performance by claiming that they could do a better job in achieving their stated goals if they just had more money. Thus, we get things like the Washington, D. C. public school system that, in 2003-03, spent more than \$16,600 per pupil on education (second only to Alaska) but whose eighth graders ranked last in the country by a wide margin in both reading and mathematical proficiency. We also get government entities, such as tea-tasting boards, that continue to exist long after their functions are no longer required, or government purchasing agents that think nothing about paying many hundreds or dollars to buy a hammer.

The problem is that non-profit institutions have no market discipline that ensures that they will use available resources efficiently to provide goods and services that the public needs or wants. Even if governmental entities or non-profit institutions produce goods or services ineffectively, they may continue to exist for extended periods of time—particularly since employees of such entities do not want to give up their sinecures. (For instance, the March of Dimes did not close its doors after polio vaccines vanquished the disease it was set up to cure. Instead, it sought to achieve other goals and for some time it incurred censure as a charitable institution because it did not use a sufficiently high portion of its contributed funds to provide funding for its newly stated goals). In fact, even if a non-profit institution or government does not operate effectively because it is inefficient or wastes too much money on overhead spending, it may still ask taxpayers or their donors for more funds to continue its activities or otherwise try to make their activities more effective. In contrast, profit making institutions who used available resources ineffectively, would not be able to sell enough products to cover their costs and would eventually go bankrupt. Consequently, profit making institutions must eliminate ineffective people from their payrolls or cut out loss-making divisions or activities lest they face the risk of bankruptcy. If they did not do so, they would become bankrupt and the bankruptcy process would free the economic resources and people that they still retained so they could be deployed more productively elsewhere.

Taxpayer revolts, government sunset legislation, or tough independent oversight boards may be required

in order to ensure that non-profit institutions achieve their stated goals effectively and use available resources in an efficient manner. If such oversight mechanisms do not work effectively or are compromised by conflicting interests of the overseers, then non-profit institutions may waste resources that could have been employed much more effectively by the profit making sector of the economy.

Thus, in the absence of effective oversight, non-profit institutions are not necessarily good—as they may waste resources even though their intentions may be good. Profit making institutions, in contrast, must use the resources they acquire efficiently or they will have to go out of business and free their people and resources up to seek more effective employment. This should be taught in schools and remembered by all public citizens when they assess governmental activities.

Policy Implications

The bottom line of the previously noted considerations is that profit making enterprises should be encouraged in that they will tend to use the nation's economic resources efficiently and in that way make people in general better off. Similarly, while non-profit institutions and governmental activities are not necessarily bad, they need to be constantly scrutinized to see if they are using resources efficiently and are not doing things that could be done more effectively by the profit making sector of the economy. Sunset legislation and zero-based budgeting principles that require that all activities be repeatedly justified should generally be applied to government activities. Oversight by efficiency seeking boards of directors should be applied to privately organized non-profit institutions to ensure that they are achieving their beneficial goals efficiently and have not become an ongoing source of funding used primarily for the enjoyment of their management rather than the for the beneficial activities for which they were originally organized.

School boards should be encouraged to add instruction and courses to their required curriculums that explain how profit making enterprises make money and why they have been critically important to our society and have added immeasurably to our country's welfare over the years. This should be an important part of our domestic civics instruction, along with an increased emphasis on the U.S. Constitution and the intent of our nations' founders in trying to ensure that all citizens would have important guarantees of both individual freedom and individual property rights. It has been the guarantee of individual freedoms and individual property rights that has enabled our country to develop as the world's strongest economy since its founding.

School boards should also think twice about abandoning subjects such as agricultural business or other business instruction that teach students about how real markets work and how businesses can be operated profitably. In fact, it would be useful if all students in publicly funded schools had some instruction in basic profit making business principles in order to understand better and more fully appreciate how our economy works.

Finally, public spirited businessmen might be willing to sponsor young people in the process of learning how businesses operate. One of the most valuable experiences I had while growing up was participation in a Junior Achievement program sponsored by local businessmen that encouraged high school students in creating and organizing small business ventures.

I hope that this talk has caused some people to think about the importance of profit making businesses to our economy. I also hope it has caused some people to realize that our current national governments' focus on non-profit activities will likely be counterproductive as it will lead to diminished economic growth and efficiency in the long run. Finally, I hope this talk has brought to people's attention the fact that our young people need to be taught more about how business operates and has contributed immensely to our nation's welfare over the years.

I thank you for giving me a forum where I can present these ideas and I hope you have found them convincing.