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# ANTI-MARKET BIAS AND ITS THREAT TO PROPERTY

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by Sinclair Davidson\*

## Abstract

Economies that rely on openness and trade for their prosperity must be based on sound and secure property rights – including intellectual property rights.

Increasingly, the basis for sound economic policy is coming under threat from activists who display an anti-market bias. For these activists, it is not enough that they do not benefit from an open and prosperous economy, but others should not benefit either.

In this paper I demonstrate how property rights and an anti-market bias interact with each other. I then illustrate the threat to intellectual property rights using the Australian example of plain packaging for tobacco products. Contrary to claims made by public health activists and the Australian government, the plain packaging policy constitutes an assault on private property rights and has not resulted in a reduction of tobacco consumption.

## Introduction

In the second chapter of his *Wealth of Nations*, Adam Smith speaks of a 'certain propensity in human nature... to truck, barter, and exchange one thing for another'.<sup>1</sup> Trade presupposes ownership and property rights. Unfortunately, while economists tend to concentrate on the benefits and costs of trade, they tend also to ignore the economics of property rights. It has only been in the last 50 years or so that economists have come to better understand the institutions underpinning the propensity to truck, barter, and exchange.

In this paper I extend the analysis of a previous paper where I argued:<sup>2</sup>

*The market economy and liberal society need apologists and propagandists. The general public should be reminded of the benefits of our social order and have their right to live their lives as they choose under the rule of law reinforced by a return to principled debate about the role and function of government.*

In this paper I apply the arguments and insights from my earlier paper to demonstrate how anti-market activists undermine existing property rights. In particular I look at intellectual property rights (trademark) and employ the example of Australia's plain packaging policy towards tobacco products.

In the next two sections I briefly outline what property rights and anti-market bias means. Next, I combine those two ideas and demonstrate the various impacts of their interaction. I then demonstrate how anti-capitalist activists can undermine intellectual property rights.



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<sup>1</sup> Adam Smith, 1776 [1976], *An inquiry into the nature and causes of the wealth of nations*, Chicago University Press.

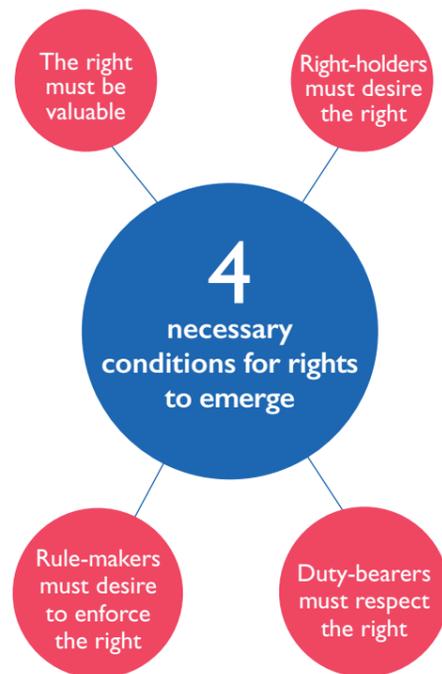
<sup>2</sup> Sinclair Davidson, 2012, 'The limits of property and freedom', *International Trade and Business Law Review*, 15: 385 – 393.

# Property Rights

Harold Demsetz has described property rights as follows:<sup>3</sup>

*Property rights are an instrument of society and derive their significance from the fact that they help a man form those expectations that he can reasonably hold in his dealings with others. These expectations find expression in the laws, customs, and mores of a society.*

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The relationship between the emergence of property rights and the state is the subject of much debate and controversy.  
”



Property rights exist to facilitate the acquisition, control, and exchange of assets. While many definitions of property rights are similar, the literature shows disagreement as to the source and origin of property rights, particularly the role that the state plays in originating, specifying and developing these rights.

The relationship between the emergence of property rights and the state is the subject of much debate and controversy. Armen Alchian, for example, writes, 'If... I talk as if the property rights were enforced by formal state police power, let me here emphasize that such an interpretation... is a gross error.'<sup>4</sup> Early theories of the emergence of property rights did not envisage an active role for the state. Demsetz (1967), the classic paper in this area, argues that property rights emerge to internalize externalities in response to changes in technology and relative prices. Property rights in this model are endogenous. Thrainn Eggertsson, however, refers to this model as naïve, as Demsetz makes no attempt to model the social and political environment in which the rights arise.<sup>5</sup>

The opposite view of the emergence of property rights is the legal centralist view. Itai Sened provides an example of scholarship in this area, arguing that property rights cannot exist without centralized law enforcement as well as the state having a monopoly in violence. In his model, property rights arise out of the interaction between political entrepreneurs who wish to internalize some opportunity and government officials. Sened (original emphasis) writes that, 'governments must grant rights before they can protect them.'<sup>6</sup> Further he writes, '[s]uch rights cannot emerge or persist unless they serve, directly or indirectly, the interests of the central authorities that pay a remarkable cost to protect and enforce them'. Sened argues that four conditions are necessary and sufficient for rights to emerge: the right must be valuable, right-holds must desire the right, rule-makers must desire to enforce the right, and some duty-bearers respect the right.

<sup>3</sup> Harold Demsetz, 1967, 'Toward a theory of property rights', *American Economic Review*, reproduced in *Ownership, Control, and the Theory of the Firm*, Blackwell.

<sup>4</sup> Armen Alchian, 1965, 'Some economics of property rights' (1965) *Il Politico*, reproduced in *Economic forces at work*, Liberty Fund.

<sup>5</sup> Thrainn Eggertsson, 1990, *Economic behavior and institutions*, Cambridge University Press.

<sup>6</sup> Itai Sened, 1997, *The political institution of private property*, Cambridge University Press.

# Anti-Market Bias

Bryan Caplan has argued that four economic biases exist that lead to poor economic decision making.<sup>7</sup> These include anti-market bias, anti-foreign bias, a pessimism bias and a make work bias. Of these four biases the anti-market bias is increasingly manifesting itself as a threat to those economies that rely on openness and trade to promote their prosperity. Ludwig von Mises has similarly described a broad anti-capitalist mentality that permeates modern society.<sup>8</sup> This he ascribes to frustrated ambition, resentment, and envy. For our purposes what is important is that the prosperity of modern open economies must be constantly defended and reinforced as the social basis for prosperity can easily come under threat from anti-market activists who pander to pre-existing biases and attitudes in the community.

We need to understand how and why these views persist. In the first instance, we can lay the blame on intellectual elites. James Buchanan tells us 'economists, along with other social scientists and intellectuals, enjoy playing God'.<sup>9</sup> By this he means that they take it upon themselves to set out their own personal utopias, but not how it might be achieved, nor how it might be reconciled with existing democratic society. As Joseph Schumpeter said, 'Why, practically every nonsense that has ever been said about capitalism has been championed by some professed economist'.<sup>10</sup>

The great English philosopher Michael Oakeshott traces the roots of anti-capitalism back to the enlightenment. Across two of his excellent essays 'On being conservative' and 'The masses in representative democracy', he sets out the dangers to the status quo. In representative democracy he argues that political individualism emerged during the enlightenment together with its antithesis, the anti-individual.<sup>11</sup>

We need not speculate upon what combination of debility, ignorance, timidity, poverty or mischance operated in particular cases to provoke this character; it is enough to observe his appearance and his efforts to accommodate himself to his hostile environment. He sought a protector that would recognize his predicament, and he found what he sought, in some measure, in 'the government'.

In being conservative he describes the anti-individuals' approach to government.<sup>12</sup>

And such people appropriately understand the office of government to be the imposition upon its subjects of the condition of human circumstances of their dream. To govern is to turn a private dream into a public and compulsory manner of living. Thus, politics becomes an encounter of dreams and the activity in which government is held to this understanding of its office and provided with the appropriate instruments.

The hallmark of anti-market bias (or anti-capitalist sentiment) is not just that the person disapproves of the market economy and then refrains from fully participating in the benefits of the market. Rather anti-market activists engage in activities to impose their preferences on other people. In modern societies, however, there are few legitimate avenues to engage in such activities. Unfortunately, the legitimate avenues include such areas as public health and the welfare state. As such we expect to observe many anti-market ideas being promoted as means to further public health and/or to preserve and expand the welfare state.

<sup>7</sup> Bryan Caplan, 2008, *The myth of the rational voter: Why democracies choose bad policies*, Princeton University Press.

<sup>8</sup> Ludwig von Mises, 1956, *The anti-capitalist mentality*, Liberty Fund.

<sup>9</sup> James Buchanan, 1977, 'Democratic Values in Taxation', reproduced in *Debt and Taxes: The Collected Works of James M. Buchanan*, Liberty Fund.

<sup>10</sup> Joseph Schumpeter, 1950, *Capitalism, Socialism and Democracy*, Harper.

<sup>11</sup> Michael Oakeshott, 1962 [1991], *Rationalism in politics and other essays*, Liberty Fund.

<sup>12</sup> Michael Oakeshott, as above.



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In modern societies, the few legitimate avenues remaining for anti-market activities are in promoting public health and expanding the welfare state  
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# A Simple Model

The matrix below shows the interaction between private property rights and an anti-market bias.

		Anti-Market Bias	
		Yes	No
Private Property Rights	Yes	<ul style="list-style-type: none"> <li>• Conflict</li> <li>• Value Destruction</li> </ul>	<ul style="list-style-type: none"> <li>• Growth</li> <li>• Prosperity</li> </ul>
	No	<ul style="list-style-type: none"> <li>• Collective Goods</li> <li>• Socialism</li> <li>• Communism</li> </ul>	<ul style="list-style-type: none"> <li>• Public Goods</li> </ul>

The first combination that we are very familiar with is the absence of private property rights and the absence of an anti-market bias. This is the provision of so-called public goods; those goods and services that are non-rival in consumption and non-excludable. In practice, these goods and services tend to be rare. The second combination that is well understood is the combination of an anti-market bias and the absence of private property rights. This combination has historically been described as either Socialism or Communism (depending on the intensity of anti-market bias and lack of private property rights). Both these ideologies have been extensively trialled, but have uniformly failed to provide rising economic prosperity.

The more interesting situations revolve around the interactions between private property rights and anti-market bias. The absence of anti-market bias and the presence of private property rights should give rise the increased economic

*The absence of anti-market bias and the presence of private property rights should give rise the increased economic growth and prosperity.*

growth and prosperity. The interaction between private property rights and an anti-market bias, however, is going to lead to societal conflict and value destruction. From a public policy perspective this becomes the most challenging quadrant of the matrix.

In the first instance, this quadrant could include crony-capitalism and rent-seeking – the situation where government creates property rights for special interest groups to the detriment of the rest of society. Conversely we could see the situation where special interest groups lobby government to revoke existing private property rights. In either situation, however,

we should expect to see conflict between interest groups and the destruction of economic value.

In high-income economies we are seeing more instances of the latter situation – where interest groups lobby government to restrict the existing rights of business to pursue profitable activities.

Recent Australian examples include environmental groups campaigning against fossil fuel mining activities and the anti-tobacco plain packaging campaign.

# The case of intellectual property rights

The case of intellectual property rights is particularly interesting. Unlike property rights in general, intellectual property rights must be created by the State. This means that Sened's model of property rights comes into play. The four conditions that he identifies apply:

- 01 The right must be valuable;** Intellectual property rights are credited with providing incentives for innovation and in reducing consumer search costs.
- 02 Right-holders must desire the right;** Intellectual property rights allow producers to appropriate the value they create.
- 03 Rule-makers must desire to enforce the right;** Intellectual property rights are highly associated with innovation and the subsequent economic prosperity. Rule makers that value economic prosperity will, in turn, desire to create and enforce intellectual property rights.
- 04 Duty-bearers must respect the right;** Intellectual property rights must add value to duty-holders – for many duty-holders this condition is met. But some duty-holders who do not wish to respect the rights and rather than simply not complying, they choose to lobby rule-makers and undermine the desire to enforce the right. It is here that the anti-capitalist mentality comes to the fore.

An instance where duty-holders have successfully prosecuted an anti-capitalist case is the instance of plain packaging of tobacco products in Australia. This policy is routinely, but incorrectly, categorised as being a public health measure. There is no doubt that tobacco consumption is associated with adverse health consequences, but there is substantial doubt that plain packaging does anything to ameliorate those adverse health outcomes.

Plain packaging is an attack on trademarks – the ability of producers to uniquely identify (brand) their products. Trademarks represent an investment in corporate reputation and allow consumers to economise on search costs when making consumption decisions.<sup>13</sup> Importantly, for our purposes, legal protection of trademarks

creates incentives for producers to invest in both their trademark and in the production of higher quality goods and services.

Closely related to the issue of trademark is advertising. Advertising is the predominant mechanism for communicating trademark information. While (many) economists have tended to emphasise information cost explanations for advertising, sociologists (and some economic thinkers such as J.K. Galbraith) have tended to suggest that advertising creates a demand for goods and services and actually undermines rather than reinforces consumer sovereignty. It is this logic that underpins the plain packaging policy.

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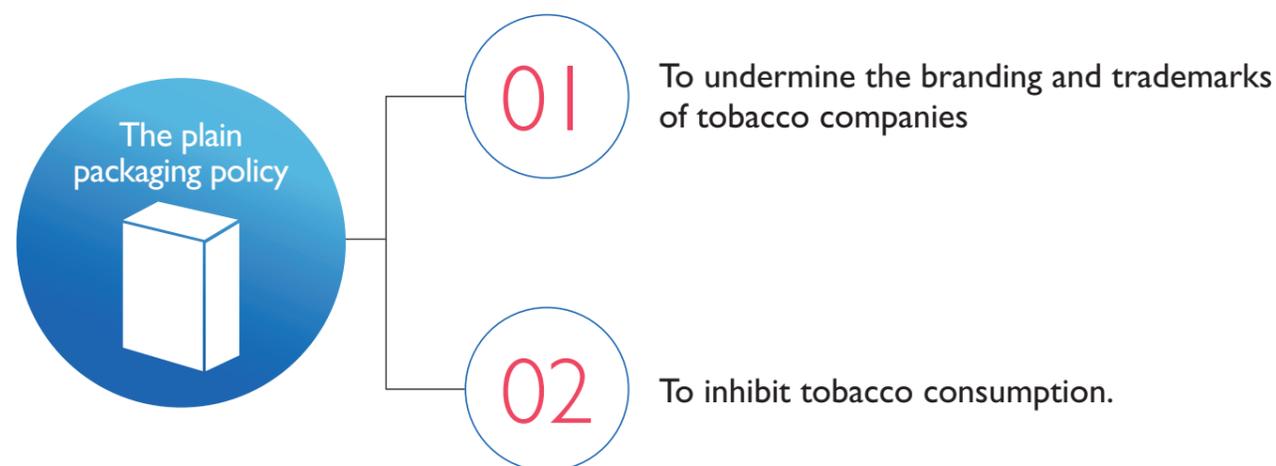
In an effort to minimise the harms associated with tobacco consumption anti-tobacco activists have pursued several strategies. In the first instance public awareness campaigns have educated consumers as to the health risks associated with tobacco consumption. Then increased excise taxes have been levied on tobacco consumption. To the extent that the demand for tobacco is relatively inelastic in the short run, it is a candidate for high levels of taxation given the revenue raising opportunities tobacco represents. In addition, to revenue raising opportunities, however, many governments have used taxation as a mechanism to further inhibit the consumption of tobacco.

<sup>13</sup> See William Landes and Richard Posner, 2003, *The economic structure of intellectual property law chapter 7 for an extensive discussion of trademarks.*

Public health activists, however, have gone well beyond lobbying government to overcome asymmetric information and provide price signals to inhibit tobacco consumption. Campaigns to restrict advertising and public displays of tobacco have been successful in several countries, as have campaigns to provide mandated health warnings on cigarette packets.

In 2011 Australia was the first country to pass so-called plain packaging legislation. This legislation mandated that all tobacco products sold after December 1, 2012 be sold in standardised packaging. Cigarette packets, for example, are required to be an unattractive olive green (labelled "brown" to avoid offending the Australian Olive Association) with brand names

and associated information also being displayed in a standardised font, size, and location on the packet. Health warnings and graphic images make up the remainder of the packets. The packets have been deliberately designed to be unattractive, and unsurprisingly subsequent research has demonstrated that consumers find the packets to be unattractive.<sup>14</sup>



The plain packaging policy, however, had two objectives. First to undermine the branding and trademarks of tobacco companies, and second to inhibit tobacco consumption. **In the first instance the policy has succeeded.** Remarkably the Australian government was able to prohibit the use of existing intellectual property without paying compensation to the right-holders. Chief Justice French of the Australian High Court ruled:<sup>15</sup>

*While the imposition of those controls may be said to constitute a taking in the sense that the plaintiffs' enjoyment of their intellectual property rights and related rights is restricted, the corresponding imposition of controls on the packaging and presentation of tobacco products does not involve the accrual of a benefit of a proprietary character to the Commonwealth which would constitute an acquisition.*

In other words while the intellectual property rights had been taken away from their owners, they were not taken to benefit the Commonwealth of Australia. This result is entirely consistent with Sened's theory – once rule-makers no longer wish to enforce a property right (in this case an intellectual property right) they cease to exist in an economic sense. While tobacco trademarks continue to exist in that nobody other than the tobacco companies may use them (indeed the government will act to prevent anyone from using the trademarks), the tobacco companies may not use or earn income from the investment they have made in their reputations and associated trademarks. In short, the economic value embodied in intellectual property is very fragile.

**The second question of interest is whether the plain packaging policy has actually succeeded in reducing tobacco consumption.** Here the public health lobby have been remarkably reluctant to provide any definitive evidence – indeed the evidence that has been provided is misleading. The Australian Department of Health has made two important claims:<sup>16</sup>

*'Recent figures released by the Australian Bureau of Statistics (ABS) show that total consumption of tobacco and cigarettes in the March quarter 2014 is the lowest ever recorded, as measured by estimated expenditure on tobacco products'*

The Australian Bureau of Statistics does not publish tobacco consumption data.<sup>17</sup> Rather it published Household Expenditure data. It is true that Household Expenditure on tobacco is declining – but that data have been declining for decades. The challenge for the public health lobby is to demonstrate that the plain packaging policy has contributed to that decline. In an extensive analysis of the Australian Bureau of Statistics Household Expenditure on tobacco data Sinclair Davidson and Ashton de Silva fail to find any evidence the plain

*Treasury data shows an increase in tobacco clearances in the year after the introduction of plain packaging*

packaging policy contributed to declining household expenditure on tobacco.<sup>18</sup>

*'Treasury has advised that tobacco clearances (including excise and customs duty) fell by 3.4% in 2013 relative to 2012...'*

This claim by the Department of Health is now discredited.<sup>19</sup> Following a Freedom of Information request the Australian Treasury released the underlying tobacco clearance data. The 3.4% decline is only true if you compare the 2012 calendar year to the 2013 calendar year and you disregard refunds that Treasury paid back to tobacco companies. Once you adjust for the refunds and you take into account that the plain packaging policy came into effect in December 2012, not January 2013, the 3.4% decline becomes a 0.5% increase. Contrary to what the Department of Health claims Treasury advised them, the actual Treasury data shows an increase in tobacco clearances in the year after the introduction of plain packaging.

It is the unintended consequences of plain packaging that are important.<sup>20</sup> Without being able to maintain brand loyalty tobacco companies can only compete on price, and consumers have no incentive to maintain brand loyalty. Tobacco companies have an incentive to introduce low-price products, while consumers have an incentive to substitute from higher-priced cigarette brands to lower-priced cigarette brands. Harry Clarke and David Prentice argue:<sup>21</sup>

*An immediate effect of plain packaging is to reduce product differentiation thereby making cigarette brands closer substitutes. This reduces prices and increases consumption.*

Consistent with that prediction, Christian Kerr reported after the fact:<sup>22</sup>

*Plain packaging laws, which came into force in December 2012, have instead boosted demand for cheaper cigarettes, with reports of a more than 50 per cent rise in the market for lower cost cigarettes.*



While it is an open question as to whether existing smokers consumed more tobacco or new consumers took up smoking this outcome is inconsistent with the plain packaging policy intent.

At the same time firms generally do not wish to compete on price or engage in sales maximisation strategies. Firms prefer to engage in profit maximisation strategies – those strategies rely on firms being able to deploy their intellectual property to grow brands and engage in pricing strategies dependent on product differentiation. Sales maximisation strategies result in higher levels of output and higher costs with lower overall profitability than do profit maximisation strategies.<sup>23</sup>

A policy that has the effect of increasing tobacco consumption at lower profits for tobacco companies cannot be described as being welfare enhancing.

<sup>14</sup> <http://www.health.gov.au/internet/main/publishing.nsf/Content/tobacco-kff>

<sup>17</sup> <http://www.abs.gov.au/websitedbs/d3310114.nsf/4a256353001af3ed4b2562bb00121564/0eef1e81b5623984ca257cb002688ca1OpenDocument>

<sup>18</sup> Sinclair Davidson and Ashton de Silva, 'The Plain Truth about Plain Packaging: An Econometric Analysis of the Australian 2011 Tobacco Plain Packaging Act', (2014) *Agenda: A Journal of Policy Analysis and Reform*, 21: 27 – 43.

<sup>19</sup> <http://catallaxyfiles.com/2015/08/19/departement-of-health-telling-porkies-on-plain-packaging/>

<sup>20</sup> In the analysis below I focus on price consequences and not on the incentives for counterfeiting and smuggling or other illegal activities.

<sup>21</sup> Harry Clarke and David Prentice, 'Will Plain Packaging Reduce Cigarette Consumption?', (2012) *Economic Papers: A Journal of Applied Economics and Policy*, 31: 303 – 317.

<sup>22</sup> <http://www.theaustralian.com.au/national-affairs/health/labors-plain-packaging-fails-as-cigarette-sales-rise/story-fn59nokw-1226945123085>

<sup>23</sup> William Baumol, 1959, *Business Behavior, Value and Growth*, Macmillan.

# Discussion

Ludwig von Mises has argued:<sup>24</sup>

*One does not make a man happier by preventing him from discriminating between a brand of cigarettes or canned food he prefers and another brand he likes less.*

By contrast, however, such a policy – which adds to consumers' search costs – will lower the profitability of businesses.

Australia's plain packaging policies are designed to undermine the intellectual property rights of business and adversely impact on the tobacco industry itself. This is the policy design and objective. **From an anti-market perspective it is merely the beginning. There are a range of other goods and services that can and will find themselves under similar pressures.** Fast food, alcohol and the sugar industry are obvious instances when business might find itself having to justify its continued existence. Less obvious candidates include banking – already we have seen the argument that bank branding is misleading consumers.<sup>25</sup> **The great challenge is for those economies, such as Singapore, that want to promote themselves as being intellectual property friendly business hubs – how do they reconcile a commitment to promoting intellectual property in a global market while facing domestic pressure to restrict the use of intellectual property?**

In addition to open and free economic policy having to have apologists and propagandists, solutions to the problem of anti-market bias include vigorous defences of existing property rights. It also necessitates careful cost-benefit analysis of societal issues. In particular we need to be wary of arguments that allege that private behaviour imposes huge social costs on the rest of society.

Private property rights underpin much of our modern prosperity and those rights need to be preserved. Arguments that purport to change or modify those rights should be treated with some scepticism. Policies that make consumers worse off, while reducing corporate profitability should not be pursued.



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<sup>24</sup> Ludwig von Mises, 1949, *Human Action: A treatise on economics*, Fourth edition, Fox & Wilkes.  
<sup>25</sup> <http://www.afr.com/business/banking-and-finance/financial-services/banks-brands-misleading-public> 20140619:j06k6

The Southeast Asia Network for Development (SEANET) is a regional research and advocacy centre that promotes policy ideas to make ASEAN's growth more inclusive and sustainable. SEANET believes in three key principles: inclusive development, property rights and free movement of people and goods.

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