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NOVEMBER 2004

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Henry Hazlitt

2 *FROM THE PRESIDENT*—Aaron Director on the Market for Goods and Ideas *by Richard M. Ebeling*

4 *PERSPECTIVE*—The More Things Change . . . *by Sheldon Richman*

6 Corporations Should Pay Higher Taxes? It Just Ain't So! *by Roy E. Cordato*

FEATURES

8 **Remembering Henry Hazlitt** *by Bettina Bien Greaves*

12 **All Poorer After the War** *by Henry Hazlitt*

15 **Henry Hazlitt and the Failure of Keynesian Economics** *by Richard M. Ebeling*

20 **Private Enterprise Regained** *by Henry Hazlitt*

24 **The Broken Window**

26 ***Economics in One Lesson*: An Appreciation** *by David R. Henderson*

29 **The Legacy of Marx** *by Henry Hazlitt*

34 **Hazlitt on Gold** *by Jude Blanchette*

37 **The Mont Pelerin Society** *by Henry Hazlitt*

39 **Hazlitt's *The Foundations of Morality*** *by Leland B. Yeager*

41 **Inflation in One Page** *by Henry Hazlitt*

COLUMNS

13 *THOUGHTS ON FREEDOM*—**Novel Economics** *by Donald J. Boudreaux*

22 *PERIPATETICS*—**Hazlitt as a Thinker** *by Sheldon Richman*

47 *THE PURSUIT OF HAPPINESS*—**Henry Hazlitt on Unions** *by Charles W. Baird*

BOOK REVIEWS

42 **The Roads to Modernity: The British, French, and American Enlightenments** by Gertrude Himmelfarb, reviewed by Richard M. Ebeling; **You Can't Say That! The Growing Threat to Civil Liberties from Antidiscrimination Laws** by David E. Bernstein, reviewed by George C. Leef; **Protecting America's Health: The FDA, Business, and One Hundred Years of Regulation** by Philip J. Hilts, reviewed by Sam Kazman.

by Richard M. Ebeling

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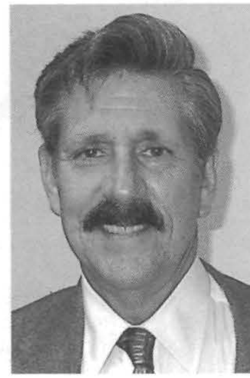

Aaron Director on the Market for Goods and Ideas

Aaron Director, one of the outstanding American economists of the twentieth century, died September 11, 2004, at the age of 102. Few people outside the circle of professional economists have heard of him. This is partly because he published very little, either of a scholarly or popular nature. His greatest influence was through his teaching from 1946 to 1966 at the University of Chicago, during which he helped change how an entire generation of economists and lawyers thought about government regulation and the impact of antitrust laws on market competition. Indeed, many of his students and colleagues have emphasized his role in the development of the field of "law and economics."

Director also influenced the trend of free-market thinking in the United States when he persuaded the University of Chicago Press to publish an American edition of Friedrich A. Hayek's *The Road to Serfdom* in September 1944, after it had first appeared in Great Britain in March of that year. In addition, Director was a founding member of the Mont Pelerin Society, attending its first meeting in Switzerland in April 1947. Organized by Hayek, the Society became an association of classical-liberal and free-market thinkers who wished to revive an interest in the ideas of freedom following World War II.

It is sometimes difficult for people today to realize how greatly the world was threatened by the ideology of socialism in the years immediately after the war. The spread of Soviet power into eastern and central Europe following the defeat of Nazi Germany, and the Marxian idea that the demise of capitalism and the triumph of socialism were historically "inevitable," had a powerful impact on Western intellectuals who had become sympathetic to the notion of government "planning" to solve the ills of society.

Socialism was made even more appealing to many of these intellectuals because they were persuaded that government control of a society's economic affairs did not require any significant loss of personal freedom or civil liberties.

Aaron Director was one of a handful of careful and serious thinkers at the time who clearly understood that securing personal freedom was inseparable from the preservation of economic liberty in a free, competitive market. He made this case in a paper delivered at a conference on Freedom and the Law at the University of Chicago Law School in 1953. The paper was published shortly afterwards under the title "The Parity of the Economic Market Place" and was reprinted over a decade later in *The Journal of Law and Economics* (October 1964).

He explained that many intellectuals failed to see the connection between personal and economic freedom because they live in a rarified and secluded academic world separate from the everyday affairs of

---

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ordinary citizens who go about earning a living in the marketplace. Furthermore, these intellectuals snobbishly and arrogantly presumed that while they were concerned with the big and important issues—virtue, justice, beauty, "the good"—the ordinary people pursued mere material satisfactions that have a far lower order of importance. The free market of ideas, therefore, is more important than any free market for material goods.

In addition, the intellectuals had a bias toward believing that the most significant competition in society occurs in the arena of democratic decision-making. Thus the exchange of ideas in political discourse is far more essential to a free society than any exchange of goods and services. Society "speaks" through the trading of ideas, not products.

Aaron Director responded with three arguments. First, he said that this attitude on the part of too many intellectuals shows a total disregard of and disrespect for the essential importance of market freedom for the general public. "For these people," he said, "freedom of choice as owners of resources in choosing within available and continually changing opportunities, areas of employment, investment, and consumption is fully as important as freedom of discussion and participation in government." Director also quoted from Alexis de Tocqueville, who in *Democracy in America* pointed out the character-building qualities that self-interested conduct taught men in the everyday marketplace.

Fewer Choices

Second, Director noted that choices and opportunities were far fewer and less frequent in the arena of politics. "It is only under a system of voluntary exchange that freedom is maximized," he explained. The democratic process was inherently coercive, with the losing minority having to accept the choices of the winning majority. There was little room for the minority to opt out between elections. "The choice for a minority which does not consent to socialist institutions . . . is that of departing with bare feet." He added, sarcastically, "And such restriction is described as regulation of possessions or property rather than of men."

In the competitive arena of supply and demand each individual has the ability to select what options he finds most attractive, and the relative degrees to which he finds them desirable, without needing to persuade many others in society to "vote" his way. The marketplace, therefore, offers pluralistic outcomes open to change every day through the consumption choices each of us makes, unlike the majoritarian winner-take-all outcomes of the democratic process.

Finally, Director warned that without the separation of politics from economics, the preservation of our civil liberties is far from certain. For example, he said, "The privilege against self-incrimination may not be an important protection of freedom . . . when the state becomes the principal employer or determines the conditions of employment . . . . [A]ny legal protection of this general type will become an empty piece of ceremonial apparatus when its exercise and protection are accompanied by the loss of one's livelihood."

When Director made this argument in 1953, he clearly had in mind the events going on in the United States during the McCarthy era, when suspicion of "disloyalty" resulted in loss of a government job. The existence of a large private sector meant that whether accused truthfully or falsely of un-American beliefs or conduct, an individual could continue to earn a living outside of government, and therefore did not have to be afraid to follow his conscience and refuse to testify at a congressional hearing.

The close connection between the free market and personal freedom may be better understood today than it was in 1953, but if this is so, it is due to the well-reasoned and articulate arguments of people like Aaron Director. □

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Cover photo: *Henry Hazlitt*

PERSPECTIVE

The More Things Change . . .

Economic fallacies die hard, which is why reading Henry Hazlitt today is as worthwhile as it ever was. There is certainly a better understanding of the virtues and benefits of markets than there has been in many years—and Hazlitt's work is surely part of the reason. But freedom will not be achieved by one man, no matter how prolific and articulate. Many people must assimilate such a man's writings and pass their lessons along to others, in whatever way is fitting.

Opening the newspaper almost any day, one finds the same subjects that occupied Hazlitt for many decades: inflation—that is, government control of money; trade restrictions; business regulation; taxation; deficit spending; the minimum wage; labor unionism; agricultural and business subsidies; price controls; the welfare state; the presumption that government can intelligently guide economic affairs.

Why haven't these issues been put to rest once and for all? There are many reasons. The political incentive to perpetuate economic fallacies is potent. Most people attracted to careers in government are uninterested in a platform that would reduce their own power and prestige. The voters to whom they appeal are rarely equipped to detect those fallacies. How many would see a problem in a law mandating longer paid vacation or other employment benefits?

Then there is the age-old temptation to get what one wants with the least exertion; the political means makes it possible to do so by having the government transfer other people's money to oneself. A host of influences, including the government's own schools, encourage us in the delusion that this is not, as Frédéric Bastiat called it, "legalized plunder."

Another impediment to economic understanding is that the market does not have to be understood for it to work. This is both its strength and weakness. If everyone had to have a Ph.D. in economics for the marketplace to run smoothly, we'd be in deep trouble. But because specialized economic knowledge isn't required, most people take prosperity for granted and never achieve even a basic understanding of the free market—which is why they can blithely favor measures that would undermine the very process that makes their comfortable lives possible.

The upshot is that the job of promoting freedom is nowhere near finished, and so Henry Hazlitt's work is as valuable as ever.

* * *

We honor Henry Hazlitt this issue with an assortment of recollections of his life, analyses of his work, and samples of his writing. The special issue, commemorating the 110th anniversary of his birth, begins with a reminiscence and brief biography by Bettina Bien Greaves, who became a friend of Hazlitt's during her many years at FEE as a staff member, senior resident scholar, and trustee.

Hazlitt began applying sound economic principles at an early age. For example, in the 1916 newspaper column we reprint here, he showed why war cannot be a route to prosperity for anyone, even the victors.

Hazlitt was most impressive in his thorough refutation of the once-dominant Keynesian theory of economics. Richard Ebeling contributes an analysis of Hazlitt's Herculean effort.

The settlers at the Plymouth Bay Colony thought collectivism was the path to plenty. They learned the hard way how wrong they were. Hazlitt retold the story in 1949, and we reproduce it in this issue.

Economics in One Lesson is justly known as Hazlitt's most influential work, with a power to persuade rarely found in economics books. David Henderson offers a personal and professional appreciation of this classic.

Aside from Keynes, the other influential writer who denied that markets are orderly and beneficent was Karl Marx. Hazlitt had no trouble showing where Marx went wrong, as demonstrated in his timely classic "The Legacy of Marx."

Henry Hazlitt was also identified with the gold standard, having written about its virtues over many years. Jude Blanchette explores Hazlitt's thinking on this timely subject.

In the dark collectivist days after World War II, a prestigious group of freedom's advocates gathered, at F. A. Hayek's invitation, in Switzerland to chart their intellectual counterattack. Henry Hazlitt was there, and he recorded his experience in an unpublished autobiography.

None topped Hazlitt at making profound economic sense while economizing on words. Witness his "Inflation in One Page."

Moral philosophy was also a major interest of Hazlitt's, and it led to an important work, *The Foundations of Morality*. Leland Yeager has long been a fan of this book, and, as another FEE Timely Classic, we reprint his foreword to the most recent edition.

Our columnists look at a variety of interesting matters. Richard Ebeling discusses the contributions of a recently deceased champion of freedom. Donald Boudreaux discovers Henry Hazlitt's novel, *Time Will Run Back*. Charles Baird discusses Hazlitt's views on unions. And Roy Cordato, reading a case for a higher corporate tax, protests, "It Just Ain't So!"

Books coming under review this issue explore Enlightenment traditions, new violations of free speech, and the Food and Drug Administration.

—SHELDON RICHMAN

THE FREEMAN (Ideas On Liberty)
NOVEMBER 2004

Corporations Should Pay Higher Taxes?

It Just Ain't So!

The May 18 *Washington Post* article "Why Companies Pay Less" is less remarkable for what it says than for who is saying it. Its author is not Ralph Nader or Robert McIntyre of Citizens for Tax Justice. It is Steven Rattner, a well-known investment banker and a founder of the Quadrangle Group, a large private investment firm. Since it is unlikely that Rattner does not realize that his argument—that corporations are not paying their fair share of taxes—is based on a false premise—that corporations *pay* taxes—I can only conclude that he is being deliberately misleading.

In his article, Rattner reports sadly, "Over the past 50 years, the share of tax revenue coming to the federal government from business has collapsed. . . . In fiscal 2003 corporate taxes represented just 7.4 percent of federal revenue, down from 32 percent in 1952. . . . Corporate taxes as a percentage of our gross domestic product dropped to 1.2 percent in 2003, compared with as high as 6 percent in the early 1950s."

In a defensive tone he denies that favoring tougher enforcement of the tax and the closing of "loopholes" is "populist or anti-business or redistributionist." All he wants is what any tax system should aim for: "to distribute the burden fairly."

The corporate income tax has always been the darling of the socialist left. For this group, whose true goal is to transfer increasing amounts of revenue from private to government control, it may be the perfect tax. It gives these self-proclaimed champions of the downtrodden a way to tax the very constituency they claim to represent, while leading that constituency to believe the tax is being imposed on its "oppressors." Indeed, corporate taxes are the most dishonest taxes used by any level of government.

It is curious that Rattner would call for a fair distribution of the tax burden on corporations, because as Rattner clearly must know, corporations *pay no taxes*. They appear to pay taxes, but as Henry Hazlitt would remind us, we need to look past appearances to see the true effects of economic polices.

Corporations pay no taxes not because of the litany of loopholes and special breaks that Rattner lists in his article or because of "the . . . sophistication of large multinational corporations in . . . shifting profits to countries with lower tax rates." It is because corporations *can't* pay taxes. All taxes, corporate or otherwise, must come out of some real human being's pocket.

All this is well known and not at all controversial. Yet Rattner does not even hint at the possibility that the true burden of the corporate tax may be borne by exactly those taxpayers he is presumably championing in his article. The unstated implication of Rattner's argument is that customers of corporations are paying too little for their products; employees of corporations are being paid too much for their work; and shareholders, even retirees and those putting a few dollars a month into IRAs and 401ks, are getting too much in return for their investments.

But even if corporate taxes were transparent to those who pay (in which case they probably wouldn't exist), they would still violate every important principle of sound tax analysis. Again, this is a point that Rattner cannot credibly claim to misunderstand. While there is no such thing as an efficient tax, some forms of taxation clearly do more economic damage than others.

A basic principle of taxation is that the tax system should seek to minimize the extent to which some market decisions are favored over others. This means that income should be taxed only once.

Double, Triple Taxation

But the corporate income tax introduces double and in some cases triple taxation into the system. A worker at Wal-Mart pays personal income tax on a salary that has already been reduced by the corporate income tax.

Wal-Mart's customers are taxed at least twice. Their purchasing power is reduced when they pay tax on their income. Then it is further reduced when the corporate tax raises the prices they pay at the cash register.

A shareholder in the company faces triple taxation. First, when any income is taxed, the tax by definition reduces the potential income stream—interest, dividends, and capital gains—that the income can generate. Second, dividends and capital gains are reduced further by the corporate income tax. And third, when dividends and capital gains are finally earned, they are taxed as part of the investor's personal income.

Corporate taxes are hidden and fraudulent. The people who pay them do not know they pay them, and thus such taxes help mask the actual cost of government. If it is true that companies are finding ways to avoid these taxes and less revenue is being generated, then we should cheer those companies on. Ultimately corporate taxes should be abolished. Lovers of big government have no better friend than a tax that everyone thinks someone else pays.

—ROY E. CORDATO
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Instead of What?

All subsidy measures, all schemes to redistribute income or to force Peter to support Paul, are one-eyed as well as shortsighted. They get their immediate appeal by focusing attention on the alleged needs of some particular group of intended beneficiaries. But the inevitable victims—those who are going to be asked to pay for the new handout in increased taxes (which directly or indirectly means almost everybody else)—are left out of account.

Only one-half of the problem has been seen. The cost of the proposed solution has been overlooked.

The vast majority of would-be social reformers think of the "cost" of something as simply its money cost; and they persistently underrate or dismiss even this because they think of money as something that can be turned out at will by a government printing press. But when economists talk of cost in the broader sense they mean whatever alternate opportunity must be forgone in order to produce the thing that is made. Everything we make, and everything we do, must be at such a cost. For every alleged benefit that the politicians confer upon us, they must necessarily deprive us of something else.

I have not raised here the political and moral issue involved when governments extend and pervert their powers to expropriate part of the earnings of Peter to turn them over as a handout to Paul, or force both to "buy" something with their earnings quite different from what either would have bought of his own free will. But even if we put aside this basic issue, the next time the politicians offer us some alleged economic gift, let us at least ask them the question: Instead of what?

—Henry Hazlitt, *The Freeman*, March 1976

THE FREEMAN
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NOVEMBER 2004

Remembering Henry Hazlitt

by Bettina Bien Greaves

Henry Hazlitt was one of a very special breed, an economic journalist who not only reported on economic and political events in clear and understandable language, but also made contributions to economics.

When I arrived at FEE in 1951, I was just a neophyte in the freedom philosophy. Hazlitt was a trustee, author of the best-selling *Economics in One Lesson*, and for several years an editor of the fortnightly free-market-oriented news-commentary magazine, *The Freeman*, predecessor of FEE's *The Freeman: Ideas on Liberty*.

But he was easy to approach; his manner was pleasant, not aloof or overbearing. He was of average height. His features were regular, and he wore a mustache. He dressed appropriately for a journalist working in midtown Manhattan in his day—in suit and tie. He was modest, always thoughtful of others, and one of the kindest and most gracious men I have known. His friends called him Harry, and in time I too came to call him Harry. I was proud to have him as a friend.

Hazlitt was born on November 28, 1894; his father died when he was a baby. He attended a private school established for poor fatherless boys in Philadelphia. When his mother remarried, the family moved to Brooklyn, where he went to the public schools. After high school, he enrolled at New York City's free-tuition City College. But his stepfather died, and he had to drop out of college after a few months to work and support his widowed mother. Yet, as Hazlitt wrote later, his short time at college "had a greater influence than may at first sight be supposed, not as much from the knowledge gained there, as from the increased consciousness of the knowledge which I still had to gain and the consequent ambition to attain it."[1] He became determined to learn.

Books became Hazlitt's university. He embarked on a self-imposed home-study course, reading and writing prodigiously. He read college texts, browsed in libraries, and studied shorthand and typing. He got a job with the fledgling *Wall Street Journal*, then a rather obscure publication reporting only news of Wall Street. In World War I he joined the Army Air Service and was sent to Texas. At war's end he returned to New York and continued to write for various newspapers—as financial editor, literary editor, editorial writer, editor, and then as a member of the editorial staff of the *New York Times*, where he wrote most of its economic editorials. He acquired his real education on the job.

Hazlitt was modest; he always attributed his success to good luck—in having read great books and having known great men.

Contributing editor Bettina Bien Greaves (bbgreaves@aol.com) came to know Henry Hazlitt during her many years as a FEE staff member, resident scholar, and trustee.

He used to say that the three biggest influences on his economic thinking were: (1) the British clergyman/economist Philip Wicksteed (1844–1927), whose book *The Common Sense of Political Economy* he encountered early in his career while browsing in a library; this book, based on the subjective marginal-utility theory of value, gave him a sound foundation in economics; (2) Chase National Bank economist Benjamin M. Anderson (1886–1949), a fellow New Yorker whom he saw frequently; and (3) the noted Austrian economist Ludwig von Mises (1881–1973).

Hazlitt lived an active life as a newspaperman. He belonged to several literary societies, attended their luncheons, and met the leading authors and intellectuals of his day. He admired, he once said "almost idolized," H. L. Mencken, whom he briefly succeeded as editor of *The American Mercury*. Hazlitt frequently debated prominent politicians on the radio: Vice President Henry Wallace, Secretary of State Dean Acheson, and U.S. Senators Paul Douglas and Hubert H. Humphrey. He came to know practically all the conservatives and libertarians of his day, not only Mises and Anderson, but also, among others, FEE founder Leonard E. Read, Isabel Paterson, Rose Wilder Lane, John Chamberlain, William F. Buckley Jr., Lawrence Fertig, Sylvester Petro, F. A. Hayek, and Ayn Rand.

In 1938 Hazlitt reviewed for the *New York Times* the English translation of Mises's *Socialism*, describing the book as "the most devastating analysis of socialism yet penned." Mises was then in Switzerland, but the two men corresponded briefly. Then in 1940 Hazlitt received a telephone call from Mises, newly arrived in New York. Hazlitt was dumbfounded: "It was as if John Stuart Mill had risen from the dead!"

Mises, a refugee from war-torn Europe, had been forced to leave his home in Vienna, Austria, a comfortable position in Geneva, Switzerland, and the academic world of Europe where he was well known. He and Hazlitt soon became the best of friends, and "Lu," short for Ludwig, found a special place in Hazlitt's heart and mind.

Henry Hazlitt in World War I

Hazlitt's Helping Hand

When Mises phoned Hazlitt, Mises was trying to start a new life in the United States. Hazlitt was always willing to help his friends. Through contacts in the State Department, he helped Mrs. Mises's daughter to escape Nazi-occupied Paris (this was before the Japanese attack on Pearl Harbor, when the United States was not yet at war). He asked his friend Benjamin Anderson, who had associates at Harvard University, to help Mises find a teaching position. Harvard wasn't interested. Hazlitt arranged a dinner for Mises with Alvin Johnson, director of the New School of Social Research, where many European victims of Nazism had received positions. But when Johnson told Hazlitt that Mises was "too extreme," Hazlitt realized that Johnson only hired socialists.

By Hazlitt's arrangement, Mises wrote several editorials for the *New York Times*. The Rockefeller Foundation gave Mises a grant for several years, enabling him to write

Ludwig von Mises, Bettina Bien Greaves, and Henry Hazlitt at the final dinner-meeting of the Mises NYU seminar for the spring of 1958.

Omnipotent Government and *Bureaucracy*. Mises soon obtained a position as visiting professor with the New York University Graduate School of Business Administration. Then Hazlitt brought him to FEE, and Leonard Read hired him as economic adviser.

In the 1950s Mises's NYU graduate seminar in economic theory was held in Gallatin House diagonally across Washington Square from the apartment where Hazlitt lived with his wife, Frances. Hazlitt felt sorry for Mises having to speak every Thursday evening to a small group of students who were tired after working all day at their regular jobs. So to buck Mises up, Hazlitt began attending the seminar. The topics varied from year to year—epistemology, history, Marxism, capitalism, monopoly, interventionism, monetary theory, and socialism. Mises frequently cited historical illustrations and amusing examples. "Interestingly," Hazlitt said later, "what I found was, no matter how many times I would go, no matter how often I heard in effect the same lectures, there would always be some sentence, some incidental phrase or illustration that threw more light on the subject."[2] On one occasion, laughter broke out. Mises: "The Soviets censor *bad* books." And then proudly with a twinkle in his eye: "*My* books!"[3]

Hazlitt considered himself especially lucky in counting Mises and his fellow noted Austrian economist F. A. Hayek (1899–1992) among his friends. Hazlitt had, of course, known both for many years through their writings, but it was only after he reviewed their books that they met and became friends. When F. A. Hayek's *The Road to Serfdom* came out in 1944, Hazlitt reviewed it for the *Times*, calling it "one of the most important books of our generation." The book became a bestseller. Hazlitt's review attracted Hayek's attention, and in 1947 he invited Hazlitt to attend the important first meeting of the free-market-oriented society he was organizing, later internationally known as the Mont Pelerin Society. (See Hazlitt's recollections on page 37.)

Hazlitt wrote 15 books in all—his first published when he was only 21. His first book on economics, *Economics in One Lesson*, was published in 1946 when he was still with the *Times*. Once I told Hazlitt that he hadn't written *Economics in One Lesson* but rather *One Lesson in Economics*. He agreed. "But it wouldn't have sold so many copies," he said. He was undoubtedly right. *Economics in One Lesson* made economics easy to understand, and it became an immediate bestseller. (See page 26 for an appreciation of *Economics in One Lesson*.)

By this time, Hazlitt had a thorough understanding of economic principles, and all his work reflected his free-market interpretation of events. As a matter of fact, he left his position on the editorial staff of the *New York Times* on that account.

After World War II, the Allies held an international conference on money, which was dominated by the then-popular ideas of British economist John Maynard Keynes. (For Hazlitt's analysis of Keynes, see page 15.) While the conference was going on in Bretton Woods, New Hampshire, Hazlitt was editorializing against it in New York City. He considered its proposals for an International Monetary Fund and a World Bank inflationary and was convinced they would end badly. However, when the IMF and World Bank were endorsed by 43 nations, *Times* publisher Arthur O. Sulzberger told Hazlitt the newspaper could no longer editorialize against them. Hazlitt agreed not to mention them in future editorials. But he also went out and found himself a new job.

Lands Job at *Newsweek*

In 1946 Hazlitt became the "Business Tides" columnist for *Newsweek*. Week in and week out for twenty years Hazlitt analyzed world events and government programs from the free-market point of view. He argued for capitalism and sound money, and against inflation, government intervention, and socialism. (For Hazlitt's views on money see page 34.) His column gained a wide and influential readership. Mises even believed that Hazlitt's columns gave Federal Reserve officials a guilty conscience and kept them from expanding credit as much as they would have liked. But Hazlitt lost his position on ideological grounds. When the left-oriented *Washington Post* took over *Newsweek*, it decided to replace Hazlitt with three more "mainstream" college professors—free-market monetarist Milton Friedman of the University of Chicago, middle-of-the-roader Henry Wallich of Yale, and Keynesian Paul A. Samuelson of M.I.T.

Hazlitt must have been amused but somewhat chagrined when Samuelson, ardent Keynesian and author of the then-most-widely used college textbook, wrote Hazlitt that "one of the reasons [he] decided to go into economics" was because he had been impressed by a Hazlitt column assigned him when a college undergraduate.[4] Hazlitt graciously thanked Samuelson for his letter. But he was too honest to let Samuelson believe he approved of his economics: "As you know, I venture to differ with you on some propositions in economics, and in my book, *The Failure of the 'New Economics,'* I may have expressed my differences with less than complete politeness. Nevertheless, I am enormously flattered to learn that something I wrote long ago influenced you and particularly that my article was one of the reasons that you decided to go into economics."[5]

Throughout his life, Hazlitt was always reading and writing. On his 70th birthday, he reflected on his career. He had been writing for most of 50 years, "practically every weekday: news items, editorials, columns, articles . . . in total some 10,000 editorials, articles, and columns; some 10,000,000 words! And in print! The verbal equivalent of 150 average-length books."[6] He earned renown in at least three areas: as a popularizer of sound economic thinking, as a critic of John Maynard Keynes, and as a contributor to ethical moral philosophy. Not bad for a poor fatherless boy and college dropout.

Henry Hazlitt continued to fight the good fight until July 9, 1993, when he died at the age of 98. □

1. Quoted from Hazlitt's annual summary, as a young man, of his intellectual development, 1912; copy on file at FEE.
2. From my interview of Hazlitt, March 27, 1977.
3. From my unpublished Mises seminar notes, December 17, 1959.
4. Samuelson letter to Hazlitt, September 15, 1966; copy in FEE's files.
5. Hazlitt letter to Samuelson, December 15, 1966; copy in FEE's files.
6. Hazlitt's remarks, November 29, 1964, reprinted in *The Wisdom of Henry Hazlitt* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1993), pp. 45–46.

THE FREEMAN
Ideas On Liberty
NOVEMBER 2004

All Poorer After the War

by Henry Hazlitt

No part of the world can become permanently richer by an immense destruction of wealth in another part. Our prosperity is bound up with that of our neighbors. If my neighbor becomes poorer, he will have fewer surplus goods to sell me; he will not be able to spare them; I myself may have to manufacture part of what I have been accustomed to buying from him; it will probably cost me more.

This may perhaps be made clearer by a concrete figure. John Ally is a rich man who lives in a magnificent mansion, and I, Uncle Sam, am a well-to-do farmer living adjacent. I sell him produce; sometimes I make articles for him; and I also keep a general store, in which I sell house furnishings.

Now John Ally gets into a feud with Bill Germany across the way. They send raiding parties against each other; they attack each other's castles—for two or three years. It is all very expensive. John Ally's needs are desperate; his raiding parties must be armed; he asks me to help him make weapons; and I stay up late at nights making weapons, and selling them to Mr. Ally at extravagant prices; and I am growing scandalously rich. Meanwhile John Ally, in his desperation, is spending not only his income; he is digging into his capital savings. Moreover, his income is less, for he is neglecting his business to equip raiding parties and to join in them.

Finally it is all over. Now I, Uncle Sam, knew that it is all up with the weapons business; but I am not nearly so discouraged as I might be expected to be. I may even imagine at times that I am going to get more business now that the feud is over than I did while it was going on. I note that Bill Germany's raiding parties have smashed many of Mr. Ally's handsome casement windows; I know he will have to replace them, and I suspect that he will come to me to do it. And I reason also that for more than two years John Ally has not been able to buy any furniture, and that the furnishings in his house must be pretty dilapidated by this time.

But what do I find? John Ally does indeed replace his broken windows, and he puts up a new barn where his old one was burned down and he calls on me to some extent for materials. But he replaces his magnificent windows with a much cheaper window wherever possible, and he puts up a much less pretentious barn. Moreover, the expected orders for furniture do not come, or come only in the most disgustingly small amounts. Furthermore, I find that he is setting a less elaborate table; my orders from him for foodstuffs cannot compare with what they were before the feud broke out.

What is the trouble? John Ally's furniture is in a worse condition than before the feud; but so is his pocketbook. He is more in need of furniture than before the feud; but he can less afford to buy it. He simply lets it go as it is for the time, and makes only the most urgent repairs and replacements. John Ally is a poorer man than he was before the feud; for a long time he is going to give me less business; and consequently I am going to be a poorer man too. □

This article appeared in the New York Evening Mail *on February 16, 1916.*

THE FREEMAN
Ideas On Liberty
NOVEMBER 2004

Novel Economics

Economist Bruce Yandle tells of his first encounter with Henry Hazlitt's *Economics in One Lesson*: "I thought to myself, 'What arrogance!'" Bruce said. "Here was I, fresh from surviving four years in a rigorous economics Ph.D. program, and I run across this slim book in which a journalist announces that he's going to teach economics in *one* lesson. Ha!"

"Well, buddy," Bruce continues. "I read that book and, darn it, the title proved to be absolutely right. It *is* economics in one lesson."

Henry Hazlitt's works do indeed challenge our obsession with pedigrees. He held no university degree and yet he understood economics more deeply and more widely than 95 percent of all Ph.D.-sporting economists. One piece of solid evidence of Hazlitt's deep understanding is his crystalline prose. His explanations are so smooth that readers sense that his words spilled from his pen effortlessly. But I'm sure that "effortless" does not apply to Hazlitt's writing. To write as clearly as he wrote requires not only profound knowledge but hard work.

Hazlitt's impressive understanding and style are on full display in his 1951 novel, *Time Will Run Back* (originally titled *The Great Idea*). Formally a work of fiction, it is really an extended lesson in economics—one not only easy to digest, but one that "tastes" good too. It has neither jargon nor pedantry, just crisp explanations of the basic workings of an economy, spiced with compelling insights on the nature of the tyranny that inevitably is unleashed by attempts at central planning.

The story opens when the dictator of Wonworld, Stalenin, falls ill and summons his only son from Bermuda, where the boy and his mother have lived since his birth, mercifully without much contact with the rest of the centrally planned tyranny that covers the globe. Wonworld is the name of the worldwide Marxist dictatorship that was created nearly 200 years earlier, in the late twentieth century, when the forces of communism defeated the last hold-out forces of capitalism and freedom.

The son, twentysomething Peter, arrives in the capital, Moscow, free of the brainwashing that numbed and ruined the minds of almost everyone else in Wonworld. Although at first accepting Marxist central planning as the only feasible means of organizing a decent society, Peter is one of few people in Wonworld who retains the power of critical observation and rational thought.

His father wants Peter to succeed him as Wonworld's dictator. Despite intrigues and assassination attempts by Stalenin's rivals for the top post, Peter manages to assume—while his father inches closer to death—much of the absolute power.

But in an unbelievable (but forgivable) plot twist, the power does not go to Peter's head. Instead, he remembers the horrors

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that he witnessed during his first days in Moscow—days that he spent as an obscure newcomer. He remembers that a girl he liked was taken away in the middle of the night on vague trumped-up charges and never again seen. He remembers that all "bourgeois" music, literature, and art have been destroyed, including the Mozart that he so loved, and replaced with grim propaganda productions. He remembers the lies incessantly trumpeted by the state-controlled press—lies about increases in the economy's output and advances in living standards. And he remembers the out-and-out fear that haunted everyone.

Peter is determined to change this, determined to enable the people of Wonworld to grow wealthier and freer. He senses that something is terribly wrong, but learns just what this something is only gradually, through long discussions with Thomas Jefferson Adams, one of the few Americans who is a member of the politburo. Adams is the only other member of that governing body whose heart and mind are large enough to share Peter's concern for the welfare of ordinary people.

Most of the novel is an extended dialogue on economics between Peter and Adams, with Peter discovering economic truths along the way, both directly through his conversations with Adams and through observing the consequences of market liberalization compared with market regimentation.

In his role as benevolent despot, Peter first frees up consumer markets. He's surprised to find that brokers soon emerge to make it easier for people to barter their goods. Even more surprising is the emergence of market prices expressed in the quantity of cigarettes, much as in the true story told by R. A. Radford in "The Economic Organization of a P.O.W. Camp." Eventually, Peter discovers that greater production—in quantity and quality—is possible only with free markets in producer goods. And this discovery is soon followed by the realization that free markets require private property rights and freedom of contract. The discussion between Peter and Adams on this point is a synopsis of the socialist-calculation debate that began with Ludwig von Mises's work.

Flight to America

In between Peter and Adams's conversations, Peter's enemies wrest control of the army. A civil war is in the offing. Peter and Adams, retaining the loyalty of the air force, flee to what was once the United States, where they proclaim their own rule, independent of Wonworld.

Setting up shop in the White House, they continue their dialogue, exploring every aspect of economics. The economy of Free World, as they call their new country, is increasingly freed from government control. Vast markets for consumer goods, capital goods, and financial instruments emerge from the millions of individual actions of these now-free people. Their prosperity grows along with their freedom. Peter then realizes that the freedom he helped restore will never be secure unless the state's powers are seriously and permanently curtailed. He introduces constitutionally limited democracy and refuses—despite his enormous popularity—to run for the highest political office in the land. He chooses instead to devote himself to his piano.

Wonworld's tyrants eventually attack Free World, but Free World's far greater creativity and productivity give its people the edge they need to defeat their communist foes. Free World flourishes.

It's an optimistic tale, one in which freedom is restored after humankind has trod the road to complete tyranny. Having traveled far down that road, might we be destined to complete this awful journey? The crumbling of the Iron Curtain suggests not. But let's not be too confident. While Marxism lies in history's dustbin, state-worship remains vibrant. Faith in the powers and benevolence of elite political "leaders" ultimately fuels the passage along this terrible road. Thus this faith must forever be challenged. One good way is to read Henry Hazlitt. An even better way is to produce more Hazlitts who think and communicate as clearly as he did. □

THE FREEMAN
Ideas On Liberty
NOVEMBER 2004

Henry Hazlitt and the Failure of Keynesian Economics

by Richard M. Ebeling

For four decades, from the mid-1930s to the 1970s, Keynesian economics almost monopolized economic policy in the United States and around the world. The "new economics," as it was called, was going to assure mankind economic stability, full employment, and material prosperity—all through wise government management of monetary and fiscal policy. So dominant was this view that only in 1959 did the first book-length refutation of the ideas of John Maynard Keynes appear: Henry Hazlitt's *The Failure of the "New Economics": An Analysis of the Keynesian Fallacies.*[1]

Keynes (1883–1946)[2] had a acquired an international reputation shortly after World War I, when he published *The Economic Consequences of the Peace*, a biting criticism of the Treaty of Versailles that formally ended the war.[3] In the 1920s he was a leading critic of the gold standard and a vocal proponent of a government-managed currency to maintain full employment. In his 1924 book, *A Tract on Monetary Reform*, Keynes declared that gold was a "barbarous relic" and that governments should use their control over the money supply to maintain a stable domestic price level even if this required abandoning a stable foreign exchange rate between the British pound and the other currencies of the world.[4]

In 1930 Keynes published *A Treatise on Money*, a two-volume work that he expected would establish his reputation as the leading monetary theorist of his time.[5] Instead, the book was savaged by reviewers, including many of the most prominent economists in Great Britain and the United States. The most devastating criticisms were made by a young Austrian economist named Friedrich A. Hayek, who in a lengthy two-part review demonstrated the logical confusions and theoretical misunderstandings that ran through the entire work.[6]

For the next five years Keynes devoted his time to devising a new theory for his argument that a free-market economy was inherently unstable and that only the guiding hand of government could assure full employment in the face of the economic disaster being experienced during the Great Depression of the early 1930s. This work finally appeared in February 1936 under the title *The General Theory of Employment, Interest, and Money.*[7]

Except for some of Keynes's young protégés at Cambridge University, most of the reviewers of the book were highly critical of many of its theoretical "innovations," as well as its inflationary prescriptions for unemployment.[8] Even some economists who later became proponents of Keynes's "new economics" were initially highly critical of his work. For example, Alvin Hansen, who was one of the leading advocates of Keynesian economics in the United States in the 1950s and 1960s, wrote in late 1936 that *The General Theory* "is not a landmark in the sense

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that it lays the foundation for a 'new economics.' . . . The book is more a symptom of economic trends than a foundation stone upon which a science can be built."[9]

Yet within a few years, and most certainly by the end of World War II, Keynes's ideas had virtually pushed aside every other explanation of the causes and cures of economic depressions.[10] Keynes's book became the foundation stone for the new "macroeconomics." His face even appeared on the cover of the December 31, 1965, issue of *Time* magazine. The feature article, titled "We Are All Keynesians Now," stated:

> Today, some 20 years after his death, his theories are a prime influence on the world's free economies, especially America's. . . . Now Keynes and his ideas, though they still make some people nervous, have been so widely accepted that they constitute both the new orthodoxy in the universities and the touchstone of economic management in Washington. . . . Now even businessmen, traditionally hostile to Government's role in the economy, have been won over. . . . They have begun to take for granted that the Government will intervene to head off recession or choke off inflation, [and] no longer think that deficit spending is immoral.[11]

Keynes argued in *The General Theory* that the free-market economy contained no built-in mechanism to assure full employment. The crucial weakness, he said, lies in the relationship between savings and investment. People tend to consume more as their incomes go up, but the increase is not as great as the increase in income. In other words, they also save a portion of their higher income. The problem, he insisted, is that saving is "non-spending" and if people do not spend all the extra income they earn, businessmen may not have the incentive to invest enough to employ all those who want to work at prevailing wages.

As a result, a large portion of the labor force may be left unemployed because the private sector has failed to create enough jobs. The economy, therefore, may be stuck for a prolonged period in what Keynes called an "unemployment equilibrium." Couldn't workers improve their prospects by accepting lower money wages? No, Keynes insisted, because workers suffer from a "money illusion"—even if prices were falling and a cut in wages would make them no worse off in real buying-power terms, workers would refuse to accept less money.

Rather than demand that workers accept lower pay, Keynes favored raising the general level of prices so employers could make profits without cutting wages. In other words, Keynes's solution to unemployment was price inflation.

Deficit Spending

Government deficit spending would provide additional market demand, pushing prices up and stimulating more hiring. Public-works projects would "prime the pump." This policy would continue until "full employment" was attained. But since, in Keynes's view, businessmen were usually shortsighted and irrational in their fears about investment prospects, the private sector would always lag behind in creating jobs. The government would have to be constantly at the monetary and fiscal controls, injecting spending into the economy to prevent it from sinking back into unacceptable levels of unemployment.

In Keynes's conception of the world, governments guided by his ideas would be wise and farseeing, assuring that the mass unemployment of the 1930s never happened again. Government would manipulate interest rates, the level of prices, and the amount and direction of investment to assure that society had high employment, socially beneficial investment, and general economic stability.

There were critics of Keynesian economics in the 1940s and 1950s, but they were virtually ignored by academic economists and policymakers.[12] Some mainstream macroeconomists also took Keynes to task. But many of their criticisms were couched in terms clearly meant not to antagonize their Keynesian colleagues.

Then in 1959 came Henry Hazlitt's *The Failure of the "New Economics."*[13] What was unique about Hazlitt's exposition was his chapter-by-chapter dissection of the arguments in Keynes's *General Theory*.[14]

Central to Keynes's theory was his insistence that "Say's Law" was wrong in claiming that "supply creates its own demand." Just because people supply goods on the market does not mean they will demand what others are selling. They may abstain from spending by holding idle cash balances. Thus there could be a general glut of goods on the market.

Say's Law

Hazlitt showed that Keynes had misunderstood what the Jean-Baptiste Say and other nineteenth-century economists meant. Goods can virtually always find buyers if prices are sufficiently attractive. The pre-Keynesian "classical" economists never denied that goods can go unsold and labor unemployed if suppliers fail to adjust their prices and wages to match existing market demand.

Furthermore, Hazlitt explained, many of the classical economists, especially John Stuart Mill, understood that individuals could "hoard" money rather than immediately spend it. But this was most frequently due to the temporary uncertainties of an economic crisis, usually caused by a prior, unstable inflationary boom.[15]

The central flaw in Keynes's thinking, Hazlitt insisted, was his unwillingness to acknowledge that the high unemployment in Great Britain in the 1920s and the United States in the 1930s was caused by government intervention, including the empowering of labor unions, that made many prices and wages virtually "rigid." Political and special-interest power prevented markets from competitively re-establishing a balance between supply and demand for various goods. Hence, the market was trapped in wage and price distortions that destroyed employment and production opportunities, resulting in the Great Depression. (Hazlitt did not deny that the contraction of the money supply in the early 1930s increased the degree to which prices and wages had to fall to re-establish full employment.)

Hazlitt considered Keynes's inflationary "fix" crude and dangerous. First, Hazlitt pointed out that Keynes's focus on macroeconomic "aggregates" concealed the microeconomic relationships among a multitude of individual prices and wages. The price level, wage level, total output, aggregate demand, and aggregate supply were all statistical fictions that had no reality in the actual market. Thus the wage level could not be too high relative to the general price level. But in the 1930s many wages for different types of labor were out of balance with the prices of individual goods sold on the market. What was needed to restore full employment was an adjustment of numerous individual wages and resource prices to the lower prices of many consumer goods. The extent to which any individual money wage or resource price might have to adjust downwards depended on the distinct supply and demand conditions in each of the individual markets.

An inflationary policy attempts to bring some individual price-wage relationships back into balance by pushing prices up throughout the economy, Hazlitt explained.

> Because Keynes, with his lump, aggregate thinking, is opposed to restoring employment or equilibrium by small, gradual, piecemeal adjustments . . . we must achieve the same result by inflating the money supply and raising the price level, so everybody's *real* wages are slashed by the same percentage. . . . The Keynesian remedy, in short, is like changing the lock to avoid changing to the right key, or like adjusting the piano to the stool instead of the stool to the piano.[16]

Second, Hazlitt pointed out that workers and labor unions are aware of how rising prices affect the real value of money wages. There is certainly no "money illusion" in an upward direction. An increasing cost of living due to rising prices soon brings worker and union demands for higher pay to make up for lost purchasing power. But if workers and unions demand the same real wages they had before the inflation, then the Keynes solution to unemployment must fail.

Finally, Keynes's macroeconomic approach also concealed the fact that beneath the aggregate rising price level, inflation distorts many of the relative price relationships, including the rate of interest. This inevitably brings about misdirection of resources, capital, and labor across different sectors of the market that will eventually require a reshuffling of supply and demand once the inflation ends. Thus the inflationary "cure" for unemployment brings in its wake an eventual new bout of unemployment when workers have to shift jobs and readjust their wage demands in the post-inflationary period.

Indeed, in a series of chapters, Hazlitt clearly showed that Keynes was confused about the actual relationships among savings, investment, and the rate of interest. The core of his theory was founded on a bundle of errors and mistakes. This resulted in Keynes's failure to comprehend that saving, investment, and capital formation—not government-stimulated increases in aggregate consumer demand—are the foundations of sustainable employment and rising standards of living.[17]

Hazlitt also took Keynes to task for advocating increasing government control and direction of investment decision-making. Keynes clearly believed, Hazlitt sarcastically observed, "that there exists a class of people (perhaps economists very much resembling Lord Keynes) who are completely informed, rational, balanced, wise, who have means of knowing at all times exactly how much investment is needed and in exactly what amounts it should be allocated to exactly which industries and projects, and that these managers are above corruption and above any interest in the outcome of the next election."[18]

If *The General Theory* had so many fundamental flaws, how did it become, in the words of one of his most enthusiastic followers, "the Keynesian bible"?[19] Hazlitt offered some possible reasons in his introduction to his edited volume, *The Critics of Keynesian Economics*, which appeared a year after his own book. He suggested that Keynes's theories rationalized the politics of special-interest groups that desired to reap the benefits of an inflation. Also, while much of *The General Theory* is written in difficult language, Keynes could dazzle the reader with literary imagery and wit that hid his central logical flaws. Keynes used the "technique of obscure arguments followed by clear and triumphant conclusions," Hazlitt said. And finally, Hazlitt conjectured that the success of the book may have had a lot to do with its appearing to overthrow the existing orthodoxy in favor of radical and fashionable ideas about social engineering. "But whatever the full explanation of the Keynesian cult," Hazlitt concluded, "its existence is one of the great intellectual scandals of our age."[20]

The monolithic domination that Keynesian economics once had over all macroeconomic policy has been broken for more than two decades. While too many of Keynes's misconceptions still underlie how economists think about inflation, recession, and unemployment, the original and primitive Keynesian thinking has been more or less overthrown. To a great extent this is because of the thorough and brilliant demolition that Henry Hazlitt performed more than 40 years ago. □

1. Henry Hazlitt, *The Failure of the "New Economics": An Analysis of the Keynesian Fallacies* (Princeton: D. Van Nostrand, 1959), reprinted by the Foundation for Economic Education in 1995.

2. The most comprehensive biography of Keynes is Robert Skidelsky, *John Maynard Keynes: Hopes Betrayed, 1883–1920* (London: Macmillan, 1983), *John Maynard Keynes: The Economist as Saviour, 1920–1937* (London: Macmillan, 1992), and *John Maynard Keynes: Fighting for Britain, 1937–1946* (London: Macmillan, 2000); in addition, see, Roy H. Harrod, *The Life of John Maynard Keynes* (London: Macmillan, 1951), and D. E. Moggridge, *Maynard Keynes: An Economist's Biography* (London: Routledge, 1992). All of them are highly sympathetic to Keynes as an economist and policy advocate.

3. John Maynard Keynes, *The Economic Consequences of the Peace* (New York: Harcourt, Brace, 1920); see the critical analysis of Keynes's arguments about the peace treaty by Etienne Mantoux, *The Carthaginian Peace, or The Economic Consequences of Mr. Keynes* (New York: Charles Scribner's Sons, 1952).

4. John Maynard Keynes, *A Tract on Monetary Reform* (New York: Harcourt, Brace, 1924); see the critical analysis of Keynes's arguments by Benjamin M. Anderson, "The Gold Standard vs. 'A Managed Currency,'" *Chase Economic Bulletin*, March 23, 1925, p. 39.

5. John Maynard Keynes, *A Treatise on Money*, 2 vols. (New York: Harcourt Brace, 1930).

6. Friedrich A. Hayek, "Reflections on the Pure Theory of Money of Mr. J. M. Keynes," *Economica*, August 1931, pp. 270–95, and February 1932, pp. 22–44; reprinted in Bruce Caldwell, ed., *The Collected Works of F. A. Hayek*, vol. 9: *Contra Keynes and Cambridge: Essays, Correspondence* (Chicago: University of Chicago Press, 1995), pp. 121–97, which also includes Keynes's reply after the appearance of part I of Hayek's review and Hayek's rejoinder.

7. John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (New York Harcourt, Brace, 1936); he earlier presented an outline of his prescriptions for an "activist" government policy in *The Means to Prosperity* (London: Macmillan, 1933).

8. Some of these reviews, especially those by Frank Knight and Jacob Viner, were published together many years later in Henry Hazlitt, ed., *The Critics of Keynesian Economics* (Princeton: D. Van Nostrand, 1960); there were many others not included in this excellent anthology, especially the reviews and essays by Henry Simons, Joseph Schumpeter, Dennis Robertson, Arthur C. Pigou, Bertil Ohlin, Erik Lindahl, and Carl Landauer, which were highly critical and insightful about fundamental errors in Keynes's ideas.

9. Alvin H. Hansen, "Mr. Keynes on Underemployment Equilibrium," *Journal of Political Economy* (October 1936), p. 686. Hansen later wrote one of the most widely read popular expositions of Keynes's ideas; see his *A Guide to Keynes* (New York: McGraw-Hill, 1953).

10. For a detailed exposition of the alternative "Austrian" analysis of the causes and cures for the Great Depression compared to the Keynesian perspective, see Richard M. Ebeling, "The Austrian Economists and the Keynesian Revolution: The Great Depression and the Economics of the Short-Run" in Richard M. Ebeling, ed., *Human Action: A 50-Year Tribute* (Hillsdale, Mich.: Hillsdale College Press, 2000), pp. 15–110.

11. "We Are All Keynesians Now," *Time*, December 31, 1965, pp. 64–67B. The quotations are from pp. 64–65. Four years later, Milton Friedman appeared on the cover of *Time* (December 19, 1969, pp. 66–72), with the magazine now saying that "Friedman, a 57-year-old economics professor at the University of Chicago . . . has reached the scholar's pinnacle: leadership of a whole school of economic thought. It is called the 'Chicago School,' and its growing band of followers argues that the money supply is by far the most important and fastest-acting of the economic regulators at the Government's disposal. . . . [M]ost economists now consider themselves . . . hybrid . . . 'Friedmanesque Keynesians'" (p. 66).

12. Among the strongly anti-Keynesian critics who took his ideas to task in some detail were W. H. Hutt, *The Theory of Idle Resources* (London: Jonathan Cape, 1939); Arthur W. Marget, *The Theory of Prices: A Re-Examination of the Central Problems of Monetary Theory*, 2 vols. (New York: Augustus M. Kelley, 1966 [1938 and 1942]); Benjamin M. Anderson, "The Road Back to Full Employment" in Paul T. Homan and Fritz Machlup, eds., *Financing American Prosperity: A Symposium of Economists* (New York: Twentieth Century Fund, 1945), pp. 9–70; L. Albert Hahn, *The Economics of Illusion: A Critical Analysis of Contemporary Economic Theory and Policy* (New York: Squier Publishing, 1949), and *Common Sense Economics* (London/New York: Abeland-Schuman Ltd., 1956); Philip Cortney, *The Economic Munich* (New York: Philosophical Library, 1949); and Hans Mayer, "John Maynard Keynes' 'Neubegründung' der Wirtschaftstheorie" ["John Maynard Keynes's 'New Foundation' for Economic Theory"] in E. Lagler and J. Messner, eds., *Wirtschaftsliche Entwicklung und soziale Ordnung* [*Economic Development and Social Order*] (Wien: 1952), pp. 39–55.

13. Four years later another detailed critical study of Keynesian economics appeared: W. H. Hutt, *Keynesianism: Retrospect and Prospect: A Critical Restatement of Basic Economic Principles* (Chicago: Henry Regnery, 1963); it later appeared in a revised edition under the title *The Keynesian Episode: A Reassessment* (Indianapolis: Liberty Press, 1979); see also W. H. Hutt, *A Rehabilitation of Say's Law* (Athens: Ohio University Press, 1974).

14. Hazlitt, *The Failure of the "New Economics,"* p. 4: "I know of no single work that devotes itself to a critical chapter-by-chapter or theorem-by-theorem analysis of [*The General Theory*]. It is this task that I am undertaking here."

15. Ibid., pp. 361–71; see John Stuart Mill, "Of the Influence of Consumption on Production" [1844] in Hazlitt, ed., *The Critics of Keynesian Economics*, pp. 24–45.

16. *The Failure of the "New Economics,"* pp. 280–81; on the degree to which inflexible money wages relative to the prices for finished consumer goods raised the real cost of employing workers in the early 1930s, and therefore resulted in rising unemployment, see Richard K. Vedder and Lowell Gallaway, *Out of Work: Unemployment and Government in Twentieth-Century America* (New York/London: Holmes & Meier, 1993), pp. 79–95.

17. See also Henry Hazlitt, *The Conquest of Poverty* (New Rochelle, N.Y.: Arlington House, 1973), pp. 217–28.

18. *The Failure of the "New Economics,"* p. 324; on the arrogance in Keynes's thinking about an elite who are wise and good enough to macro-manage the economy, and the harmful real world consequences, see also James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977).

19. Seymour E. Harris, "About this Book," in Seymour E. Harris, ed., *The New Economics: Keynes' Influence on Theory and Public Policy* (New York: Alfred A. Knopf, 1948), p. 9.

20. Hazlitt, "Introduction" in *The Critics of Keynesian Economics*, pp. 9–10.

THE FREEMAN
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Private Enterprise Regained

by Henry Hazlitt

Governor Bradford's own history of the Plymouth Bay Colony over which he presided is a story that deserves to be far better known—particularly in an age that has acquired a mania for socialism and communism, regards them as peculiarly "progressive" and entirely new, and is sure that they represent "the wave of the future."

Most of us have forgotten that when the Pilgrim Fathers landed on the shores of Massachusetts they established a communist system. Out of their common product and storehouse they set up a system of rationing, though it came to "but a quarter of a pound of bread a day to each person." Even when harvest came, "it arose to but a little." A vicious circle seemed to set in. The people complained that they were too weak from want of food to tend the crops as they should. Deeply religious though they were, they took to stealing from each other. "So as it well appeared," writes Governor Bradford, "that famine must still ensue the next year also, if not some way prevented."

So the colonists, he continues, "began to think how they might raise as much corn as they could, and obtain a better crop than they had done, that they might not still thus languish in misery. At length [in 1623] after much debate of things, the Gov. (with the advice of the chiefest among them) gave way that they should set corn every man for his own particular, and in that regard trust to themselves. . . .

"And so assigned to every family a parcel of land. . . .

A Great Success

"This had very good success; for it made all hands very industrious, so as much more corn was planted than otherwise would have been by any means the Gov. or any other could use, and saved him a great deal of trouble, and gave far better content.

"The women now went willingly into the field, and took their little ones with them to set corn, which before would allege weakness, and inability; whom to have compelled would have been thought great tyranny and oppression.

"The experience that was had in this common course and condition, tried sundry years, and that among godly and sober men, may well evince the vanity of that conceit of Plato's and other ancients, applauded by some of later times;—that the taking away of property, and bringing in community into a commonwealth, would make them happy and flourishing; as if they were wiser than God. For this community (so far as it was) was found to breed much confusion and discontent, and retard much employment that would have been to their benefit and comfort.

This essay was written in 1949 and subsequently appeared in the first volume of FEE's Essays on Liberty, *published in 1952. Governor Bradford's spelling has been modernized.*

"For the young men that were most able and fit for labor and service did repine that they should spend their time and strength to work for other men's wives and children, without any recompense. The strong, or man of parts, had no more in division of victuals and clothes, than he that was weak and not able to do a quarter the other could; this was thought injustice. . . .

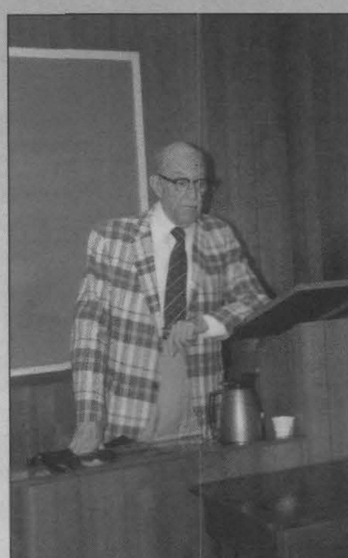
"And for men's wives to be commanded to do service for other men, as dressing their meat, washing their clothes, etc., they deemed it a kind of slavery, neither could many husbands well brook it. . . .

"By this time harvest was come, and instead of famine, now God gave them plenty, and the face of things was changed, to the rejoicing of the hearts of many, for which they blessed God. And the effect of their particular [private] planting was well seen, for all had, one way and other, pretty well to bring the year about, and some of the abler sort and more industrious had to spare, and sell to others, so as any general want or famine has not been among them since to this day."

The moral is too obvious to need elaboration. □

Henry Hazlitt Through the Years

A young Hazlitt (left) and companions on an outing



Henry Hazlitt lecturing in FEE's classroom in the 1980s

F.A. Harper, Henry Hazlitt, and Felix Morley at the first meeting of the Mont Pelerin Society in 1947

by Sheldon Richman

THE FREEMAN (Ideas On Liberty)
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Hazlitt as a Thinker

Henry Hazlitt was not only a prolific writer, he also succeeded at it early in life. In an unpublished autobiography, Hazlitt recalls that before landing his job at the *Wall Street Journal* in 1913, at the age of about 18, he finished writing his first book, "with the modest title" *Thinking as a Science*. He gave the manuscript to a friend, Lewis Mumford (1895–1990), who later became a prominent critic and historian, for comment.

Meanwhile, Hazlitt sent it to five or more publishers, each of which returned it with a form rejection. "Finally discouraged," he recalls, "I put it away in a drawer somewhere, where it lay for many months."

Then Mumford, having just read a book on thinking that he regarded as inferior to Hazlitt's, inquired about his manuscript. "I was ashamed to tell him of all my rejections and final discouragement," Hazlitt says. "So I mailed the manuscript off to still another publisher, E. P. Dutton & Company, then wrote Lewis admitting the previous rejections, but telling him the book was now in Dutton's hands."

About a month later, Hazlitt received a phone call from his mother while he was at work. "Dutton's has taken your book!" she said. Hazlitt assumed she had misunderstood the letter, so she read it to him. The first thing he did was "leap in the air."

His next feeling was fear. "I was afraid to accept Dutton's invitation to come to their office. I was sure that when they saw this kid they would try to get out of their offer. But finally I overcame my reluctance." He snapped at Dutton's offer, though the terms "would be considered incredible today": no royalties on the first 1,000 copies. "I do not believe the royalty rate rose above 10 percent," he writes.

As Hazlitt recalled the big day:

> A Mr. Acklom, who interviewed me, seemed to feel at one point that I did not sufficiently realize the chance they were taking on me. "You know, we make money on only one out of five of the books we print," he said.
>
> I must have looked at him as if he were a fool. "Why do you publish the other four?"

Hazlitt reports that the book "sold well for the market in those days." But how many copies, he didn't remember.

"So I was an author," Hazlitt wrote. "The notion went a little to my head, and it led me to make a serious mistake." The mistake was to imitate the writing style of Arnold Bennett, the British author whose self-improvement books had caught Hazlitt's fancy. "Then I wrote a full-length book, *The Way to Will Power*, in direct imitation of his style and themes, and submitted it to Dutton's. They published it! They had hardly done so when I realized that I had done the wrong thing; and for years, up to the present writing, I did not list the book among my writings in my *Who's Who* entry."

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Thinking as a Science came out in 1916, when Hazlitt was 21. He begins by noting that for each person a particular evil stands out above the rest. "I, too, have a pet little evil, to which in more passionate moments I am apt to attribute all the others. This evil is the neglect of thinking. And when I say thinking, I mean real thinking, independent thinking, hard thinking." And by that he meant "thinking with a purpose, with an end in view, thinking to solve a problem."

He proceeds to ruminate on thinking in great detail, outlining various methods and offering advice on how to think efficiently and maintain concentration. He discusses the relationship between thinking and writing, and thinking and reading. On the latter, Hazlitt endorses Schopenhauer's statement that "the safest way to have no thoughts of one's own is to take up a book every moment one has nothing else to do." Hazlitt was a champion of engaging in a little "unaided thought" about a subject before reading anything about it. To the man who claimed that one cannot say anything intelligent about economics before reading *The Wealth of Nations*, Hazlitt replied, "If this be true, Adam Smith himself was hardly qualified because he certainly could not have read his own book before he had written it!"

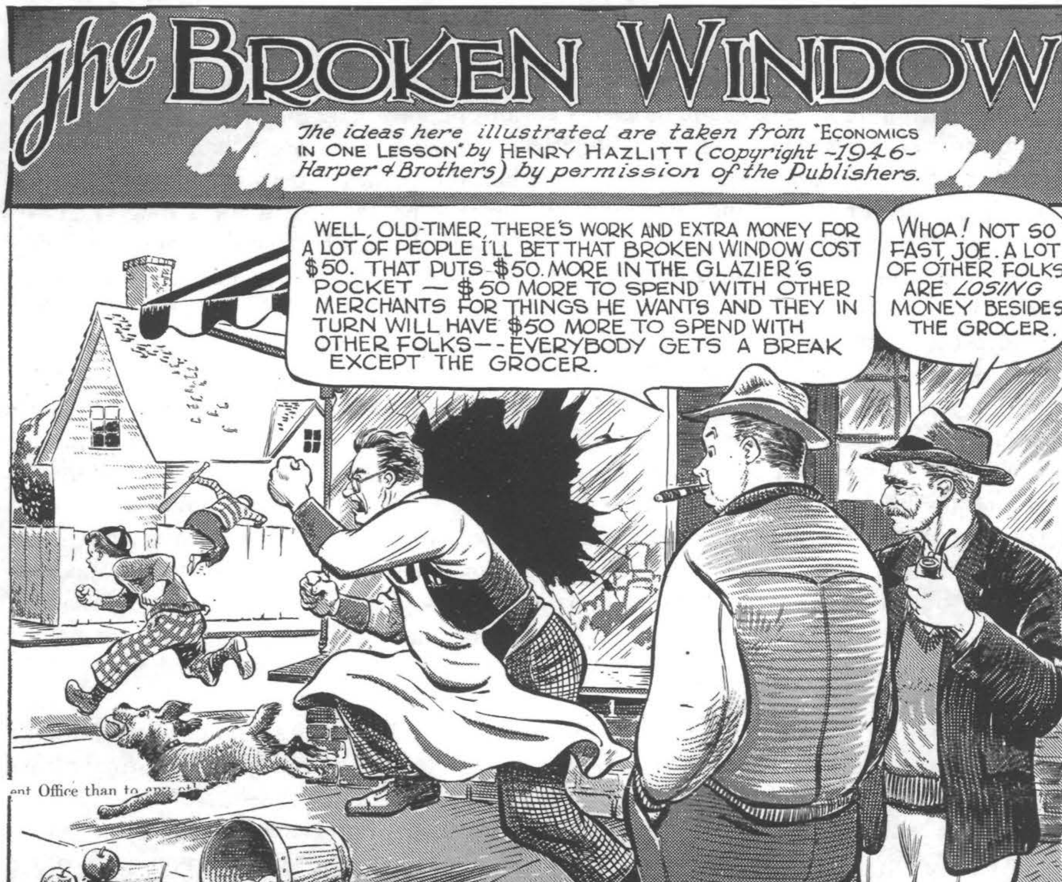
"Rules Are Needful"

Hazlitt concedes that "The great thinkers of the past improved their innate powers not by the study of rules for thinking, but by reading the works of other great thinkers, and unconsciously imitating their habitual method and caution." But he goes on to state that "Rules are needful because they teach in little time what would otherwise require much experience to learn, or which we might never discover for ourselves at all."

Hazlitt's chapter on prejudice is particularly relevant to those who wish to help others see the virtues of the freedom philosophy. He points out that people often hold to an opinion for reasons other than its validity. A person may resist changing an opinion because he has a personal interest in it, or because he has held it for a long while, or because changing it would require changing other opinions too, or because his current opinion is fashionable—or unfashionable. What we can learn from Hazlitt is that such a person is not likely to be open to the logic of sound economics and political philosophy. This fact reinforces FEE founder Leonard E. Read's principle that one should speak about the freedom philosophy only when someone has expressed interest in it. Force-feeding is not likely to succeed. Hazlitt's chapter brings to mind Jonathan Swift's maxim: "It is useless to attempt to reason a man out of a thing he was never reasoned into."

For Hazlitt, prejudice is not something to watch for only in others: "The distinguishing mark of the great thinkers of the ages was their comparative freedom from the prejudices of their time and community. In order to avoid these prejudices one must be constantly and uncompromisingly sounding his own opinions. Eternal vigilance is the price of an open mind."

In 1969 a new, slightly updated edition of Hazlitt's book was published. (This edition was reissued by University Press of the Pacific last summer.) In a new preface, Hazlitt explains that he resisted the temptation to rewrite the book, but he did add an epilogue discussing how he'd write it anew. Hazlitt fans will enjoy seeing the changes in this remarkable man's thinking between the ages of 21 and 75. □


The BROKEN WINDOW
The ideas here illustrated are taken from "ECONOMICS IN ONE LESSON" by HENRY HAZLITT (copyright -1946- Harper & Brothers) by permission of the Publishers.
WELL, OLD-TIMER, THERE'S WORK AND EXTRA MONEY FOR A LOT OF PEOPLE I'LL BET THAT BROKEN WINDOW COST $50. THAT PUTS $50. MORE IN THE GLAZIER'S POCKET — $50 MORE TO SPEND WITH OTHER MERCHANTS FOR THINGS HE WANTS AND THEY IN TURN WILL HAVE $50 MORE TO SPEND WITH OTHER FOLKS-- EVERYBODY GETS A BREAK EXCEPT THE GROCER.
WHOA! NOT SO FAST, JOE. A LOT OF OTHER FOLKS ARE *LOSING* MONEY BESIDES THE GROCER.
I DON'T FOLLOW YOU.
WELL, NOW THAT THE GROCER IS OUT $50 HE WON'T BE ABLE TO USE THAT MONEY TO BUY A NEW SUIT OR SOMETHING ELSE HE NEEDED — SO THE GLAZIER'S $50 GAIN IS THE TAILOR'S $50 LOSS. WHEN YOU ADD IT UP, THE COMMUNITY HAS NO MORE WINDOWS THAN IT HAD BEFORE *AND ONE LESS SUIT*. AND NO NEW EMPLOYMENT HAS BEEN ADDED.
NO HELP WANTED

WELL - UH— THAT'S ONE WAY OF LOOKING AT IT.
SURE - AND THE SAME THING APPLIES TO WASTE AND SPOILAGE IN OUR SHOP. THE MONEY THAT IT COSTS TO REPLACE SPOILED PARTS AND WASTE IS A COMPLETE LOSS. AS A RESULT THINGS THAT ARE NEEDED— —MAYBE NEW MACHINE TOOLS, NEW BUILDINGS AND SUPPLIES - CAN'T BE BOUGHT WITH THAT MONEY AND THE CARPENTERS, MASONS AND MACHINISTS WHO WOULD HAVE MADE THEM - ALL LOSE THE WORK.
SCRAP
SCRAP
BUT ISN'T THEIR LOSS BALANCED BY THE GAIN OF THE MINERS, STEEL-WORKERS AND MACH-INISTS WHO REPLACE THE WASTE?
NO, IT DOESN'T WORK OUT THAT WAY EITHER. REPLACING OUR WASTE SIMPLY TAKES FROM THE OTHER CUSTOMERS OF OUR SUPPLIERS, AND THE SAME GOES FOR US. THE ADDED PRODUCTION WE MIGHT HAVE HAD IS TOSSED RIGHT OUT THE WINDOW AND MACHINES LAY IDLE.
YOU MEAN THAT WASTE REALLY DOES MAKE A DIFFERENCE?
YOU BET! WASTE AND SPOILAGE, LIKE THE BROKEN WINDOW, BRING NO NEW EMPLOYMENT. INSTEAD THEY MEAN A LOSS TO EVERYONE — TO OURSELVES, TO OUR COMPANY AND TO OUR CUSTOMERS — — IN OTHER WORDS, JOE, *Waste hurts us all!*
WATCH YOUR WASTE LINE

THE FREEMAN (Ideas On Liberty)
NOVEMBER 2004

Economics in One Lesson: An Appreciation

by David R. Henderson

"The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups."

So writes Henry Hazlitt in chapter one of his classic, *Economics in One Lesson*. I first read this book at age 17, after I had seen it praised in an Ayn Rand publication. Hazlitt's book gave me my first strong grasp of basic economic reasoning. It made total sense to me: it was logical, factually based, and calmly reasoned. What was not to like?

Hazlitt did for twentieth-century economic journalism what his intellectual forefather, Frédéric Bastiat, did in early nineteenth-century France: He wrote in prose so clear that his ideas seem obvious. Reading it again from cover to cover after these many years was a rare treat. In 214 pages Hazlitt demolishes fallacy after fallacy. To document his tour de force in a complete way would cause me just to repeat much of his lucid reasoning. Therefore, I shall highlight some of the best examples, ones that are just as relevant in 2004 America as they were in his day.

A typically clear bit of reasoning is in chapter 6, "Credit Diverts Production." In that chapter, Hazlitt demolishes the case for government lending to favored industries. He points out that whereas private lenders seek to lend to those who have a high probability of repaying, governments often lend on fuzzier criteria. The result is that capital is diverted from good risks to not-so-good risks, which means that capital is wasted. If government did use the same strict standards that private lenders use, Hazlitt writes, there would be no good argument for government lending. In making his case, he points out that private lenders are selected by "a cruel market test." If they make bad mistakes, he notes, they are unlikely to have much money to lend in the future. Government lenders, by contrast, are either those who have passed civil-service exams and know how to answer hypothetical questions hypothetically, or those who can give the most plausible reasons for making loans and the most plausible explanations of why it wasn't their fault that the loans failed.

One of Ludwig von Mises's major contributions to the discussion of economic policy was his demonstration of how one government intervention often causes destructive consequences that the government recognizes and then tries to correct by intervening further, causing more destructive conse-

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quences, leading to more intervention, and so on. Hazlitt, a friend of Mises who learned a great deal from the Austrian master, applies his insight in the chapter on government credit. Hazlitt shows that government credit leads to favoritism and to recriminations whenever the taxpayers' money is thrown away on enterprises that fail. Because government loses taxpayers' money, Hazlitt writes, some people demand socialism, arguing that if taxpayers take the risks, why should private capitalists who got the cozy loans be able to take the profits? This increased demand for socialism is an unintended, and destructive, consequence of the original government loan program.

Another Hazlitt example of a government program whose unintended negative consequences lead to more intervention and more unintended negative consequences is the American government's subsidy of cotton in the 1950s. By fixing the price of cotton at a high level and offering to buy any amount not sold in the market, the government caused a huge oversupply. By August 1, 1956, the government had amassed a record 14,529,000 bales of cotton, more than a full year's normal production and consumption. So, to make cotton competitive in world markets, it offered a subsidy of 6 cents a pound to cotton exporters. The unintended, but completely predictable, result was that foreign textile producers got cotton at a lower price than U.S. producers did, which hurt U.S. textile producers.

Rent Control

Hazlitt's chapter on rent control is a high point of the book. In it Hazlitt covers virtually all the bases. First he shows how rent control, by keeping the rent below free-market levels, creates shortages. It also causes wasteful use of space, since families in rent-controlled apartments who need less space are less likely to move, because they might end up in a higher-priced, but smaller, non-rent-controlled apartment. Next, Hazlitt notes, because rent control also reduces the incentive to build new rental apartments, governments often exempt new construction from the controls. But builders are not stupid. They fear, justifiably, that once their apartments are built, governments, no matter what their promises, will proceed to impose controls on the new apartments. In fact, this is just what has happened in New York City.

That's not all. Rent control discourages landlords from remodeling and even maintaining apartments, thus creating ill will between tenants and landlords. Legislatures often respond by removing rent control from "luxury" apartments, while keeping it on low-grade apartments. The unintended result: builders are encouraged to build more luxury apartments and discouraged from building more low-cost housing. Hazlitt also points out that the tenants who benefit from rent control are often wealthier than the landlords who lose. And people in other businesses who support rent control because they care about tenants "do not go so far as to suggest that they themselves be asked to assume part of the tenant subsidy through taxation." Instead, the burden "falls on the single small class of people wicked enough to have built or to own rental housing."

One other virtue of *Economics in One Lesson* is Hazlitt's careful weaving of interesting historical facts with basic economic theory. In chapter 7, "The Curse of Machinery," for instance, Hazlitt takes on the argument that the introduction of machinery causes massive unemployment. He uses as an example the story of the cotton-spinning machinery invented by Richard Arkwright in 1760. At that time, notes Hazlitt, there were in England 5,200 spinners using spinning wheels and 2,700 weavers—a total of 7,900 people producing cotton textiles. Workers opposed Arkwright's machinery because they thought it threatened their livelihood. Yet just 27 years later, in 1787, the number of people producing cotton textiles had risen to 320,000, an increase of about 4,000 percent. (For some reason, the figure 4,400 appears in the book.)

Why the big increase? Precisely because of the machines. Hazlitt traces out the increased productivity from the machines' introduction, and then the lower prices of cotton textiles due to competition among various textile producers. The lowering of prices to a fraction of their previous level caused sales of cotton textiles to mushroom, and with it, employment. Hazlitt points out, though, that it is mistaken to think that the primary result of the machines was to create jobs. Rather, the primary result was to increase production and bring down prices, thus increasing standards of living. "It is no trick," he notes, to employ everybody. Even the most primitive economies had full employment. What they didn't have was high living standards. Interestingly, Hazlitt documents that even Gunnar Myrdal, who won the Nobel prize in economics along with Friedrich Hayek in 1974, opposed the introduction of labor-saving devices in underdeveloped countries because he thought they decreased the demand for labor.

Hazlitt does more than lay out basic economics and explode the fallacies behind various beliefs in government intervention. He also explains why much of the bad thinking is so widespread. In chapter 1, "The Lesson," Hazlitt notes that the inherent difficulties in understanding economics are multiplied a thousand times "by a factor that is insignificant in, say, physics, mathematics or medicine—the special pleading of selfish interests." No group is out lobbying for us to doubt whether gravity exists, some California bumper stickers to the contrary. But slick, well-paid, plausible-sounding lobbyists do try to make us doubt whether we're better off buying goods cheaper from foreign countries, because these spokesmen represent powerful interests whose jobs and wealth depend on persuading us that free trade causes losses.

In chapter 25, "The Lesson Restated," Hazlitt writes that the failure to see the subtle, long-term consequences of a government action is "an almost inevitable result" of the division of labor. With an extensive division of labor, each person typically specializes in producing one good while buying thousands of goods, and so, when the price of the good he produces falls, he tends to think this is a bad thing. But if the fall is due to, say, improved technology or a new opening to trade, it is a good thing, not for him, but for the society generally. Division of labor obscures this fact.

Although professional economists might be tempted to dismiss a book that claims to teach economics in one lesson, the fact is that few professional economists have ever read Hazlitt's book. More's the pity. Even some professional economists who pick it up might, I suspect, dismiss it as obvious and unsubtle. But what it really is is obvious and *subtle*—obvious because Hazlitt makes things so clear; subtle because his clarity helps him untangle otherwise complicated issues, such as the one discussed in the previous paragraph. As the famed H. L. Mencken wrote about Hazlitt on the book's jacket, "He is one of the few economists in human history who could really write." Indeed, were 100 professional economists to stop writing their abstract economics articles and, instead, start writing as clearly as Hazlitt on the same subjects he wrote on, the world would become dramatically more informed about economics, and well could become freer as a result. I'd settle for ten such economists.

Postscript

My article for a Hazlitt birthday is not complete without a personal recollection. I met Henry Hazlitt and his lovely wife, Frances, in June 1974 at the first Austrian economics conference in South Royalton, Vermont. The main thing I remember about him is what a nice man he was: charming, polite, and curious. At the time, I had a large head of dark-brown curly hair. When I was sitting talking to Frances, she ran her hand through my hair affectionately, smiling and joking about how much hair I had. I still get a surge of pleasure when I think of that two-second event. □

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The Legacy of Marx

by Henry Hazlitt

A number of women (and men) have recently been contending that women who are just as productive as men are being employed on the average for only about 70 percent as much pay, and that the statistics prove it.

I am not going to quarrel with the comparisons of men's and women's actual wages, but with the contention about productivity. In a market in which competition is permitted between employers and between workers, the situation ascribed could not long exist. What would prevent it, what does prevent it, is the selfishness of employers.

Let us suppose that there was an industry in which both male and female workers were producing enough to bring the employer an ascertainable added profit of just over $10 an hour, but in which the men workers were receiving $10 an hour, and the equally productive women workers only $7 an hour.

It would soon occur to an unscrupulously selfish employer that he should henceforth employ only women workers from which he could make a net $3 more an hour than from his male workers. He would let his men workers go. Other employers would follow his example, and for the same reason. But this would mean that the female workers would start demanding higher individual wages until their pay was on an equality with that previously received by males.

In other words, selfish employers would prefer to make only $2 an hour net by employing female labor at $8 an hour rather than see competing employers make $3 net out of them. They would even choose to make only $1 an hour net by paying them $9 an hour rather than stand by and watch other employers making $2 net out of them. This would continue until prevailing female wages in that industry were very close to female labor productivity in dollar terms. (In the long run, of course, there would be no drop in the prevailing men's pay, because their productivity would still make it profitable to employ them at that rate.)

To state this more briefly and bluntly, any employer would be a fool to hire male workers for $10 an hour when he could hire equally productive women workers for $7 an hour.

There are, it is true, special conditions, temporary and localized, in which labor productivity might not be the dominant factor in determining wage levels. In a small mill town, for example, in which there was only one mill, not large enough to employ the entire working population, the wages paid by that mill might fall below the worker-productivity level. But this would tend to prove only a temporary situation. Two developments would be likely to change it. The unemployed surplus workers would start to leave for other towns. And the mill owners would be tempted to reinvest their profits and expand their operations.

This article first appeared in The Freeman, *March 1986.*

So far, I have been writing about the factors that tend to eliminate wage discrimination on sexual grounds where it exists. But the same considerations would also tend to eliminate wage discrimination on grounds of color, race, nationality, or other reasons. Where such wage differences persist, they tend to reflect real differences in productivity.

Let me now carry my contention a giant step further. The selfishness of individual employers is the force that, under competitive capitalism, brings the level of wages up close to the full value of the productivity of the workers.

Of course, there are never conditions of perfect competition; of full knowledge on both sides, employer and employed, of their respective opportunities. There are individual accidents, immobilities, prejudices, and other factors that prevent everybody's wage or salary from corresponding with the approximate value of his or her contribution or output. But this correspondence is the dominant long-run *tendency*.

There is nothing original in this explanation. I have simply been stating, in fact, in an unusual form, what is known as the marginal-productivity theory of wages. This is the theory held by the overwhelming majority of serious economists today.

The Marginal-Productivity Theory of Value

This theory was astonishingly late in its development. It did not make its appearance until the very end of the nineteenth century, in the principal works of the Austrian economists Carl Menger (1871), Friedrich von Wieser (1884), and Eugen von Böhm-Bawerk (1884), and of the American economist John Bates Clark (1899).

Why did its development take so long? It took so long partly because the field was already occupied by other theories—wrong theories. And how did they in turn get started? They got started partly through the errors of writers that were in some respects acute and even profound thinkers. The first of these was the economist David Ricardo (1772–1823), who, by abstract reasoning, developed a labor theory of value in which the contributions of capital investment, initiative, invention, and management somehow got buried.

Then, along came Karl Marx. Ostensibly taking off from Ricardo, he presented a pure "exploitation" theory of wages, and declared outright that as long as the "capitalist system" continued in existence there could be no real improvement in the condition of workers.

This assertion was made in the face of some very noticeable improvement in the economic condition of the "masses" before 1848, when the *Communist Manifesto* was published, and certainly in the remaining 35 years of Marx's life.

Doubtless there was some excuse for Marx's failure to notice this improvement. In the early years of his life some relics of the medieval system were still around. Great tracts of land were still held by princes, dukes, and barons, and the men who tilled the soil were often forced to pay excessive rents. Production was by our present standards incredibly low. Capital goods—tools, implements, machinery, vehicles, and other equipment—were still rare, crude, and primitive. There was a scarcity of donkeys, horses, and other farm animals. On the farms, human beings were forced to carry great burdens on their own backs, as they still do in China today. Only very slowly were more capital goods produced. The great bulk of labor went into producing tomorrow's food and other necessities.

But let us now turn to the actual text of the *Communist Manifesto*. That document, of approximately 40 pages, was written by Karl Marx and Friedrich Engels partly as a call for civil war—"Working men of all countries, unite!"—partly as propaganda, and partly to explain the economic theories of Communism to the workers. But the reader will look in vain to find those theories spelled out in any reasoned form.

We are told that there are two main classes in society—the "proletariat," which consists of the "workers," employed and unemployed, and forms allegedly about nine-tenths of the population, and the "bourgeoisie," which consists of the employers and a few other groups who are comfortably well off. The bourgeoisie rule. They hire the proletariat; and because they do, they necessarily "exploit" them. The only way this dreadful situation can be changed is by revolution, in which the proletariat must seize all the property of the bourgeoisie, and, if they object, kill them.

The Marxist Exploitation Dogma

No explanation is offered in the *Manifesto* of how this "exploitation" is possible, or what is its exact extent. The word implies that the employers pay their workers only a fraction of what they are worth—of what they add to production or profits. The fraction is not mentioned. Let us say it is only 50 percent. As individual employers would be making such a big profit at that rate, and would obviously want to hire workers away from other employers, what stops them? The exploitation theory implies that the employers must all be in some secret agreement to keep wages down to this existing near-starvation level, and maintain it through the most drastic penalties against humane employers, if any, who attempt to offer more. "The average price of wage-labor is the minimum wage, i.e., that quantum of the means of subsistence which is absolutely requisite to keep the laborer in bare existence as a laborer."

All this is pure fiction. The exploitation theory implies that the wage level cannot rise. In trying to maintain this, the *Manifesto* quickly falls into inconsistencies and self-contradictions. We are told that: "The bourgeoisie, by the rapid improvement of all instruments of production . . . draws even the most barbarian nations into civilization. The cheap prices of its commodities are the heavy artillery with which it batters down all Chinese walls. . . . The bourgeoisie, during its rule of scarce one-hundred years, has created more massive and more colossal productive forces than have all preceding generations together," with "whole populations conjured out of the ground."

But this enormously increased production could not have been possible without equally increased consumption. The increased population that the increased production made possible must have consisted mainly of the proletarians, and the increased production itself could only have taken place in response to an increased demand. This demand must have been made possible by increased purchasing power, and that in turn either by increased wages or lower prices. But nowhere in the *Manifesto* is this necessary chain of causation acknowledged. The exploitation dogma blinded Marx to the obvious.

The *Manifesto* keeps compounding its economic errors. Obviously capital—which is most usefully thought of as capital goods—is used because it increases production. And because it increases production, it must increase the income of the owner or user. The carpenter would get nowhere without the use of hammers, saws, chisels, and even more elaborate machinery. And so for all other artisans. These tools and machines must at least promise to "pay for themselves" before they are acquired.

Yet we find the authors of the *Manifesto* writing: "In proportion as *the use of machinery* and division of labor *increases*, in the same proportion the burden of toil *increases*, whether by prolongation of the working hours, by increase in the work exacted in a given time, or by increased speed of the machinery, etc." (My italics.) Even if the reduction in weekly working hours recorded through the years did not show this *Manifesto* statement to be false, it was nonsense on its face. Yet Marx and Engels go on: "Machinery obliterates all distinctions of labor, and *reduces* wages to the same level!" (My italics.)

The Historical Record

From the 1830s on, however, the historic record shows a reduction of hours and an increase of wages from the introduction of machinery. Prof. W. H. Hutt, in his essay on *The Factory System of the Early Nineteenth Century*, writes: "That the apparent benefits wrought by the early Factory Acts are largely illusory is suggested by the steady improvement which was undoubtedly taking place before 1833, partly as a result of the development of the factory system itself" (*Capitalism and the Historians*, edited by F. A. Hayek, p. 181).

Tooke and Newmarch, in their book *A History of Prices From 1792 to 1856*, publish extracts from a report issued by the City Chamberlain of Glasgow in 1856. This records that in 1856 wages of skilled labor in the building trades (masons, carpenters, and joiners) increased 20 percent from the level of 1850–1, and wages of unskilled labor 48 percent in the same period. He attributes this principally to "increased production in consequence of improvements in machinery."

"It must also be borne in mind," he adds, "that weavers and spinners worked 69 hours per week in 1841 and only 60 hours in 1851–6, and hence received in 1851–6 more money for less labor." He also notes at another point that in 1850: "The number of hours per week worked by masons, carpenters and other artisans employed in the building trades was 60 hours, or six days of 10 hours each, with a deduction of 1½ hours for meals. Since 1853, the weekly time has been reduced to 57 hours."

For the United States (which seems to have lagged greatly behind England), the official publication, *Historical Statistics of the U.S.: Colonial Times to 1957*, reports (p. 90) that in 1860, the weighted average of working hours in all industries was 11 hours a day (Monday through Saturday inclusive), and that by 1891 this had fallen to 10 hours. In 1890, the working week was 60 hours (6 times 10 daily) and by 1926 had fallen to 50.3.

Recent issues of government publications, the annual *Statistical Abstract* and the current monthly *Economic Indicators*, show that the average of manufacturing hours fell from 51 a week in 1909 to 39.8 in 1957 and to 35 in 1985. Thus average working hours per week under capitalism, in other words, show a steady fall for nearly a century and a half.

In the *Manifesto*, our two authors mention frequently how "the competition between the workers" undermines solidarity and reduces wages. But they never once acknowledge the existence of competition among employers for workers. It is precisely this that brings wages up to the value of the workers' specific contribution to output. And this is not because the employers have or need to have any altruistic motives, but simply the motive of maximizing their own individual profits.

The Ominous Appeal of Hatred

Karl Marx must himself later have felt a great deal of misgiving about the lack of any real explanation of the maleficent workings of the existing economic system that he had portrayed in the *Manifesto*. For in 1867 he published (in Germany) a volume entitled *Das Kapital*. This was apparently intended to be the first of further volumes, but though Marx lived to 1883, nothing more appeared. Some commentators have surmised that Marx had reached an impasse, and could not decide how to continue. After Marx died, Engels undertook to "complete" the work in three volumes by supplementing his friend's unfinished manuscripts. The Austrian economist Eugen von Böhm-Bawerk thoroughly demolished the argument of the finished work in his *Karl Marx and the Close of His System* (1896), a masterful refutation that does not have to be done again.

Let me remind the reader once more that the thesis with which I began this piece—that the assumption of pure selfish competition on the part of the employers would be enough to explain how workers on the average receive practically the full value of their productive contribution—is only a novel way of presenting the marginal-productivity theory of wages, now accepted by the overwhelming majority of present-day economists.

The factual substantiation of that theory is particularly impressive in the United States. The annual reports of nonfinancial corporation earnings, going back for more than thirty years, show that the employees today receive an average of about 90 percent of corporate gross earnings in their wages and the stockholders only about 10 percent in their profits. In fact, a man's personal income often seems to have little to do with whether he is technically an employee or an employer. A baseball, football, basketball, or prize-fighting star may receive an income in the million-dollar range, far above that of the promoter who technically employs him. It is a result of the star's "productivity"—his box-office appeal. It is the competition among promoters, employers, that brings this about.

Selfish Capitalists vs. the *Communist Manifesto*

From the standpoint of common sense, the appeal of the *Manifesto* to violence and class war seems entirely needless. If the proletariat (supposedly some nine-tenths of the population) would be better off under a Communist economy, all that was necessary was to make this clear to them, and they could be trusted to vote themselves into power and such an economy into being. (Democracy was emerging in Britain in 1848, and, for whites, already functioning in America.)

But such an appeal gave little promise of starting a "movement" or leading to early political action. Marx and Engels were agitators, activists—and shrewd psychologists. They knew that most people who find themselves at the bottom of the economic ladder are tempted to put the blame, not on themselves, but mainly on somebody else. The exploitation theory, however weak as an economic doctrine, was tremendously persuasive psychologically and as a call for action. It was an essential part of their propaganda.

So, though the *Communist Manifesto*, even in its own time, failed completely as an economic guidebook, it did succeed thoroughly in instilling class hatred. This hatred, unfortunately, has been its most permanent contribution. It was originally directed ostensibly against a special class, the bourgeoisie—the employers, and all those comparatively well off—in revenge for "exploiting" the workers.

But, with the passing years, the target of this hatred has been quietly changed. As the employing class in Russia was liquidated by various means, a still existing group had to be substituted. To stay in command, a dictatorship must continue to point to a powerful enemy to be feared and destroyed. Fortunately, such an enemy can still be pointed to. It is the "capitalist" nations as a whole, especially the United States. Sixty-eight years after the Bolshevik Revolution, most of the American population is notably better off than the population in the Soviet Union. Though Russian school children are taught that we are an "imperialist" nation, the American "proletariat" are now tacitly included, as the Russian "bourgeoisie" once explicitly were, among the people to be envied and somehow blamed for the plight of the Communist-ruled countries.

This newly directed fear and hatred are ominous. They have led to an enormous armament buildup in Russia, and to the development and storage of multiple nuclear weapons which are forcing the West to try to keep uneasy pace. None of us can foresee the ultimate outcome. □

THE FREEMAN (Ideas On Liberty)
NOVEMBER 2004

Hazlitt on Gold

by Jude Blanchette

Henry Hazlitt concentrated much of his thinking and writing on the topic of money, producing two books and dozens of articles and columns on the subject. His writings during the dark years following World War II, published on the editorial page of the *New York Times* and in *Newsweek*, offered intelligent readers ammunition against the feverish calls for monetary socialism. His anti-Keynesian columns and articles of the 1960s and '70s provided uncommon knowledge for those who sided against inflation, budget deficits, and the belief that "we owe it to ourselves."[1]

Hazlitt was well known for his views on monetary theory and specifically his advocacy of a gold standard. In its final, polished form, his case for the gold standard was profound and persuasive. What's more, the clarity and precision of his work made the subject accessible to the intelligent public.

Following in the footsteps of the Austrian economist Carl Menger (1840–1921), Hazlitt begins with the origin of money as a commodity. In times of barter, men traded goods directly—two eggs for six apples, for example. It soon became apparent to the more observant traders that there were goods preferred by almost all individuals who traded, and what's more, these highly demanded goods could be used to acquire other goods through indirect exchange. As Hazlitt explained it, "people tried to exchange their goods first for some article that nearly everybody wanted, so that they could exchange this article in turn for the exact things they happened to want."[2] Menger describes this *near* universal demand for a certain good as its "saleableness" (*Absatzfähigkeit*). Because of their numerous advantages over rival commodities, precious metals evolved through the marketplace to become money.[3]

No doubt part of gold's historical appeal as money was its allure. For some who disparage its monetary role, this is indicative of its hold over the imaginations of traders and merchants. Keynes disparagingly called it "*auri sacra fames*" ("the accursed hunger for gold").[4] Hazlitt, however, thought this was one of the attributes that made gold superior to paper money. To be universally desired (and hence to have a high degree of "saleableness"), gold (or whatever commodity came to be used as money) must be held in high esteem; that is, it must be desired by almost all consumers at almost all times. Besides its aesthetic value, gold never spoils and is extremely scarce. As Hazlitt wrote, it could be "hammered or stamped into almost any shape or precisely divided into any desired size or unit of weight."[5] As transactions in gold became omnipresent, traders looked for more efficient ways to exchange goods for gold.

The advent of banks was for Hazlitt another example of the market's supplying

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society with a newer and better way of doing business. Yet Hazlitt also believed that with the appearance of banks, economic booms and busts were born. Banks began simply as depositories for gold. An individual would carry or keep at home enough gold to facilitate daily or small transactions, and would store the rest in a bank vault. When a larger purchase was to be made or when gold for daily purchases was running low, he would return to the bank for more. As Hazlitt wrote, "Then came a development that probably no one had originally foreseen. The people who had left their gold in a [bank] vault found, when they wanted to make a purchase or pay a debt, that they did not have to go to the vaults themselves for their gold. They could simply issue an order to the [banker] to pay over the gold to the person from whom they had purchased something." He continued, "If the receipts were made out by the [bank], for round sums payable to bearer, they were bank notes. If they were orders to pay made out by the legal owners of the gold themselves, for varying specified amounts to be paid to particular persons, they were checks."[6]

The Roots of Fractional-Reserve Banking

It is from this system, however, that fractional-reserve banking evolved, Hazlitt writes. And from this came the devastating economic fluctuations known as the business cycle. Bankers soon began to realize that the amount of gold demanded in its physical form was far less than the amount of gold held in reserve. For the entrepreneurial banker here was a profit opportunity. If loans were made from the present gold stock and this gold stock was rarely touched, why not increase the amount of outstanding credit beyond the bank's reserve capability? Hazlitt notes that "honest" banks would not expand credit beyond what they had in *total* assets, that is, the amount of gold in reserve plus the amount of assets held as collateral for other existing loans. However, because gold deposits must be paid out on demand and assets held as collateral are to be returned at some fixed point in the future, a "bank might be 'solvent' (in the sense that the value of its assets equaled the value of its liabilities) but it would be at least partly 'illiquid.' If all its depositors demanded their gold at once, it could not possibly pay them all."

Thus according to Hazlitt, banks continued to lend funds above the amount of gold held in their vaults. It is here that the "boom" begins. Hazlitt outlines a hypothetical scenario in which banks lower their reserve ratio to 50 percent. With twice the lendable funds, banks are "now suddenly free to extend more credit. They can, in fact, extend twice as much credit as before. Previously, assuming they were lent up, they had to wait until one loan was paid off before they could extend another loan of similar size. Now they can keep extending more loans until the total is twice as great. The new credit plus competition causes them to lower their interest rates. The lower interest rates tempt more firms to borrow, because the lower costs of borrowing make more projects seem profitable than seemed profitable before."[7]

Hazlitt thus found in such credit expansion a cause of the business cycle, which he thought could occur even with "free banking," because banks would be pressured by competition constantly to lower their reserve ratios. While inflation under free banking would be substantially less than under government-managed credit expansion, it would persist nonetheless. Because of his profound dislike of inflation, regardless of the source, Hazlitt favored a "pure" gold standard, or a 100 percent reserve requirement. To secure this, Hazlitt advocated strict government regulation of required reserves. Any expansion of credit above the amount of gold held in reserve was fraudulent, and as such, should be prosecuted by government authorities, he wrote in *The Inflation Crisis, and How to Resolve It.*[8]

Here Hazlitt's position differs from that of his friend Ludwig von Mises, who saw the boom/bust phenomenon as exclusively government-created. While Hazlitt viewed interbank competition as a driving force behind the creation of fiduciary money, for Mises it was exactly *because* banks compete with one another that solvency is assured. Mises conceded that while a slow creation of bank credit would potentially occur under free banking, competitive forces would limit a bank's ability to inflate: "Since the overissuance of fiduciary media on the part of one bank . . . increases the amount to be paid by the expanding bank's clients to other people, it increases concomitantly the demand for the redemption of its money-substitutes. It thus forces the expanding bank back to a restraint."[9]

Subjective Valuation

Value in currency is not something that can be declared, decreed, or ordered by a government or any private institution, Hazlitt wrote. It is, like the value of all other economic goods, a matter of subjective valuation by market participants. While there is an objective purchasing power for money, it "is derived from the composite of . . . subjective valuations."[10] Economists and government planners who use crude mathematical formulas and rigid exchange relationships between money and prices miss the subjective and thus unquantifiable nature of money's value.

Hazlitt considered all monetary reform specious if it lacked gold redeemability. A monetary system either was sound or it was not. There was no middle ground. He also believed private citizens should be free to mint and circulate private coins for business transactions. Private paper currency would be allowed insofar as it was "redeemable on demand in the respective quantities of the metals specified."[11]

For Hazlitt a gold standard was preferable to any form of government-managed currency because no one controls it. "The supply of gold is governed by nature; it is not, like the supply of paper money, subject merely to the schemes of demagogues or the whims of politicians. Nobody ever thinks he has quite enough money. Once the idea is accepted that money is something whose supply is determined simply by the printing press, it becomes impossible for the politicians in power to resist the constant demands for further inflation."[12] Thus for Hazlitt the gold standard's inflexibility is its great strength. □

1. Henry Hazlitt, *Man vs. The Welfare State* (New Rochelle, N.Y.: Arlington House, 1969), pp. 10–14.
2. Ibid., p. 154.
3. For an interesting fictional description of this process, see Henry Hazlitt, *Time Will Run Back* (New Rochelle, N.Y.: Arlington House, 1966), pp. 186–212.
4. John Maynard Keynes, *Essays in Persuasion* (New York: Harcourt, Brace and Company, 1932).
5. *Man vs. The Welfare State*, p. 154.
6. Ibid., p. 155.
7. Henry Hazlitt, "Gold Versus Fractional Reserve," *The Freeman*, May 1979, pp. 259–66.
8. Henry Hazlitt, *The Inflation Crisis, and How to Resolve It* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1995 [1997]), pp 187–88.
9. Ludwig von Mises, *Human Action: A Treatise on Economics* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996), p. 444.
10. *The Inflation Crisis*, p. 89.
11. Ibid., p. 187.
12. *Man vs. The Welfare State*, p. 162.

THE FREEMAN
Ideas On Liberty
NOVEMBER 2004

The Mont Pelerin Society

by Henry Hazlitt

Editor's Note: The following is an excerpt from Henry Hazlitt's unpublished autobiography, My Life and Conclusions, *written in 1984, as he turned 90.*

I once had the good fortune to be present at a triangular conversation with Ludwig von Mises and Professor William Rappard of the Institute of High International Studies of Geneva. Dr. Rappard had just been appointed by the United Nations as a member of a commission to promote international intellectual cooperation and was poking light fun at the appointment:

"Now international intellectual cooperation," he was saying, "consists in this: that one man writes a book, and another man reads it."

His description was, of course, correct—but not all-inclusive. Face-to-face meetings, in addition, can be very important. And this was something that Rappard himself recognized when he seconded and supported the initiative of Professor F. A. Hayek, then of the London School of Economics, in calling together a group of 36 economists, political scientists, journalists, and three observers, altogether from ten different countries—Belgium, Denmark, England, France, Germany, Italy, Norway, Sweden, Switzerland, and the United States. . . .

It speaks volumes for Hayek's scholarship that this list of 36 participants was picked solely by him, so far as I am aware, and out of his personal knowledge of what each had done and written.

The inclusion of myself may need some special explanation. I was then an editorial writer on the *New York Times*. In 1944 John Chamberlain, who was then book editor of the *Times* and writing a three-times-a-week column, dropped into my office to let me know that he had written an introduction to a book by F. A. Hayek, then in England, called *The Road to Serfdom*, that was appearing a few weeks from then, and that he thought I might be interested in reviewing it. I told Donald Adams, who was then editor of the Sunday book section, of my interest, and he turned the book over to me.

I was deeply impressed by it, and wrote that "Frederick [sic] A. Hayek has written one of the most important books of our generation. It states for our time the issue between liberty and authority. It is an arresting call to all well-intentioned planners and socialists, to all those who are sincere democrats and liberals at heart, to stop, look, and listen."

When Donald Adams gave me the book for review, he had probably planned on publishing what I wrote somewhere on the back pages. When it arrived, he decided to run it on page one. As a result, as I remember, the book appeared immediately on the list of the ten bestsellers among nonfiction volumes.

A slightly later consequence was that *Reader's Digest* of April 1945 printed a condensation of the book preceded by comments from my review.

But before I say anything about what went on at Mont Pelerin itself, I must tell of the ocean trip that took some of us there.

I have already pointed out that the largest national contingent present consisted of sixteen Americans. I do not think this was necessarily because Dr. Hayek thought that the largest number of qualified philosophical "liberals" were to be found there. But this may in fact have been so, because the list of "Americans" contained the names of such immigrants as Mises and [Fritz] Machlup. Probably, however, the American contingent was as large as it was because Hayek personally knew of that number.

Passage was booked for some of us on the *Queen Elizabeth*. At the table to which I was assigned there were also Professors Milton Friedman, Frank H. Knight, George J. Stigler, and V. Orval Watts. I've forgotten the exact seating arrangement, but I remember that Milton Friedman and I got into a friendly argument every night, and it was always about the same subject—Milton's strict quantity theory of money, which he seemed to have taken over from Irving Fisher.

I cannot remember why this argument was so persistent, which one of us most often initiated it, or which of us was more disputatious. What I do remember is that neither of us ever convinced the other of anything. We always ended precisely where we began. But the argument never became bitter or personal. The others at the table took very little part in it and seemed to be bored by it.

So far as I can recall now, this is the only major theoretical or policy issue in which I differ from Milton except that I take the subjective view characteristic of Austrian economics, while Milton still seems to find this as alien as it sounds.

The Mont Pelerin meeting lasted from April 1 to 10, 1947. On the opening day Dr. Hayek made a lengthy address telling his reasons for calling the conference. Briefly, they were to bring together a group of economic and political "liberals" (using the word in its traditional sense) from as many countries in the world as could be found and form a permanent society where they could mutually clarify and purify their ideas and ideals and help increase their individual and collective influence. In his words:

"The immediate purpose of this conference is . . . to provide an opportunity for a comparatively small group of those who in different parts of the world are striving for the same ideals, to get personally acquainted, to profit from each other's experiences and perhaps also to give encouragement to each other."

. . . Dr. Hayek's speech was followed by a talk from Professor Rappard. . . . His talk was mainly devoted to supporting and supplementing Hayek's own remarks, but he wandered into a discussion of "the economic man" as conceived by Adam Smith, and how far this concept could be stretched. . . .

It was at this meeting, I believe, that Hayek made the proposal that the permanent organization he had in mind should be called The Acton-Tocqueville Society, after Lord Acton of England and Alexis de Tocqueville of France. Immediately Ludwig von Mises stood up and argued against this. I do not believe that he, any more than any of the rest of us, knew that this particular proposal would be made. But out of his amazing range of knowledge he began to list the mistakes that he thought both Lord Acton and Tocqueville had made in their lives and the criticism that might be made of them and therefore of the society. He went on to point out that we were meeting at a place called Mont Pelerin, and that if we called ourselves the Mont Pelerin Society the name would be quite neutral and not open to attack. It had, in addition, a positive value. "Pèlerin" was the French word for "pilgrim." "Pilgrim" had a good name, especially in United States history.

Mises's suggestion was adopted, we became "The Mont Pelerin Society."

I found the meeting immensely stimulating, as I am sure most of the others did also. I formed friendships that lasted through life; and in my subsequent trips abroad, I made a point of visiting these foreign friends. I attended the next two or three annual meetings of the Society as it met in various places in Europe. But nothing equaled the stimulation of the first meeting, in discovering people in many nations who shared the same economic and political ideas and ideals. □

THE FREEMAN (Ideas On Liberty)
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Hazlitt's *The Foundations of Morality*

by Leland B. Yeager

Editor's Note: In 1964 Henry Hazlitt published what would become one of the books of which he was most proud, The Foundations of Morality. *The following first appeared as the foreword to the 1998 FEE edition of Hazlitt's book.*

Any sensible policy position presupposes understanding the reality that the natural and social sciences investigate. It also presupposes value judgments—notions of good and bad, desirable and undesirable, right and wrong. Ethics thus enters not only into private lives but also into public policy. But what is the grounding of ethics?

For many decades, utilitarian ethics has undeservedly had a bad press, not least in libertarian circles. It draws scorn as the mindset of crass, grasping, unprincipled people. It supposedly invites government hyperactivity aimed at maximizing some misconceived aggregate welfare. The critics would instead ground ethics and policy in noble and intuitively obvious principles such as unswerving respect for human dignity and natural human rights.

In this hostile intellectual atmosphere, Henry Hazlitt forthrightly and courageously avows a utilitarian ethics (although he did seek a more attractive label, perhaps cooperatism). Two classical-liberal think tanks, earlier the Institute for Humane Studies and now FEE, also deserve admiration for keeping his book in print. Hazlitt does not scorn human dignity and rights—of course not. But precisely because they are important, those values deserve a solider grounding than mere intuitions reported in noble-sounding language. The inviolability of rights rests, he says, "not . . . on some mystical yet self-evident 'law of nature' . . . [but] ultimately (though it will shock many to hear this) utilitarian considerations" (p. 286). Utilitarian philosophers can give reasons, grounded in reality, for respecting cherished values and the standard precepts of morality.

The bare facts of objective reality cannot by themselves provide this grounding. Some fundamental value judgment (or conceivably more than one) is also necessary, a judgment so ultimate that it lies beyond any series of reasons one might offer. Examples of relatively *specific* value judgments, in contrast, are the standard condemnations of murder, lying, cheating, and stealing. For them, one can give reasons that adduce the realities of human affairs, as well as some further and fundamental intuition. Only sloppy ethical theorizing appeals to a variety of specific intuitions instead of to one broad and fun-

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damental value judgment. Hazlitt recommends applying Occam's razor to the promiscuous multiplication of alleged intuitions.

The one fundamental intuition of utilitarianism is approval of human flourishing, of people's success in making good lives for themselves, and disapproval of the opposite conditions. To use a single word for each, though each word requires much unpacking, utilitarianism welcomes happiness and regrets misery. This is a tame value judgment, to be sure; but combined with positive knowledge of the physical world and human affairs, it goes a long way in ethics. What fundamental value judgment or criterion could be more plausible?

Henry Hazlitt's great insight, following writers like David Hume and Ludwig von Mises, is that direct appeal to the criterion of happiness over misery is seldom necessary. A surrogate criterion is more tractable. Mises and Hazlitt call it "social cooperation." It means a well-functioning society, one in which people live together peaceably to their mutual advantage, all reaping gains from specialization and trade, trade not only in the narrow business sense but also in the informal interactions and mutual accommodations and courtesies of everyday life. Actions, institutions, rules, principles, customs, ideals, dispositions, and character traits count as good or bad according as they support or undercut such a society, which is prerequisite to the happiness of its members. Economics and the other social and natural sciences have much to say about what does support or undercut social cooperation.

Hazlitt gives powerful reasons for repudiating the brand of utilitarianism ("act-utilitarianism") that calls for whatever action seems most likely, on each particular occasion, to contribute most to the sum total of happiness. Although that brand has now sunk almost to the status of a mere straw man, it remains the favorite target of superficial critics of utilitarianism. Hazlitt advocates "rules-utilitarianism" instead, which, following John Gray's reading of John Stuart Mill, might better be named "indirect utilitarianism." Hazlitt calls for adherence, almost without exception, to ethical principles that do satisfy the utilitarian criterion.

Hazlitt also argues that the interests of the individual are not fundamentally in opposition to those of "society." A person's rightly conceived or long-run self-interest coincides with what serves social cooperation. (This reconciliation holds in a long-run or probabilistic sense, as the Austrian philosopher Moritz Schlick and others have explained; for life offers no absolute guarantees.)

Of all of Hazlitt's books on various topics and of all books on ethics that I have read, *The Foundations of Morality* is my favorite by far. Hazlitt himself, in a 1977 interview, called it his own favorite among the fifteen books he had then written. Yet—let us face the fact—it has so far made only a small splash among academic philosophers and economists. Why? One reason, I suppose, is that Hazlitt lacked the standard academic credentials. He was a profoundly educated man, but mostly self-educated. Holding no professorship, he could form no school of students and disciples. The book itself, with its many long direct quotations from other writers, may have repelled potential readers who merely flipped through it. But Hazlitt chose his quotations remarkably well, and they do help carry his own argument forward.

Hazlitt's book is admirable not only for substance but also for writing style. The editor of a condensed version (also published by FEE) could not employ the "Reader's Digest" approach. As I understand it, that approach tries to squeeze out superfluous words by rewriting even individual sentences and paragraphs. Hazlitt's writing left little scope for such tightening. Instead, the editor had to discard large chunks of text, including whole paragraphs, quotations, and chapters. Readers graduating to—or starting with—the complete book deserve congratulations. It is a full exposition of the intelligent utilitarianism that provides (in my view) the soundest philosophical basis for the humane society that is the ideal of classical liberals. □

THE FREEMAN
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Inflation in One Page

by Henry Hazlitt

1. Inflation is an increase in the quantity of money and credit. Its chief consequence is soaring prices. Therefore inflation—if we misuse the term to mean the rising prices themselves—is caused solely by printing more money. For this the government's monetary policies are entirely responsible.

2. The most frequent reason for printing more money is the existence of an unbalanced budget. Unbalanced budgets are caused by extravagant expenditures which the government is unwilling or unable to pay for by raising corresponding tax revenues. The excessive expenditures are mainly the result of government efforts to redistribute wealth and income—in short, to force the productive to support the unproductive. This erodes the working incentives of both the productive and the unproductive.

3. The causes of inflation are not, as so often said, "multiple and complex," but simply the result of printing too much money. There is no such thing as "cost-push" inflation. If, without an increase in the stock of money, wages or other costs are forced up, and producers try to pass these costs along by raising their selling prices, most of them will merely sell fewer goods. The result will be reduced output and loss of jobs. Higher costs can only be passed along in higher selling prices when consumers have more money to pay the higher prices.

4. Price controls cannot stop or slow down inflation. They always do harm. Price controls simply squeeze or wipe out profit margins, disrupt production, and lead to bottlenecks and shortages. All government price and wage control, or even "monitoring," is merely an attempt by the politicians to shift the blame for inflation on to producers and sellers instead of their own monetary policies.

5. Prolonged inflation never "stimulates" the economy. On the contrary, it unbalances, disrupts, and misdirects production and employment. Unemployment is mainly caused by excessive wage rates in some industries, brought about either by extortionate union demands, by minimum-wage laws (which keep teenagers and the unskilled out of jobs), or by prolonged and overgenerous unemployment insurance.

6. To avoid irreparable damage, the budget must be balanced at the earliest possible moment, and not in some sweet by-and-by. Balance must be brought about by slashing reckless spending, and not by increasing the tax burden that is already undermining incentives and production. □

This is reprinted from The Freeman, *May 1978.*

BOOKS

The Roads to Modernity: The British, French, and American Enlightenments

by Gertrude Himmelfarb

Knopf • 2004 • 304 pages • $25.00 hardcover

by Richard M. Ebeling

In 1945, Austrian economist F. A. Hayek delivered a lecture on what he called "Individualism: True and False." The gist of his argument was that there had been a great deal of confusion and misunderstanding concerning the relationship between the individual and society, both in terms of social theory and practical politics.

He juxtaposed what he suggested could be considered two traditions of social and political individualism: the British and the French. The British tradition included such thinkers as John Locke, Bernard Mandeville, Edmund Burke, David Hume, Adam Smith, and Adam Ferguson (the last three of whom were among those often referred to as the Scottish moral philosophers). For these British thinkers, social theory began with a focus on the individual because they understood that "society" is not an entity separate from the interactions of the individuals who comprise it. To understand the origin and evolution of society, we must understand the logic and interactive processes of human action.

Furthermore, in this British tradition the conception of man is not that of a rational calculator presumed to possess perfect knowledge and guided only by a narrow material notion of "self-interest." Instead, man was seen as motivated by passions as much as by cool reason, with imperfect and limited knowledge. The social order and many of its institutional traditions, customs, and rules of interaction have evolved slowly and in unanticipated and unpredictable ways over many human lifetimes. Much of what is called human society and civilization is seen as "the result of human action, but not the execution of any human design" (to use the phrase coined by Ferguson and often quoted by Hayek).

Thus the British tradition of individualism had little confidence in the ability to plan society. And particularly because of man's imperfections and foibles, these thinkers were reluctant to see power centralized in the hands of government. Far better to decentralize decision-making in the private competitive market so as to limit the potential damage from error and abuse.

In the alternative French tradition represented by thinkers such as Descartes, Hayek argued, there was a tendency toward hyper-rationality, a belief that man through his reason could understand clearly and definitely how to remake society. All social institutions and traditions not "provable" through logic and rational reflection to be "useful" or "good" were to be criticized and torn down. In their place would be constructed a new world according to a politically planned design. In many of his writings over the years, Hayek tried to show the "fatal conceit" in those who presumed to possess the knowledge and ability to reconstruct man and society in their own "enlightened" image.

From a different conceptual vantage point and with other interpretative purposes in mind, the historian Gertrude Himmelfarb offers a similar contrast between these two traditions in her recent book, *The Roads to Modernity*. She highlights those aspects of the French Enlightenment that emphasized the power of man's reason to comprehend not only the natural world, but the social order as well. Superstition—and all religion in the eyes of many of these French thinkers represented superstition—blinded man from seeing the world as it really is. Pure reason could cut through the jungle of irrational tradition and custom to clear the way for man to remold society to his liking. But such reasoning was not open to all men, most of whom were mired in ignorance and unable to think clearly. An elite of enlightened thinkers could be trusted to design a utopia for mankind. Himmelfarb reminds us that such hubris led to the reign of terror and dictatorship in the wake of the French Revolution.

She points out that while the Enlightenment is often identified with this circle of French thinkers, there were two other eighteenth-century Enlightenment traditions, the British and the American. Himmelfarb argues that rather than being a cult of reason, the British tradition was concerned with understanding society and its foundations in the character and nature of men. Besides his unique reasoning quality, man also possesses a social and moral sense that makes him sensitive to the circumstances of his fellow human beings.

While the degree of religious faith varied among these British thinkers, they all believed that man's potential for personal and social virtue was an outgrowth of and inseparable from an understanding of his relationship to a higher Being who breathed these qualities into the human character. This fostered a sense of individual responsibility and a spirit of benevolence and charity toward others that generated a vast array of voluntary philanthropic associations to assist in alleviating the hardships of the less fortunate in society. As Himmelfarb points out, this was neither inconsistent with nor antagonistic to a general acceptance of Adam Smith's conception of a "system of natural liberty," in which men normally interacted in a network of free-market commerce and exchange.

The unique quality of the American Enlightenment, she says, was its development of institutions for the preservation of political liberty. The constitutional order that the Founding Fathers produced encapsulated their vision of a system that would leave men free to pursue their personal and social virtues without the heavy-handed presence of political domination. She gives special attention to the extent to which the Founding Fathers considered that the spirit and practice of freedom were grounded in religious conviction.

Equally important, Himmelfarb points out the role that self-interest was seen to play in maintaining a free and good society. She contrasts the ancient world's notion of heroism and great men with the American ideal of ordinary free men learning and practicing virtuous conduct through the interplay of commerce and industry. The marketplace fosters good and moral conduct that establishes standards in social affairs which help maintain the health of a free society.

In the concluding chapter, Himmelfarb highlights those features that have made the American experience unique and which she thinks still undergird the character and conduct of the American people today. She surely underestimates the extent to which the interventionist-welfare state has undermined the spirit of self-responsibility that existed in America, say, a hundred years ago. She also seems not to see the extent to which the welfare state (some aspects of which she clearly supports) is fundamentally inconsistent with her ideal of free and virtuous people.

Nonetheless, her book offers a useful and often insightful appreciation of the far-more-enlightened British and American Enlightenment traditions, which have been unfairly overshadowed by the French tradition. □

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You Can't Say That! The Growing Threat to Civil Liberties from Antidiscrimination Laws

by David E. Bernstein

Cato Institute • 2003 • 166 pages • $20

Reviewed by George C. Leef

The chiseling away of constitutional limits on government power is a topic familiar to readers of these pages. For a long time the First Amendment's prohibition against laws that infringe freedom of speech remained relatively untouched by people who would like to use state power to silence their opponents. But as David Bernstein, a George Mason University law professor, reports in *You Can't Say That!* the First Amendment is now taking some heavy blows.

The old restrictions on free speech were mostly confined to "commercial" speech, communications by businesses. That was bad enough. The new threat to civil liberties, Bernstein argues, comes from America's sweeping "antidiscrimination" laws, and almost anyone might find himself in trouble for his speech or thoughts. "Intolerant activists are determined to impose their moralistic views on all Americans, regardless of the consequences for civil liberties," Bernstein writes.

Before discussing the numerous ways this new threat shows itself, Bernstein takes on the preliminary question: Should the First Amendment take priority over the supposed need to stop discrimination? That might seem like a "no-brainer," but there are quite a few scholars who disagree, contending that, as Bernstein writes, "First Amendment rights should be subordinated to antidiscrimination claims because the 'constitutional value' of equality as reflected in the Fourteenth Amendment is in tension with the First Amendment 'value' of freedom of expression."

Bernstein quickly dispatches that argument. The Fourteenth Amendment only applies to government. When an individual says even the most flagrantly racist things, the First Amendment protects him from government sanctions—or should. The alleged "tension" between the "values" of the two amendments is merely a thin excuse for giving the state power to punish anyone who harbors the wrong sentiments. Going beyond the Constitution, though, Bernstein maintains that freedom of speech is too important to entrust to bureaucrats, judges, and those intolerant activists. "Although much private speech is wrongheaded or even dangerous," he writes, "it is even more dangerous to put the government in charge of policing it."

The book is loaded with cases that illustrate the author's concerns. For example, when the San Francisco Ballet's preprofessional school rejected applicant Fredrika Keefer because she did not have the body type expected for ballerinas, her mother sued on the basis of a city ordinance banning discrimination based on weight and height. Even though Fredrika was able to dance elsewhere, the irate mother took the matter before the San Francisco Human Rights Commission. At the time of the book's publication, the case was still pending, but Bernstein skewers the whole controversy: "Properly interpreted, the Constitution's protection of free expression from government interference bars San Francisco from legislating ballet standards."

Several cases deal with bureaucrats' attempts to punish individuals for opposing their plans for remaking the world. In one egregious case from the early 1990s, several people spoke out against a public-housing proposal in Berkeley. Personnel in the Department of Housing and Urban Development (HUD) warned them that under the federal Fair Housing Act, they could be fined up to $100,000 each and sentenced to a year in prison for acts of "discrimination against the disabled."

Bad publicity over the prosecution caused HUD to back down, but then Assistant Attorney General Deval Patrick stepped in. Revealing the mindset of antidiscrimination zealots, Patrick drew an analogy between political leaflets and baseball bats, arguing that it would be as bad to use one as the other if your intent was to violate civil-rights laws. Fortunately, a federal judge tossed the case out, but it would be foolish to think that the wolf has been driven far from the door.

Bernstein concludes his book with a superb chapter on the American Civil Liberties Union. Once a formidable defender of First Amendment rights, in recent years the organization has largely succumbed to pressure from various "liberal" groups that want nothing to stand in the way of their agendas of increased state control. □

George Leef is book review editor for The Freeman.

Protecting America's Health: The FDA, Business, and One Hundred Years of Regulation

by Philip J. Hilts

Alfred A. Knopf/University of North Carolina Press • 2003/2004 • 410 pages • $26.95 hardcover; $14.95 paperback

Reviewed by Sam Kazman

George Stigler once compared regulating on the basis of corporate misdeeds to an audition at which the second singer is selected after only the first has sung. When it comes to food and health, Philip Hilts, a veteran medical reporter, runs the same sort of abbreviated audition. His latest book is an eminently readable, amply documented history of the U.S. Food and Drug Administration (FDA), from its origin nearly a century ago to its current status as regulator of nearly one quarter of American consumer expenditures. Unfortunately, it is also a frustratingly one-sided book.

Let's start with something simple, like ketchup. Hilts's first regulatory hero is Dr. Harvey Wiley, a government chemist who in the early 1900s began campaigning for a ban on many food preservatives. Wiley came close to getting President Theodore Roosevelt's backing for a prohibition on benzoate in ketchup, but failed. Hilts closes the chapter with Wiley supposedly being vindicated by history because some of the firms that originally opposed him eventually stopped using the chemical.

You won't learn it from this book, but Wiley's views of benzoate's risks turned out to be wrong; even today, the chemical is widely used as a preservative. Banning benzoates in Wiley's time might well have increased ptomaine poisonings. And finally (for you public-choice fans), it's likely that the few ketchup companies that *supported* Wiley, such as Heinz, had more than the public interest at heart. Yes, they used better tomatoes and production methods, but they also charged more—Heinz cost over twice as much as regular ketchup. Wiley's ban would have helped Heinz competitively, while punishing people who had better use for their money than high-priced ketchup.

Medicine is more complicated than ketchup, but Hilts's simplistic approach doesn't change here. In his world, corporate greed is to blame for all defective drugs, the FDA's incentives are always beneficial, and the few government mistakes he acknowledges could be cured by more funding. As for the lives lost due to FDA delays in approving new therapies, those are a figment of the New Right conspiracy to dismantle the agency.

For example, Hilts excuses the FDA's three-year delay in approving Interleukin-2 for advanced kidney cancer because, he claims, the drug "was useful to only a small number of patients" and during the delay the agency provided "early availability for those who felt they needed to take the risk." Now it's true that Interleukin-2 produced temporary remissions for only 15–20 percent of those taking it, and that the drug itself was highly dangerous. But many patients preferred that to the 100 percent death rate of the disease itself. As for its alleged pre-approval availability, the head of the National Kidney Cancer Association had a one-word comment at the time, a word we won't reproduce in this magazine.

Compare this to Hilts's stirring account of how the FDA took only six weeks to approve the first of the protease inhibitors for AIDS. The agency didn't insist on data of reduced mortality because such information would have taken far more time to collect and demanding it was viewed as unethical given the life-and-death situation of AIDS patients. Instead, the agency approved the drug on the basis of preliminary data that showed improved cellular function.

AIDS patients were highly organized; kidney cancer patients were not. If they had been, they probably would have been treated better by the FDA. When access to new therapies is controlled by government, political clout may well determine who gets better service. But this issue doesn't fit into Hilts's framework.

Corporate wrongdoing has certainly been a factor in such medical disasters as thalidomide and the Dalkon Shield, but regulatory delays inflict at least as much damage. When the FDA approves a life-saving therapy, some number of people have to have died waiting for the agency to act. Hilts, however, refuses to even acknowledge this. He characterizes as "grotesque" the argument that the FDA's focus on preventing bad drugs may lead it to delay or deny useful drugs. But this risk is clear. While defective drugs and drug delays both have adverse medical consequences, their political impacts are incredibly different. Drug recalls are the subject of news stories and congressional hearings. Drug delays, on the other hand, rarely get noticed; all that their victims know is that their doctors can't do more for them. The skewed regulatory incentives that result were acknowledged by former FDA head David Kessler, another of Hilts's heroes, who wrote that "speeding access to urgently needed products was not nearly so deeply ingrained in our culture."

In its emphasis on drug recalls and its rationalizations for drug delays, *Protecting America's Health* unintentionally demonstrates this very point. It's unfortunate that, in a book of this scope, this issue gets a bum's rush. □

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THE FREEMAN
Ideas On Liberty
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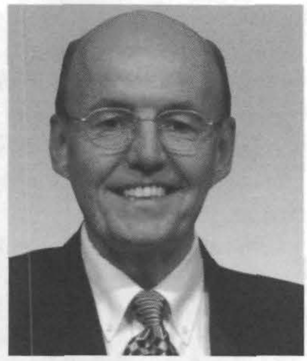

Henry Hazlitt on Unions

Henry Hazlitt wrote often on unions, and what he did write was significant.* In 1971, after carefully analyzing several economic effects of unions, he summed them up in his usual forthright style:

> The net overall effect of unions and of union policy has been to exclude non-union members, to drive them into less attractive and lower-paid jobs, to distort the structure and balance of production, to increase inflation, to reduce productivity, to discourage new investment, to retard capital formation, and hence to reduce the total production for all of us and the total real wages of the whole body of workers below what it would otherwise have been. It is altogether probable that even the highest real wages now received by members of strong unions are lower than such wages would have been if the unions and their historic policies had never existed. (*The Strike*, p. 74)

Hazlitt's explanations for each of these conclusions are brilliant, but in this limited space all I can do is commend them to you. Hazlitt held that the reason unions are able to wreak such economic havoc is that politicians placed them outside the rule of law.

In addition to the economic effects of unions summarized above, Hazlitt discussed several other important aspects of American union law. Here are three of them.

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Exclusive representation means that a union (usually chosen by majority vote of workers) is the monopoly representative of all workers in a bargaining unit within a firm. The union represents its voluntary members, but it also, perforce, represents workers who want nothing to do with it. Individuals are forbidden to represent themselves. Mandatory good-faith bargaining means that an employer must bargain with the monopoly representative on wages and salaries and other terms of employment, and he must bargain in "good faith," which, in practice, means that he must make concessions to the union.

I argue that exclusive representation is an illicit extension of democracy (mandatory submission of a numerical minority to the will of a numerical majority) into the private sphere of human action where it does not belong. I also hold that forced bargaining is never justified. In ordinary contract law a necessary, but not sufficient, condition for a contract to be valid is that all the parties agree both to bargain and to the final terms that emerge from the bargaining. A contract is an agreement, and "forced agreement" is oxymoronic. Hazlitt agreed on both points. On mandatory bargaining: "The employer, like the employee (or any of the rest of us in all our other business relations) must have

*I know of three (somewhat repetitive) sources for Hazlitt's views on unions: Chapter 20, "Do Unions Really Raise Wages?" in *Economics in One Lesson* (1946); Chapter 13, "How Unions Reduce Real Wages," in his *The Conquest of Poverty* (New Rochelle, N.Y.: Arlington House, 1973); and his chapter in *The Strike: For and Against*, introduced by Harold H. Hart (New York: Hart Publishing Company, Inc. 1971).

the unequivocal right *not* to bargain, the clear right to terminate negotiations if he considers a given union's demands unreasonable, the clear right to bargain with whomever and in whatever peaceable manner he chooses. The specious insistence on 'collective bargaining' is simply a denial of the right of individual bargaining" (*The Strike*, pp. 76–77).

On exclusive representation, he argued that the National Labor Relations Act should at least be amended to "restrict unions to bargaining only for their own members and no longer designate them as the exclusive bargaining agent for all employees in a unit" (p. 77).

Here Hazlitt seems to have changed his mind between 1946 and 1971. Earlier he held that because "competition of workers for jobs, and of employers for workers, does not work perfectly," any individual worker "may be in a weak bargaining position." He went on to explain that a worker's "whole means of livelihood is involved" in the hiring decision, while to the employer a decision regarding one worker is of little consequence when "he may employ a hundred or a thousand men." He concludes that "When an employer's workers deal with him as a body . . . they may help to equalize bargaining power and the risks involved in making mistakes" (*Economics in One Lesson*, p. 141).

In 1971 he had a different view. He called the picture of the impotent single worker at the mercy of an employer who hires large numbers of employees a "caricature." There may be isolated cases where workers feel forced to accept wages less than their true market value, but even they will be alert to better alternatives. The employer, not the worker, is at a disadvantage.

> The bigger the employer the less he can afford . . . to haggle with each of 1,000 workers, say, to get him at the lowest possible wage. To keep reasonable morale in his working force, he must pay equal wages for all those doing equal work. To get and to hold the number of workers he needs, he must offer at least as much as his actual or potential competitors for labor. To maintain reasonable efficiency, he must offer enough to attract the superior workers rather than only the inferior ones. (*The Strike*, pp. 61–62)

Bargaining power depends on alternatives. Hazlitt's earlier view might have been clouded by the unusual circumstances of the Great Depression in which many workers had few employment alternatives. In more normal times employers must be concerned with many alternatives open to workers.

Hazlitt saw nothing wrong in any worker "withholding his labor" when he didn't like the terms and conditions of employment offered by an employer. Neither did he see anything wrong with a group of like-minded workers collectively and simultaneously withholding their labor from that employer. If such workers were bound by an extant hiring contract not to withhold their labor and they did so anyway, they would be liable for breach of contract, but that would be all. Elsewhere I have called this the "voluntary-exchange right to strike."

Hazlitt recognized that the legal right to strike was altogether different from such a voluntary-exchange right. The legal right to strike, he said, involves giving unions the privilege of using force, violence, and intimidation, mainly through mass picketing, to prevent other workers from accepting the jobs that strikers refuse to do, and to prevent suppliers and customers from doing business with strike targets. In effect the legal right to strike grants strikers an illicit property right to the jobs they abandon. Strikes are aimed against the public more than against the employer. Hazlitt condemned the Norris-LaGuardia Act (1932) for legalizing mass picketing and forbidding federal courts to issue injunctions against strike-related violence.

Hazlitt's analysis of other union issues—for example, the proper roles for voluntary unions, the correct understanding of freedom of association, and the "Great Illusion" of labor solidarity—are well worth considering. I will do so in a later column. □

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—HENRY HAZLITT (1894–1993)

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