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Ludwig von Mises

Capitalism

DESCRIPTIVE terms which people use are often quite misleading. In talking about modern captains of industry and leaders of big business, for instance, they call a man a "chocolate king" or a "cotton king" or an "automobile king." Their use of such terminology implies that they see practically no difference between the modern heads of industry and those feudal kings, dukes or lords of earlier days. But the difference is in fact very great, for a chocolate king does not rule at all, he *serves*. He does not reign over conquered territory, independent of the market, independent of his customers. The chocolate king—or the steel king or the automobile king or any other king of modern industry—depends on the industry he operates and on the customers he serves. This "king" must stay in the good graces of his subjects, the consumers; he loses his "kingdom" as soon as he is no longer in a position to give his customers better service and provide it at lower cost than others with whom he must compete.

Two hundred years ago, before the advent of capitalism, a man's social status was fixed from the beginning to the end of his life: he inherited it from his ancestors, and it never changed. If he was born poor, he always remained poor, and if he was born rich—a lord or a duke—he kept his dukedom and the property that went with it for the rest of his life.

As for manufacturing, the primitive processing industries of those days existed almost exclusively for the benefit of the wealthy. Most of the people (ninety per cent or more of the European population) worked the land and did not come in contact with the city-oriented processing industries. This rigid system of feudal society prevailed in the most developed areas of Europe for many hundreds of years.

However, as the rural population expanded, there developed a surplus of people on the land. For this surplus of population without inherited land or estates, there was not enough to do, nor was it possible for them to work in the processing industries; the kings of the cities denied them access. The numbers of these "outcasts" continued to grow, and still no one knew what to do with them. They were, in the full sense of the word, "proletarians," outcasts whom the government could only put into the workhouse or the poorhouse. In some sections of Europe, especially in the Netherlands and in England, they became so numerous that, by the eighteenth century, they were a real menace to the preservation of the prevailing social system.

Today, in discussing similar conditions in places like India or other developing countries, we must not forget that, in eighteenth-century England, conditions were much worse. At that time, England had a population of six or seven million people, but of those six or seven million people, more than one million, probably two million, were simply poor outcasts for whom the existing social system made no provision. What to do with these outcasts was one of the great problems of eighteenth-century England.

Another great problem was the lack of raw materials. The British, very seriously, had to ask themselves this question: what are we going to do in the future, when our forests will no longer give us the wood we need for our industries and for heating our houses? For the ruling classes it was a desperate situation. The statesmen did not know what to do, and the ruling gentry were absolutely without any ideas on how to improve conditions.

The Start of Mass Production

Out of this serious social situation emerged the beginnings of modern capitalism. There were some persons among those outcasts, among those poor people, who tried to organize others to set up small shops which could produce something. This was an innovation. These innovators did not produce expensive goods suitable only for the upper classes; they produced cheaper products for everyone's needs. And this was the origin of capitalism as it operates today. It was *the beginning of mass production,* the fundamental principle of capitalistic industry. Whereas the old processing industries serving the rich people in the cities had existed almost exclu-

PHOTO BY DAVID JARRETT

Ludwig von Mises, 1881-1973, was one of the great defenders of a rational economic science, and perhaps the single most creative mind at work in this field in our century.

Found among the papers of Dr. Mises were transcripts of lectures he delivered in Argentina in 1959. These have now been edited by his widow and are available as a Regnery/Gateway paperbacked book. This article, one of the lectures, is here reprinted by permission of the publishers.

The book, *Economic Policy: Thoughts for Today and Tomorrow,* also may be purchased at $4.95 from The Foundation for Economic Education, Inc., Irvington-on-Hudson, N.Y. 10533.

sively for the demands of the upper classes, the new capitalist industries began to produce things that could be purchased by the general population. It was mass production to satisfy the needs of the masses.

This is the fundamental principle of capitalism as it exists today in all of those countries in which there is a highly developed system of mass production: Big business, the target of the most fanatic attacks by the so-called leftists, produces almost exclusively to satisfy the wants of the masses. Enterprises producing luxury goods solely for the well-to-do can never attain the magnitude of big businesses. And today, it is the people who work in large factories who are the main consumers of the products made in those factories. This is the fundamental difference between the capitalistic principles of production and the feudalistic principles of the preceding ages.

Consumer Sovereignty

When people assume, or claim, that there is a difference between the producers and the consumers of the products of big businesses, they are badly mistaken. In American department stores you hear the slogan "the customer is always right." And this customer is the same man who produces in the factory those things which are sold in the department stores. The people who think that the power of big business is enormous are mistaken also, since big business depends entirely on the patronage of those who buy its products; the biggest enterprise loses its power and its influence when it loses its customers.

Fifty or sixty years ago it was said in almost all capitalist countries that the railroad companies were too big and too powerful; they had a monopoly; it was impossible to compete with them. It was alleged that, in the field of transportation, capitalism had already reached a stage at which it had destroyed itself, for it had eliminated competition. What people overlooked was the fact that the power of the railroads depended on their ability to serve people better than any other method of transportation. Of course it would have been ridiculous to compete with one of these big railroad companies by building another railroad parallel to the old line, since the old line was sufficient to serve existing needs. But very soon there came other competitors. Freedom of competition does not mean that you can succeed simply by imitating or copying precisely what someone else has done. Freedom of the press does not mean that you have the right to copy what another man has written and thus to acquire the success which this other man has duly merited on account of his achievements. It means that you have the right to write something different. Freedom of competition concerning railroads, for example, means that you are free to invent something, to do something, which will challenge the railroads and place them in a very precarious competitive situation.

In the United States the competition to the railroads—in the form of buses, automobiles, trucks, and airplanes—has caused the railroads to suffer and to be almost completely defeated, as far as passenger transportation is concerned.

Capitalism Transformed the World

The development of capitalism consists in everyone's having the right to serve the customer better and/or more cheaply. And this method, this principle, has, within a comparatively short time, transformed the whole world. It has made possible an unprecedented increase in world population.

In eighteenth-century England, the land could support only six million people at a very low standard of living. Today more than fifty million people enjoy a much higher standard of living than even the rich enjoyed during the eighteenth-century. And today's standard of living in England would probably be still higher, had not a great deal of the energy of the British been wasted in what were, from various points of view, avoidable political and military "adventures."

These are the facts about capitalism. Thus, if an Englishman—or, for that matter, any other man in any country of the world—says today to his friends that he is opposed to capitalism, there is a wonderful way to answer him: "You know that the population of this planet is now ten times greater than it was in the ages preceding capitalism; you know that all men today enjoy a higher standard of living than your ancestors did before the age of capitalism. But how do you know that you are the one out of ten who would have lived in the absence of capitalism? The mere fact that you are living today is proof that capitalism has succeeded, whether or not you consider your own life very valuable."

Development of Factory System

In spite of all its benefits, capitalism has been furiously attacked and criticized. It is necessary that we understand the origin of this antipathy. It is a fact that the hatred of capitalism originated *not* with the masses, *not* among the workers themselves, but among the landed aristocracy—the gentry of England and the European continent. They blamed capitalism for something that was not very pleasant for them: at the beginning of the nineteenth century, the higher wages paid by industry to its workers forced the landed gentry to pay equally higher wages to their *agricultural* workers. The aristocracy attacked the industries by criticizing the standard of living of the masses of the workers.

Of course—from our viewpoint, the workers' standard of living was extremely low; conditions under early capitalism were absolutely shocking, but not because the newly developed capitalistic industries had harmed the workers. The people hired to work in factories had already been existing at a virtually subhuman level.

The famous old story, repeated hundreds of times, that the factories employed women and children and that these women and children, before they were working in factories, had lived under satisfactory conditions, is one of the greatest falsehoods of history. The mothers who worked in the factories had nothing to cook with; they did not leave their homes and their kitchens to go into the factories, they went into factories because they had no kitchens, and if they had a kitchen they had no food to cook in those kitchens. And the children did not come from comfortable nurseries. They were starving and dying. And all the talk about the so-called unspeakable horror of early capitalism can be refuted by a single statistic: precisely in these years in which British capitalism developed, precisely in the age called the Industrial Revolution in England, in the years from 1760 to 1830, precisely in those years the population of England doubled, which means that hundreds of thousands of children—who would have died in preceding times—survived and grew to become men and women.

Trade Brings Improvement

There is no doubt that the conditions of the preceding times were very unsatisfactory. It was capitalist business that improved them. It was precisely those early factories that provided for the needs of their workers, either directly or indirectly by exporting products and importing food and raw materials from other countries. Again and again, the early historians of capitalism have—one can hardly use a milder word—falsified history.

One anecdote they used to tell, quite possibly invented, involved Benjamin Franklin. According to the story, Ben Franklin visited a cotton mill in England, and the owner of the mill told him, full of pride: "Look, here are cotton goods for Hungary." Benjamin Franklin, looking around, seeing that the workers were shabbily dressed said: "Why don't you produce also for your own workers?"

But those exports of which the owner of the mill spoke really meant that he *did* produce for his own workers, because England had to import all its raw materials. There was no cotton either in England or in continental Europe. There was a shortage of food in England, and it had to be imported from Poland, from Russia, from Hungary. These exports were the payment for the imports of the food which made the survival of the British population possible. Many examples from the history of those ages will show the attitude of the gentry and aristocracy toward the workers. I want to cite only two examples. One is the famous British Speenhamland system. By this system, the British government paid all workers who did not get the minimum wage (determined by the government) the difference between the wages they received and this minimum wage. This saved the landed aristocracy the trouble of paying higher wages. The gentry would pay the traditionally low agricultural wage, and the government would supplement it, thus keeping workers from leaving rural occupations to seek urban factory employment.

Eighty years later, after capitalism's expansion from England to continental Europe, the landed aristocracy again reacted against the new production system. In Germany the Prussian Junkers, having lost many workers to the higher-paying capitalistic industries, invented a special term for the problem: "flight from the countryside"—*Landflucht*. And in the German Parliament, they discussed what might be done against this *evil*, as it was seen from the point of view of the landed aristocracy. Prince Bismarck, the famous chancellor of the German

Reich, in a speech one day said, "I met a man in Berlin who once had worked on my estate, and I asked this man, 'Why did you leave the estate; why did you go away from the country; why are you now living in Berlin?' "

And, according to Bismarck, this man answered, "You don't have such a nice *Biergarten* in the village as we have here in Berlin, where you can sit, drink beer, and listen to music." This is, of course, a story told from the point of view of Prince Bismarck, the employer. It was not the point of view of all his employees. They went into industry because industry paid them higher wages and raised their standard of living to an unprecedented degree.

Living Standards under Capitalism

Today, in the capitalist countries, there is relatively little difference between the basic life of the so-called higher and lower classes; both have food, clothing, and shelter. But in the eighteenth century and earlier, the difference between the man of the middle class and the man of the lower class was that the man of the middle class had shoes and the man of the lower class did *not* have shoes. In the United States today the difference between a rich man and a poor man means very often only the difference between a Cadillac and a Chevrolet. The Chevrolet may be bought secondhand, but basically it renders the same services to its owner: he, too, can drive from one point to another. More than fifty percent of the people in the United States are living in houses and apartments they own themselves.

The attacks against capitalism—especially with respect to the higher wage rates—start from the false assumption that wages are ultimately paid by people who are different from those who are employed in the factories. Now it is all right for economists and for students of economic theories to distinguish between the worker and the consumer and to make a distinction between them. But the fact is that every consumer must, in some way or the other, earn the money he spends, and the immense majority of the consumers are precisely the same people who work as employees in the enterprises that produce the things which they consume.

Wage rates under capitalism are not set by a class of people different from the class of people who earn the wages: they are the *same* people. It is *not* the Hollywood film corporation that pays the wages of a movie star; it is the people who pay admission to the movies. And it is *not* the entrepreneur of a boxing match who pays the enormous demands of the prize fighters; it is the people who pay admission to the fight. Through the distinction between the employer and the employee, a distinction is drawn in economic theory, but it is not a distinction in real life; here, the employer and the employee ultimately are one and the same person.

There are people in many countries who consider it very unjust that a man who has to support a family with several children will receive the same salary as a man who has only himself to take care of. But the question is not whether the employer should bear greater responsibility for the size of a worker's family.

The question we must ask in this case is: Are you, as an individual, prepared to pay *more* for something, let us say, a loaf of bread, if you are told that the man who produced this loaf of bread has six children? The honest man will certainly answer in the negative and say, "In principle I would, but in fact I would rather buy the bread produced by a man without any children." The fact is that, if the buyers do not pay the employer enough to enable him to pay his workers, it becomes impossible for the employer to remain in business.

The Meaning of Capitalism

The capitalist system was termed "capitalism" not by a friend of the system, but by an individual who considered it to be the worst of all historical systems, the greatest evil that had ever befallen mankind. That man was Karl Marx. Nevertheless, there is no reason to reject Marx's term, because it describes clearly the source of the great social improvements brought about by capitalism. Those improvements are the result of capital accumulation; they are based on the fact that people, as a rule, do not consume everything they have produced, that they save—and invest—a part of it.

There is a great deal of misunderstanding about this problem and—in the course of these six lectures—I will have the opportunity to deal with the most fundamental misapprehensions which people have concerning the accumulation of capital, the use of capital, and the universal advantages to be gained from such use. I will deal with capitalism particularly in my lectures about foreign investment and about that most critical problem of present-day politics, inflation. You know, of course, that inflation exists not only in this country. It is a problem all over the world today.

An often unrealized fact about capitalism is this: savings mean benefits for all those who are anxious to produce or earn wages. When a man has accrued a certain amount of money—let us say, one thousand dollars—and, instead of spending it, entrusts these dollars to a savings bank or an insurance company, the money goes into the hands of an entrepreneur, a businessman,

> The owner of producer's goods in the frame of a market economy is forced to employ them for the best possible satisfaction of the wants of the consumers. He forfeits his property if other people eclipse him by better serving the consumers. In the market economy property is acquired and preserved by serving the public and is lost when the public becomes dissatisfied with the way in which it is served. . . . By the instrumentality of the profit-and-loss system, the owners are forced to deal with "their" property as if it were other peoples' property entrusted to them under the obligation to utilize it for the best possible satisfaction of the virtual beneficiaries, the consumers.

enabling him to go out and embark on a project which could not have been embarked on yesterday, because the required capital was unavailable.

How Capital Creates Jobs

What will the businessman do now with the additional capital? The first thing he must do, the first use he will make of this additional capital, is to go out and hire workers and buy raw materials—in turn causing a *further* demand for workers and raw materials to develop, as well as a tendency toward higher wages and higher prices for raw materials. Long before the saver or the entrepreneur obtain any profit from all of this, the unemployed worker, the producer of raw materials, the farmer, and the wage-earner are all sharing in the benefits of the additional savings.

Whether the entrepreneur will get something out of the project depends on the future state of the market and on his ability to anticipate correctly the future state of the market. But the workers as well as the producers of raw materials get the benefits immediately. Much was said, thirty or forty years ago, about the "wage policy," as they called it, of Henry Ford. One of Mr. Ford's great accomplishments was that he paid higher wages than did other industrialists or factories. His wage policy was described as an "invention," yet it is not enough to say that this new "invented" policy was the result of the liberality of Mr. Ford. A new branch of business, or a new factory in an already existing branch of business, has to attract workers from *other* employments, from other parts of the country, even from other countries. And the only way to do this is to offer the workers higher wages for their work. This is what took place in the early days of capitalism, and it is still taking place today.

When the manufacturers in Great Britain first began to produce cotton goods, they paid their workers more than they had earned before. Of course, a great percentage of these new workers had earned nothing at all before that and were prepared to take anything they were offered. But after a short time—when more and more capital was accumulated and more and more new enterprises were developed—wage rates went up, and the result was the unprecedented increase in British population which I spoke of earlier.

Theory of "Impoverishment"

The scornful depiction of capitalism by some people as a system designed to make the rich become richer and the poor become poorer is wrong from beginning to end. Marx's thesis regarding the coming of socialism was based on the assumption that workers *were* getting poorer, that the masses *were* becoming more destitute, and that finally all the wealth of a country would be concentrated in a few hands or in the hands of one man only. And then the masses of impoverished workers would finally rebel and expropriate the riches of the wealthy proprietors. According to this doctrine of Karl Marx, there can be no opportunity, no possibility within the capitalistic system for any improvement of the conditions of the workers.

In 1865, speaking before the International Workingmen's Association in England, Marx said the belief that labor unions could improve conditions for the working population was "absolutely in error." The union policy of asking for higher wage rates and shorter work hours he called *conservative*—conservatism being, of course, the most condemnatory term which Karl Marx could use. He suggested that the unions set themselves a new, *revolutionary* goal: that they "do away with the wage system altogether," that they substitute "socialism"—government ownership of the means of production—for the system of private ownership.

If we look upon the history of the world, and especially upon the history of England since 1865, we realize that Marx was wrong in every respect. There is no western, capitalistic country in which the conditions of the masses have not improved in an unprecedented way. All these improvements of the last eighty or ninety years were made *in spite of* the prognostications of Karl Marx. For the Marxian socialists believed that the conditions of the workers could never be ameliorated. They followed a false theory, the famous "iron law of wages"—the law which stated that a worker's wages, under capitalism, would not exceed the amount he needed to sustain his life for service to the enterprise.

The Marxians formulated their theory in this way: if the workers' wage rates go up, raising wages above the subsistence level, they will have more children; and these children, when they enter the labor force, will increase the number of workers to the point where the wage rates will drop, bringing the workers once more down to the subsistence level—to that minimal sustenance level which will just barely prevent the working population from dying out.

But this idea of Marx, and of many other socialists, is a concept of the working man precisely like that which biologists use—and rightly so—in studying the life of animals. Of mice, for instance.

Improved Conditions Depend on Sound Economic Policies

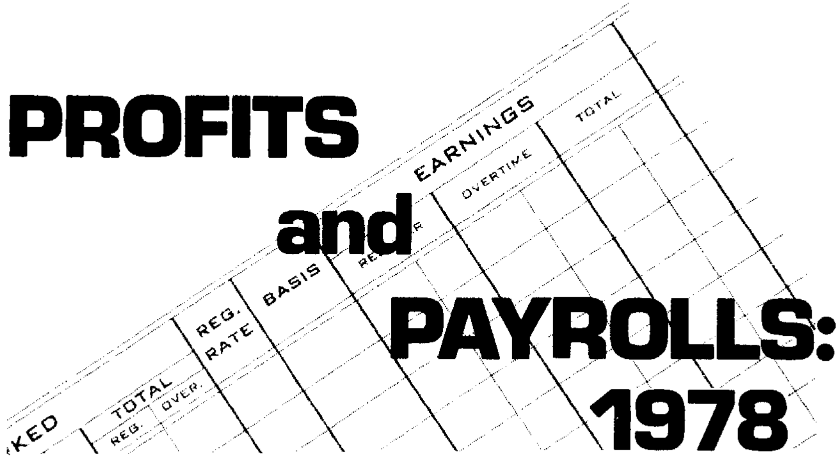
If you increase the quantity of food available for animal organisms or for microbes, then more of them will survive. And if you restrict their food, then you will restrict their numbers. But man is different. Even the worker—in spite of the fact that Marxists do not acknowledge it—has human wants other than food and reproduction of his species. An increase in real wages results not only in an increase in population, it results also, and first of all, in an *improvement in the average standard of living*. That is why today we have a higher standard of living in Western Europe and in the United States than in the developing nations of, say, Africa.

We must realize, however, that this higher standard of living depends on the supply of capital. This explains the difference between conditions in the United States and conditions in India; modern methods of fighting contagious diseases have been introduced in India—at least, to some extent—and the effect has been an unprecedented increase in population but, since this increase in population has not been accompanied by a corresponding increase in the amount of capital invested, the result has been an increase in poverty. A country becomes more prosperous in proportion to the rise in the invested capital per unit of its population.

But you have to remember that, in economic policies, there are no miracles. You have read in many newspapers and speeches, about the so-called German economic miracle—the recovery of Germany after its defeat and destruction in the Second World War. But this was no miracle. It was the application of the *principles of the free market economy*, of the methods of capitalism, even though they were not applied completely in all respects. Every country can experience the same "miracle" of economic recovery, although I must insist that economic recovery does *not* come from a miracle; it comes from the adoption of—and is the result of—sound economic policies.

Henry Hazlitt

PROFITS and PAYROLLS: 1978



IN the August issue of *The Freeman* I pointed out that, in the division of the part of the gross income of the corporations available for the employees and for the stockholders, the employees got the lion's share. In 1977, for example, the last full year for which the figures were then available, the employees got 89.4 per cent of the division and the owners were credited with net profits after taxes of only 10.7 per cent. They did not actually receive that much, but dividends amounting to only 4.5 per cent of the combined total.

Henry Hazlitt, noted economist, author, editor, reviewer and columnist, is well known to readers of the *New York Times, Newsweek, The Freeman, Barron's, Human Events* and many others. Among the more recent of his numerous books are *The Inflation Crisis and How to Resolve It* and a revised edition of *Economics in One Lesson*.

This division, I went on to show, was in no way unusual, but in fact typical of the division over the years. In the whole thirty-year period from 1949, the employees received an average of 88.1 per cent of the two-way division, the stockholders were credited with an average of 11.9 per cent: the actual dividends they received came to only 5.3 per cent. And in the last ten of those thirty years, contrary to what newspaper headlines, union leaders and political speeches during the period would lead one to expect, the average division was even more in favor of the employees. In those ten years employees had been getting an average of 90.2 per cent of the combined total available for division between the two groups, and stockholders an average of only 9.8 per cent.

So much for the previous record. The percentages I have been citing are calculated from the corporation earnings of the nation as compiled by the Bureau of Economic Analysis of the U.S. Department of Commerce and published in its monthly Survey of Current Business. The final figures for calendar 1978 are now available, as they were not when my August article was written. What do they show?

> For the last thirty years the employees of this country's corporations have been receiving an average of eight times as much from them as has been credited to the stockholders.

The reader will recall that a few months ago, when preliminary figures of corporate earnings in 1978 were first appearing, they were being roundly denounced by politicians and by some Administration leaders as not only excessive but as shocking, "obscene," and even "disastrous." It is true, as might have been expected in such an inflationary period, that in dollar amount they rose to record levels. The profits after taxes of the nation's corporations rose in 1978 to $111.3 billion, compared with $94.7 billion in 1977, itself a record year for profits in dollar terms.

But these figures have to be seen in their full context. For the compensation of employees of the country's corporations, in dollar terms, also rose in 1978 to the highest level on record—$884.9 billion compared with $776.9 billion in 1977. So the employees in 1978 received 88.8 per cent of the total available for both, compared with 11.2 per cent credited to the stockholders. The stockholders were actually paid in dividends only $42.1 billion, or 4.2 per cent of the total available for employees plus stockholders.

It will be noticed that this division does not differ very markedly from that in 1977 or the average in the last ten years. The percentage distributed in dividends actually fell below the 4.5 per cent average of the preceding ten years.

> Any government action that seriously reduces profits must diminish employment and payrolls as well.

What is most striking about all these facts is their complete contrast not only with leftist propaganda but with prevailing public assumptions. Frequent polling by the Opinion Research Corporation, for example, has found that the consensus of most Americans is that the corporate stockholders get about 75 per cent of the two-way division of gross earnings and the employees only about 25 per cent. Judging by their statements, this must also be close to the assumption of the Washington bureaucrats. And millions of Communists throughout the world still adhere to the Marxist myth that labor under capitalism is paid the merest fraction of what it helps to produce and is forced to accept just enough to stay alive and reproduce its numbers.

> The truth is that—when recalculated to allow for the distortions of inflation—corporate profits are still far too low for the health of the American economy.

Though corporate wages in 1978 were eight times corporate profits after taxes, though wages made up 76 per cent of the national income and profits only about 7 per cent (really much lower if accounting procedures were permitted by the IRS to make full allowance for inflation) it was the latter figure that was denounced as "obscene" and "disastrous."

This demagogic hatred of profits has in fact done immense harm to the American economy, and above all to the workers. For payrolls and profits, as statistics have shown year by year over the last half century, go up and down together. They are interdependent, and causally tied. The amount and outlook for profits determines employment and new investment. The way to encourage employment is to encourage employers. The way to increase real wages is to increase productivity; the way to do that is to encourage investment; and the way to do that is to encourage adequate profits.

The result of our actual policies is that our average annual percentage increase in productivity in the period from 1960 to 1977 was lower than that in Japan, in France, in Germany, in Canada, and in Britain. Our rate of capital investment between 1966 and 1976, as a percentage of GNP, was also lower than in any of these countries.

The lesson ought to be clear.

Melvin D. Barger

Dishonest About Inflation

MOST of the opinion polls tell us that inflation is the public's Number One worry. We shouldn't need the pollsters to tell us that. We can listen to the complaints in the lines at the supermarkets, read the headlines in newspapers, or hear the pronouncements of business leaders and political candidates. Inflation is a terrible cancer that must be brought under control, we are constantly warned, or we face a bleak future and perhaps an economic disaster.

But what *causes* inflation? Many economists and savants tell us that inflation is a very complex problem with neither a single cause nor a single solution. Few economists would dare deny that arbitrary government expansion of money and credit produces inflation. Yet, there seems to be a universal desire to bring in other alleged causes: the greed of unions and businessmen, government regulations, rising oil prices, and even such matters as lowered American productivity and reduced capital investment.

What is behind all this confusion about inflation? It grows out of the same character defect that causes inflation in the first place. That character defect is *dishonesty,* and it has seduced a whole nation. But events may eventually force us to accept inflation as a *dishonest human action* that can be avoided if people have the will and the understanding to do so. Nor is inflation a complex problem when one is prepared to see it as a moral issue rather than simply as political or social phenomena.

A steel company executive named Enders M. Voorhees pointed to the moral problem of inflation in a 1950 speech entitled, "Wanted—Dependable Dollars." Even then, corporate financial officers in Mr. Voorhees' position were discovering that inflation distorted business cal-

Mr. Barger is a corporate public relations executive and writer in Toledo, Ohio.

culations and made future business planning a nightmare. In the same speech, he unashamedly showed a preference for the terms "dependable dollars" or "honest money" rather than such terms as "sound money" or "gold standard." He had harsh words for "printing-press money," i.e., money created by government manipulations. But why were we beguiled by "printing press" money and why were we unable to stop inflation? Mr. Voorhees concluded, "In the end we may discover that it is *our own deficiency in moral stamina* that is to blame, and that the printing-press operators are merely reflecting our own attitudes." (emphasis added)[1]

Mr. Voorhees was politely saying that character defects get in the way of efforts to stop inflation. He could have gone on to say that dishonest money is produced by dishonest people who are trapped by greed, fear, and weakness. This would be a very strong statement, but the facts bear it out. Inflation begins with an expansion of the money supply which immediately produces benefits for certain people while causing losses for others. In general, people on fixed incomes and holders of bonds, loans, and savings accounts are cheated, while borrowers, property owners, and inflation-wise speculators show gains.

Lying and Cheating

Lying and bland promises are an essential part of the inflation program. The public is constantly told that inflation will be brought under control, for it is important that most of the victims be unaware of what is going on. Still, a student of inflation is finally forced to believe that the public wants to go on believing in the inflation game. The old saying, "You can't cheat an honest man," may have some relevance to the way we are cheating and being cheated by inflation.

It would be unfair to say that the current generation of Americans is less honest than earlier generations that somehow were able to maintain an "honest" or "dependable" dollar. And for that matter, it would even be unfair to say that Americans are more dishonest, say, than the Germans or Swiss who have been able to maintain the strength of their currencies. Our problem, as Americans, is that we have been practicing a *selective dishonesty.* While often insisting on rigorous honesty in other matters, we have accepted the dishonest practices that produce inflation. Then we have gone further in this deceit and have attributed the shrinkage of the dollar's buying power to conditions that are really

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[1]See Enders M. Voorhees, *Financial Policy in a Changing Economy,* Sowers Printing Company, Lebanon, Pennsylvania, 1970. See particularly pp. 184-200. Speech was presented at Dartmouth in 1950.

the *effects* of inflating. This tends to deflect attention from the actions that dilute the market value of money and ought to be stopped.

Needed: An Acceptable Definition

One of our most disturbing problems is that professional economists do not agree in their definitions of inflation. One of the most widely accepted definitions of inflation is that it is a rising general level of prices.[2] Another popular definition of inflation is "too much money chasing too few goods." Actually, more honest and precise than either of these definitions would be an explanation of the actions that cause prices to rise *generally* or bring "too much money" into existence.

The public should understand that a widespread drought may result in temporarily higher prices for food, relative to prices of other things. But that is not the same as a government action that arbitrarily produces more paper money and credit and results in a persisting general increase in prices.

Why do professional economists employ such deceptive and misleading definitions of a condition that could prove to be a terminal illness for our way of life? One reason for this dishonesty is that the need to maintain "sound" or "honest" money was badly ridiculed and discredited in the early 1930s and since then has never been defended except by a few economists. There is also something about inflation that promotes demands for centralized government control, which many economists advocate. Finally, the Keynesian deficit spending programs endorsed by many economists make inflation unavoidable.

Yet another argument against "honest money" is that it is a return to the gold standard, which had its severe critics and was often looked upon as a means of keeping money scarce and concentrating power in the hands of eastern bankers. Actually, honest money could take several forms and could be backed by metals and commodities other than gold. It is even possible to conceive of a privately-issued currency without any specific backing other than the assets of the bank or company which offers it. A gold standard will soon collapse if it is seen as a hindrance to progress rather than a way of protecting the public.

Effects Seen As Causes

In the general dishonesty about inflation, most experts make the error of blaming inflation on conditions that are really the *effects* of expanding the money supply. Business leaders like to focus on "cost-push" inflation, for example, with unions as the villains. According to

[2] Campbell R. McConnell, *Economics* (New York: McGraw-Hill, 1975), p. 197.

this argument, monopolistic unions are able to impose increased costs on business which must eventually be passed through as price increases. If unions would only be less greedy, cost-push inflation could be kept under control.

Union leaders and their staff economists seize on the same argument, usually with the twist that inflation is caused by unwarranted price increases, excessive profits, high executive salaries, and monopolistic or oligopolistic enterprises. Both unions and management, in making such arguments, play directly into the hands of politicians who would like to institute wage-price controls. Despite the fact that wage-price controls are virtually unworkable and result in a bureaucratic nightmare, the demand for them is kept alive by the persistent belief that unions cause inflation by raising wages or managements cause the same condition by increasing prices.

Professional economists could perform a great service by rooting out the fallacies in these beliefs. They could show, for example, that raising either wages or prices without corresponding expansion of the money supply will result in unemployment; there is less demand for either labor or goods if wages and prices go up with no equivalent increase in available money. With no expansion in the money supply, workers who demand too much or businesses which raise prices above the market would merely lose out to competitors.

Blaming Government Regulations

Inflation commentators have recently discovered another culprit in producing inflation: the high costs of government regulation. This has been useful to managements protesting the costs of meeting factory emission regulations or of making government-required product changes. There are good reasons to oppose these regulations and to deplore the costs of meeting them. It is false, however, to say that costly government regulations *cause* inflation.

The economic effect of a government regulation is exactly the same as a wage increase or any other cost, including higher oil prices. It is something that must be included in the prices of the goods or services being offered by the company. Taxes are in the same category. And if the firm's customers will not accept the increased prices, the company either will go out of business or will divert its production to lines that can be marketed profitably.

But regulations in themselves do not cause inflation. They do cause higher prices of certain products. These higher prices are mistakenly called inflationary, when they really reflect higher costs. The customer who must pay these higher prices will make equivalent reductions in other purchases.

Is Low Productivity a Cause of Inflation?

Low productivity is still another suspect in causing the inflation mess. With lower-priced imports flooding the country, there is increased concern about conditions that adversely affect American productivity. One of these conditions is the high cost of wages and benefits which raises unit costs of American goods. There is also deepening concern about the decline in capital investments. It is alleged that our own plant capacity is becoming obsolete and inefficient in comparison with the plants of foreign producers. Meanwhile, prices of most manufactured goods are going up. But with higher productivity, prices would tend to stabilize, or at least the increases would not be so large.

Here again, low productivity is blamed because it supposedly increases the unit costs of certain products. Productivity itself has nothing to do with causing inflation, nor can it stop the process. The best spur to productivity is the producer's desire to capture a larger share of the market and to increase his overall productivity. Few producers are likely to increase their efforts simply to fight inflation.

But there is a very serious deception in the effort to use higher productivity as an inflation-fighter. This deception comes from defining inflation as a general rise in prices. Theoretically, an annual increase of four per cent in the money supply would not result in a general price rise if there also was a four per cent improvement in productivity. Prices would probably remain at the same level.

This would not mean, however, that inflation had been stopped. It would only mean that its effects had been concealed. For, without an arbitrary expansion of the money supply, the four per cent improvement in productivity would have gone to certain workers, owners, and customers, as wages, dividends, or lower prices. So increased productivity only makes inflation less visible, and perhaps more acceptable politically. But it is not the answer to inflation.

The End of Dishonesty

We can probably expect more dishonesty about inflation until events force us to change our ways. There is reason to believe that the American people become very worried when inflation passes the double-digit level. While this does not lead to a complete understanding of the problem, it does cast doubt on some of the glib explanations and solutions being offered. Unfortunately, the most recent surge in inflation was attributed to higher oil prices, when in reality the OPEC nations who raise their crude prices do so to protect themselves from the continuous inflating of the American dollar.

Yet, honesty or truth about money must always have its day; even the inflationists know that. As Ludwig von Mises explained, inflation cannot go on endlessly. "If one does not stop in time the pernicious policy of increasing the quantity of money and fiduciary media, the nation's currency system collapses entirely. The monetary unit's purchasing power sinks to a point which for all practical purposes is not better than zero." Still, Mises believed that money and credit expansion could be stopped in time if people had only the will and the understanding to do so.[3]

Hans F. Sennholz, an economist who studied under Mises, has been less optimistic about the future of the dollar. In his view, two-digit inflation will be ended only by the advent of three-digit inflation. He also has suggested that American inflation may end in a frenzied, hysterical spending debacle not unlike that which overtook Germany in 1923.

But whether the landing from dishonest money is soft or hard, Americans will some day become more honest about the causes and effects of inflation. We will become courageous enough to demand honest, or dependable, money.

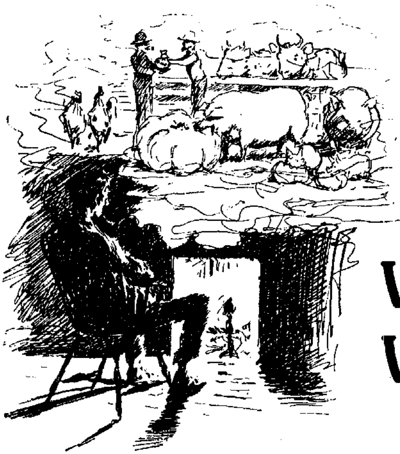
And we should not be too hard on ourselves when we finally learn how we have been deceived about the nature of inflation. Mr. Voorhees, in his plea for dependable dollars, pointed out that it seems to be those people who have had bitter personal experience of living under bad currencies who most appreciate good currencies and are willing to make some sacrifices to secure and maintain them. He was probably referring to the West Germans, whose bitter experiences of 1923 probably taught them the value of strong, honest, dependable money.

We have had no experience similar to Germany's runaway inflation of 1923. Let's hope we don't have to endure such a disaster, which some observers thought was a worse calamity for Germany than their losses of World War I. But adversity, if it cannot be avoided, can at least be put to good use. In the case of an inflationary collapse, it could teach us honesty. As Sennholz says, "Affliction is a school of virtue that may correct levity and interrupt the confidence of sinning. But how long and how often must man be afflicted before he learns the lesson?"[4]

[3]Ludwig von Mises, *Planning for Freedom* (South Holland, Illinois: Libertarian Press, 1974), p. 155.

[4]Hans F. Sennholz, "Two-Digit Inflation," *The Freeman*, January, 1975.

Jess Raley



Where There Was a Will—

IN AMERICA today there seems to be near universal awakening to the fact that something is wrong. Individuals in vast numbers are no longer inspired to excel in their respective fields of endeavor.

Business leaders fault labor, OPEC, government, imports and employee apathy. Labor blames business, government, OPEC, and the low wages paid in exporting countries. Rank and file citizens generally believe government, OPEC, labor, business and lousy working conditions to be the primary culprits. Government suspects business, OPEC, foreign ingenuity, lack of respect for the dollar abroad and malingering personnel on production lines. (Labor controls too many votes to be faulted by those who have to stand for election from time to time).

Every cognizant individual old enough to remember when the zest for life was, of necessity, honed to a fine edge is fully aware that the intangible known as the American will has, in fact, diminished perceptibly. The only thing I can't understand about the case of diminishing will—and it really bugs me—is so many people asking why.

One of the few things I know for an absolute certainty is why the American will (that seems to be the accepted term used, no doubt, to avoid complicated nomenclature) is less vivacious, aggressive, and steadfast than it once was—why so many individuals feel little, if any, responsibility for themselves, their job, family and government. I know why because I was there when it

Mr. Raley is a free-lance author, speaker, philosopher from Gadsden, Alabama.

happened, saw the seeds of irresponsibility planted and observed the first bitter fruits of that harvest.

Let me say at this point that I have never known or learned to think of an *average* person. The people I meet, get to know, learn to like or dislike, are all individuals and a surprisingly large number of them are by no means devoid of will. On the other hand relentless encroachment on freedom of choice, innumerable restrictive regulations on enterprise and the fact that people have learned that losers, as well as those who never see the starting gate, have equal recourse to one or more government wealth-sharing program tends to, more or less, dull the once fine cutting edge of America's will to excel.

In January 1933 I found it necessary to drop out of school. Dad was having a difficult time just feeding the family so I decided to move to my granddad's farm in Appalachia where I could, hopefully, earn my own living. Being in my middle teens at the time, I even expected to save enough money to return to school.

The old farm was in a steep narrow valley and, except for a few small level plots, the productive soil had washed away many years before. This was not particularly important to me since I didn't have the means to cultivate the land anyway, but I did find innumerable ways to make a living. I learned to hunt and trap animals for their fur, dig medicinal roots, especially ginseng, and where to sell them; find and rob wild bees; pick and market wild berries; and numerous other ways to earn money.

As a matter of fact I had a ball in Appalachia, lived well after the first few weeks and actually accumulated enough in the process to return to school. I was, therefore, really just a transient who learned from the local residents what I needed to know to attain my appointed goal, and then I moved on.

Everyone in the area must have been well below poverty level if there was a poverty level in those days. But the people who lived in the larger valleys and owned more level land seemed to be doing fairly well. It was the real poor folk, however, who lived in the ridges and small eroded valleys where I was, and were almost as poor, that I came to know and admire. These were the hustlers who parlayed their meager crops with what they could earn from other sources to sustain their families. In my opinion—and I've had a love affair with anthropology since the fifth grade—man, living in an organized society, has never been more free and independent than those people were. They accepted full responsibility for themselves and their families; no one expected anything from a source other than their own efforts.

Sometime that summer the government programs started. An agent came through offering to pay farmers from eleven to twenty-one dollars an acre, depending on how good he judged their cotton to be, to plow up all or any part of it. Most farmers plowed up some part of their crop. With cotton selling for about five cents a pound and the area's history of low productivity, it was the practical thing to do.

The difference in payment caused considerable resentment among neighbors, however, since in midsummer most farmers think their crop is as good as the best and better than the rest. I had put in a small crop that year after all by plowing for an elderly gentleman in exchange for the use of his mule and plow, a day for a day. Since I had only three acres of cotton, I didn't destroy any of it. I did get a preview, however, of how government programs would be administered when the agent paid his cousin top money for seven acres of very poor cotton while offering or paying at or near the bottom level to most everyone else.

Next came the commodity program designed by the "philanthropists" in Washington to feed the poor better than they could feed themselves while reducing the mountains of surplus commodities. The program seemed to work well in that it achieved these goals. No doubt its sponsors were quite pleased with themselves. But I still hurt when I remember what it did to most of the people who participated. In retrospect, these first ripples of government intervention were very small indeed in relation to the tidal waves that have followed. However, they were that first step of a long journey, a foot in the door that had heretofore been strictly private, the first pitch of a whole new ballgame.

At first only a few of the more indolent signed up to receive commodities. Then, as others saw their neighbors eating better without effort than they could eat by scratching as hard as they could, more and more people capitulated. It was like watching trees in a virgin forest fall and knowing they would never grow quite so tall again. Envy and resentment played a major role, along with nagging spouses. But for whatever reason, when individuals signed up for commodities they seemed to become different people, lose the essence of their zest for life.

Everyone in the area must have been eligible to receive commodities. At first, only a few signed up so the people who had accepted the job of distributing them were forced to get out and beat the bushes in an effort to find people who would take the mounting piles of food off their hands. I happened to be at a friend's house one day—we had cut a bee tree and were dividing the honey—when a commodity agent came by looking for prospects. He explained that the food was piling up and that he had to move it to hold his job. When we declined his offer the agent asked my friend point-blank why we refused; and I doubt to this day that a better answer could have been given.

"I don't do nigh as good a job supporting my family as I would like to do," he said, "but I well know whose job it is." That, I believe, is a classic example of the will, once so prevalent, that built America—the will so many people are hoping their fellow citizens can recapture in this age.

By the time I left Appalachia it was easy to detect participants in the commodity program just by talking with them. People who had been eager to help cut a bee tree, dig a load of rhododendron and ferns to sell, or any of the numerous projects that offered some small remuneration, were no longer interested after being on commodities for a while. More than this, their thinking changed perceptibly. Americans, since the Revolution, had felt responsible—not to government but for government—in the same sense that they felt responsible for themselves and their family. As individuals accepted or were forced to participate in various programs, they changed positions, in their own mind, placing government in the parent role of primary authority and responsibility. In less than two years, fully one-third of the people in the area were accepting government handouts in lieu of individual will.

The things I saw happen in that remote region were, of course, being acted out in every nook and corner of these United States. As the years passed, more and more people became addicted to an ever-increasing number of government programs. Industrial workers protected by powerful unions with unrealistic contracts, obtained in many cases with the aid of government pressure, often do no more than dabble at their work. Extra effort and ingenuity is not necessary to hold a job; as a matter of fact, motivation is often frowned on by fellow workers where just drifting with the flow has become the norm. After all, if the company goes broke, the employees can always draw their pennies.

Since the stone of necessity no longer keeps a cutting edge honed on individual will the American economy has been forced to draw more and more on that reserve we hillbillies are wont to call gut fat—capital, labor, technology and motivation invested before the American will was inhibited by government handouts and restrictions. In those days a man was responsible without recourse for his own house. He could invest his means in a business venture knowing that as the owner he could hire acceptable personnel, direct operations, enjoy the fruits of success, or suffer loss if the venture was a failure. The people employed by such a man knew they could do their job well and stay on the payroll, possibly moving to a better position if the business prospered; or they could fail to show incentive and find themselves terminated.

A long-time friend of mine has been associated with railroads all his working life. He and I were discussing this gut-fat proposition recently and he ventured the guess that if a railroad were built from scratch today, rights of way included, the builder having to contend with all the regulations and restrictions prevalent at this time, it would cost at least one hundred dollars to ship a peck of wheat bran, on said railroad, from St. Louis to Chicago. No doubt my friend exaggerated somewhat, but I would be unwilling to promote such a project hoping to prove him wrong.

With American productivity deteriorating progressively, rank and file citizens as well as leadership in government and business are voicing grave concern about the erosion of this element known as the American will. Even coming late in the game as it has, when our place in the sun is much less secure than it once was, this near universal awakening should be good for the country. I must admit, however, that I would be a great deal more elated if cognizant adults would quit "playing like" they don't know what's causing the trouble. This breed has been known to pour water on a drowned man in a sincere effort to revive him.

Grover Cleveland

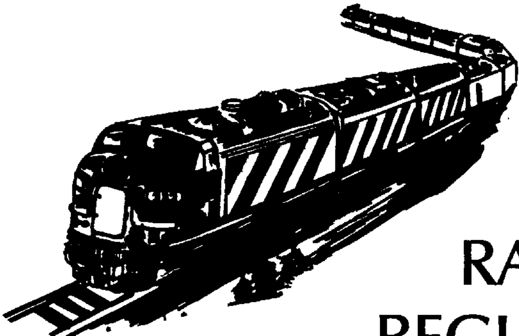
IDEAS ON LIBERTY

THE LESSON of paternalism ought to be unlearned and the better lesson taught that while the people should patriotically and cheerfully support their Government, its functions do not include the support of the people.

Every thoughtful American must realize the importance of checking at its beginning any tendency in public or private station to regard frugality and economy as virtues which we may safely outgrow. The toleration of this idea results in the waste of the people's money by their chosen servants and encourages prodigality and extravagance in the home life of our countrymen.

John Semmens

THE SOCIAL COST OF RAILROAD REGULATION



DESPITE the fact that the economic regulation of transportation has been an unmitigated disaster from the very beginning, substantive reform has been negated at every juncture. Worse still, each succeeding crisis has instead served as an excuse to aggravate the ills of existing government interventions by enacting even more regulations. These further interventions have been "justified" on the grounds that the consequences of deregulation would be too gruesome to contemplate. Removal of government controls would place the transportation industry and its customers at the mercy of the market. And we all "know" how horrible that would be.

Mr. Semmens is an economist for the Arizona Department of Transportation and is studying for an advanced degree in business administration at Arizona State University.

Well, perhaps we don't know how horrible it would be. After all, we cavalierly entrust our survival to essentially unregulated markets for food, clothing, and shelter. Transportation, though, we are assured, is different. One could hardly argue with that, if for no other reason than that it has been treated as different through government policy for nearly 100 years. It is a sobering thought to consider that a mere mountain of bizarre and absurd government rules and regulations is all that stands between the consumer of America and the menace of competition in transportation.

Given the professed importance of rail transportation to the "public interest" one might have anticipated that public policy would have paid greater heed to the financial health of the industry. Strangely, though, the importance of rail service has spawned curious theories of one-sided obligations.

The theory of the railroads' obligation to serve begins innocently enough with the rather bland assertion that railroads are different from other businesses. While this is true, it hardly follows that railroads can exist outside the constraints of economics that face every human enterprise in a world of scarcity. Rail service is not guaranteed merely because it is necessary or useful. Rail service, like any other economic good, requires resources. Yet, what are we to make of government decrees that railroads may be required to operate at a loss?[1] Or that such mandated losses do not constitute a form of confiscation?[2]

Ostensibly, the losses incurred in performing the vital public service of expending scarce resources on unused or underused rail service are to be made up by cross subsidy. The idea is that some other part of the rail system will bear an inordinate portion of the costs by excessive charges levied against its customers. However, both economic theory and experience indicate that cross subsidization doesn't work. Jacking up rates in excess of full cost invites competition to take away the disfavored customers. This is precisely what has happened in the transportation industry.

The government can force the railroads to suffer losses on little-used routes, but cannot deliver on the promise of higher profits elsewhere. The result is that despite the legislated "fair" rate of return of 5½% promised by the Transportation Act of 1920, the railroad industry has enjoyed a return of less than 5% since 1929, and less than 4% since 1955.[3] Even these anemic earnings overstate the return on investment because no adjustment is made for the effects of inflation. The impact of inflation is revealed in the insufficient reserves set aside for capital consumption. Since depreciation is based on historical cost rather than replacement cost, the yearly amount allowed for depreciation reserves will, when the time for replacement arrives, amount to too little to replenish the worn out track and equipment. Meanwhile, money which should have been accumulated to serve this purpose has been reported, and taxed, as income.

Railroad Earnings

The magnitude of the impact of inflation is indicated by the estimated differences in return for the fifteen largest railroads (based on 1977 revenues) for selected years since 1960. As can be seen from the table, after adjustment for inflation, the return on investment never exceeded 3%. Worse yet, by 1977 the return was a pathetic .2% (two tenths of one percent).

IMPACT OF INFLATION ON INVESTMENT RETURNS FOR FIFTEEN RAILROADS, 1960-1977

Year	Based on Reported Earnings	After Inflation Adjustment
1960	3.3%	.8%
1965	4.7%	2.8%
1970	3.9%	2.2%
1975	3.6%	.2%
1977	4.7%	.2%

Sources: *Moody's Transportation Manual* and *Survey of Current Business* (Bureau of the Census). The reported financial results were adjusted using the implicit price deflators for rail structures and equipment and the estimated proportion of asset life remaining.

The 15 railroads used in the sample were: Burlington Northern; Southern Pacific; Santa Fe; Union Pacific; Norfolk & Western; Missouri Pacific; Seaboard Coast Line; Louisville & Nashville; Baltimore & Ohio; Southern Railway; Illinois Central & Gulf; Chesapeake & Ohio; Chicago & Northwestern; Chicago, Rock Island & Pacific; St. Louis-San Francisco.

Such low rates of return are clearly inadequate to sustain anything close to existing levels of rail service regardless of the legislated "obligations to serve." Under such conditions, the shift of capital out of the railroad business becomes inevitable. Since capital is a limited resource, those opportunities which offer better rates of return go to the head of the line. Almost anything beats the return yielded by rail investments. It should come as no surprise, then, that the management of railroad firms would seek to diversify out of the rail business.

Some degree of concern has been voiced that the diversion of rail retained earnings to non-rail investments will weaken the capacity to provide rail services. There can be little doubt that the trend is away from rail investment and that this must inevitably reduce the capacity of the rail system. Far from being a sinister threat to the public welfare, however, this shift of resources from potential rail investment to other lines of business is a pragmatic response to a more urgent order of consumer needs. Channeling resources to these more urgent needs is a prime example of the exercise of socially responsible corporate management. Since resources are limited, it is desirable that they be put to their best use. The venture into non-rail lines of business by railroad firms is a reaction to, not a cause of, low returns in the rail industry.

Signals for Change

Low return on investment is a social signal indicating that consumers want less of the particular product or service offered and more of some other product or service. Railroad management would be misusing the resources under their control if they were to ignore this signal. Perhaps the signal is less than completely valid given the fact of heavy governmental intervention in the business. It is quite possible, even likely, that this intervention, itself, has played a key part in reducing returns and diverting resources out of railroading. If legitimate high order of urgency needs for rail service are not being met, we must look to the constraints imposed by public policy for an explanation, not fault railroad management for pursuing sound investment opportunities through diversification.

It may be that the low return in regulated industries results from the old theory that such industries, having an "assured" level of profit written into law, were less risky, and therefore, would normally be expected to experience low rates of return. In recent years, though, it has become painfully obvious that the "assured" level of profit all too often has proven a ceiling rather than a floor. Consequently, at the same time that the internal rate of return on rail investment has been declining, the return on investment demanded by securities holders has been increasing.[4]

Capital Requirements

Investors looking to the future are unimpressed by the regulatory authorities' concern with insuring that firms recover historical costs. Stock prices have been bid down below tangible book value, effectively cutting the regulated firm off from new equity capital. Access to external sources of capital may be critical to the railroad industry in the years immediately ahead. The U.S. Department of Transportation has estimated the railroad industry will require $16 billion in outside capital between 1980-1985 in order to maintain the existing level of service. Unless the rate of return on rail investment improves markedly in this period, the public interest can be best served by reduction of service and disinvestment in low-yielding rail facilities. In this way, resources that would be underutilized on lightly traveled rail lines could be redirected to society's more urgent needs.

It is unreasonable to expect railroads to continue to invest money at such low rates of return. This realization has spawned a number of subsidy proposals. In 1970 the Rail Passenger Service Act established Amtrak—a government-owned and operated passenger service. In 1976 the Railroad Revitalization and Regulatory Reform Act led to the formation of Conrail—a government-owned and operated freight service. The 1976 Act also set up procedures whereby unprofitable branch lines could receive subsidies to retain rail service. While it is true that government subsidies could improve the return on investment from the perspective of the railroad firm, the subsidy, since it is a transfer payment, does nothing to improve the total return on society's limited resources. In fact, since the funds for subsidy must be drawn from investments with higher rates of return, the net social benefit of the transfer is negative. That is, fewer goods and services in total will be available than if the transfer were not made.

Paying the Price

Two general policy directives provide the guidance for Interstate Commerce Commission regulation of transportation. On the one hand, the Commission is bound to prevent rate discrimination. On the other hand, the inherent advantage of each mode is to be preserved. To begin with, "preventing" and "preserving" are innately conservative activities. Even if such activities were appropriate when first instituted, time would inevitably render them less and less satisfactory. As it is, though, the directives are based upon fallacious economic doctrine and are representative more of wishful thinking than practical policy.

The social prejudice against rate discrimination springs from the notion that it is unfair to charge different prices to different buyers for the "same" service. The early examples of rate discrimination involved circumstances in which a railroad might charge a lower rate for a long haul than for a short haul. The lower rate is to be distinguished from a mere quantity discount. The long haul total charge would amount to less than a short haul charge, sometimes over the same track. Superficially, using estimates of average costs to provide service, it can appear "unfair" that a short haul which should cost less to supply, has a higher price tag. The problem with this line of reasoning is two-fold. First, no two buyers of rail service are purchasing identical service. Second, the reported "cost" of providing a service, even if it can be accurately determined, may be relatively unimportant in establishing the price of any specific transaction.

Transportation is purchased in terms of origins, destinations, and time periods. Even goods moving between the same two points may require different handling in terms of quantity, time of year, hour of the day, and the like. The service provided cannot be uniformly divided into equivalent units, such as ton-miles. Yet, this is precisely what regulation has led to. The imposition of this type of price control can have two kinds of results: none and bad. In the instances where the regulated price exactly matches what would have been the free market price, the regulation will have no impact. In the far more frequent instances where the decreed price is either higher or lower than what the market price would have been, undesirable consequences will result.

Wasteful Controls

In the cases where the controlled rate exceeds what would have been the market rate, traffic will be diverted to a second best alternative. This leads to inefficient use of resources, as the second best alternative will almost certainly be at a higher cost. At the same time, the loss of revenue occasioned by the diversion will reduce the incentive and capacity of the firm to produce and provide the first best alternative. This phenomenon is demonstrated when the regulatory authority prohibits rate reduction by insisting that a move must cover fully allocated costs. Given the high proportion of fixed to variable costs typical in the railroad business, this regulatory approach prevents the realization of certain economies of scale, places the railroad at a competitive disadvantage, lowers total economic output, and increases the aggregate expenditure of resources.

In cases where the controlled rate is less than what would have been the market rate, uneconomic demand for the service will be stimulated. If the rate control were the only intervention, the suppliers of the service would seek to withdraw from the market. Unfortunately, further regulatory impositions usually prevent this from taking place. Railroads are frequently required to retain service which cannot earn enough to pay its own way. The retention of such "vital" services is not without its attendant social cost. The resources expended at a loss are thereby unavailable for more useful employment.

Furthermore, the alternative modes which could have provided economical service are prevented from making a contribution toward a net societal profit. This regulatory approach is especially insidious. The preservation of lightly traveled branch lines is the readily observable effect. What is not seen is the sacrifice of more beneficial alternatives. In this case, certain diseconomies are enforced, leading to a weakening of other rail services, lower total economic output, and wasteful consumption of scarce resources.

The 1940 Transportation Act instructed the Interstate Commerce Commission to preserve the inherent advantages of each mode under its jurisdiction. As anyone familiar with economics knows, the market, left to itself, will promote efficiency. As resources seek the highest rates of return, the "inherent advantages" of any operation will most assuredly be employed. Since the economy is dynamic, today's "inherent advantages" may be tomorrow's outmoded techniques. Instructing the ICC to preserve the inherent advantages of each mode in 1940 has had the unhappy result of retarding progress.

That this preservation policy has stifled innovation is demonstrated by the historical record. The ICC's persistent adherence to full cost allocation, as exemplified in "Rail Form A" costing rules, has killed off several rail car innovations. The required average cost basis for rate making would not permit rates low enough to generate the volume needed to support the innovations. Interstate Commerce Commission rigidity resulted in some classic instances of delay in the introduction of rail inventions, including retarding the spread of unit train technology for over 40 years.[5]

Who's to Blame?

The railroad industry and its managers have often been chided for lack of imagination. It is sometimes claimed that the poor rates of return enjoyed by the industry are a result of this lackluster management. But which is cause and which effect? The poor returns on investment are directly traceable to regulatory policy. In turn, poor investment return reduces the resources available for innovation. Finally, the necessity to have changes in business operations approved by a group of politically appointed Commissioners must frustrate whatever innovative urges may arise. The fact that business is dynamic and forward looking, while the process of regulation is deliberative and static, poses a serious threat to the survival of the railroad industry.

The magnitude of the social cost of railroad regulation is enormous. One author called the welfare loss "huge" and "certainly greater than all of the welfare losses from pure enterprise monopoly combined."[6] In 1969 the social cost of railroad regulation was estimated at between \$2.7 and \$4.1 billion per year.[7] Given the rampant inflation of all costs since that time, especially rail inputs which have increased in cost faster than the more general consumer price index, a reasonable estimate of the current social cost of railroad regulation would range from \$5.5 to \$8.0 billion per year.

Conclusion

There can be no question but that regulation of the railroads has led to higher overall transportation costs, serious resource misallocation, and sacrificed alternatives. Public policy has made the economic pie smaller by its intervention into the transportation industry. That this result could be in the "public interest" seems ludicrous. Yet, promoting the "public interest" is the reputed goal of public policy. Two explanations come readily to hand. It may be that various "private interests" may manipulate public policy to their own advantage.[8] Alternatively, it may be that the makers of regulatory law fail to anticipate the consequences of their actions.[9]

Wherever the truth may lie, the observable consequences of economic regulation of the railroad industry are demonstration enough that the current system not only imperils the railroads, but has a negative net impact on the general welfare. This in itself should be sufficient evidence that deregulation will benefit both the railroads and the U.S. economy.

—FOOTNOTES—

[1]Arizona Corporation Commission vs. Southern Pacific, 87 AZ 310.

[2]Northwest Pacific Railroad vs. ICC, 288 F. Supp. 690.

[3]Alexander Morton, "Northeast Railroads: Restructured or Nationalized?" *American Economic Review* (May, 1975), pp. 284-288.

[4]Stevan Holmberg, "Investor Risk and Required Rate of Return in Regulated Industries," *Nebraska Journal of Economics and Business* (Autumn, 1977), pp. 61-74.

[5]Paul MacAvoy and James Sloss, *Regulation of Transport Innovation* (N.Y.: Random House, 1967).

[6]George Hilton, *The Transportation Act of 1958* (Bloomington: Indiana University Press, 1969).

[7]Ann Friedlaender, "The Social Costs of Regulating the Railroads," *American Economic Review* (May, 1971), pp. 226-234.

[8]George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics* (Spring, 1971); Sam Peltzman, "Toward a More General Theory of Regulation," *Journal of Law and Economics* (August, 1976), pp. 211-240; and John Semmens, "Regulation of the Truckers, By the Truckers, For the Truckers," *Reason* (March, 1979), pp. 26-29.

[9]Robert Harbeson, "Social Welfare and Economic Efficiency in Transport Policy," *Land Economics* (Feb., 1977), pp. 97-105, and William Capron (ed) *Technological Change in Regulated Industries* (Washington, D.C.: Brookings Institution; 1971.)

P. Dean Russell

EDUCATION and GRADES

THE AWARDING of grades is often the most distasteful task faced by teachers on any level. To some extent, the grading process automatically puts a barrier to learning between student and teacher. This is especially true on the senior high school and college levels. The student may hesitate to say what he thinks because the instructor may mark him down for heretical ideas, i.e., disagreeing with the instructor. This fear is all too often based on the student's experience.

The student-teacher relationship that most appeals to me is the one developed a millennium or so ago by the Saracens. We know those people as the "bad guys" in the Crusade capers of our European ancestors.

Anyone who wanted to teach in the old Saracen civilization could do so, if he could find someone who wanted him as a teacher and who would pay for his services. Jew and Christian and Moslem, black and white, all participated. Race and religion were *not* barriers to entry into this serious business of learning, either as a teacher or as a student.

The teacher was not licensed or certified to be a teacher, and he didn't license or certify anyone as a student. There were no academic requirements for admission into this learning process. The student and teacher just made an arms-length bargain acceptable to both. If the student became dissatisfied with his teacher, he simply found another teacher who pleased him more, in much the same manner that you and I change swimming instructors or piano teachers. When the student had learned as much as he wanted to learn, he left. He, and he alone, made the decision, precisely as a present-day student in a commercial language school decides when he has learned as much as he is willing to pay for.

No formal examinations were given in those ancient centers of learning. No degrees were awarded.

Professor Russell hands this essay on education to all students who take his course in Business Communications at the University of Wisconsin at La Crosse.

No academic records were kept. Thus the only power possessed by the teacher in the old Saracen tradition of education was the power of logic and persuasion. He didn't have a "magic marking pencil" loaded with an unlimited number of A's and F's as we instructors do today.

The students could hardly riot against the Saracen education establishment. There wasn't any. And, apparently, those centers of learning (universities) were generally free from supervision and control by government. Nor were there any academic accrediting associations which, of course, cannot precede but must necessarily follow the establishment of a formalized educational system.

The physical plant (the actual buildings) of those places of learning were sometimes provided by the religious authorities, sometimes by government, sometimes by commercial interests on a rental basis, sometimes by the same commercial interests on a "for free" basis dictated by self-interest, sometimes by individuals (teachers and others) who used their homes as classrooms, and sometimes the students and their teacher just met for discussions in some public coffee house. Sometimes the physical plant was a combination of all of these, located around a library that had developed in much the same way as the rest of this center of learning or university. The supporting services—food, lodging, medicine, social life, and so on—were provided by persons who profited directly from supplying the product or service.

Those universities continued to grow and develop over the centuries into renowned centers of learning with, apparently, almost no academic formality or authoritarian supervision. In some respects (but certainly not in all respects) many of the medieval universities of Europe were patterned upon that old Saracen concept of education.

In today's world, there is not any academically successful arrangement that's quite like the ancient Saracen method of teaching and learning. The concept of the "University Without Walls" that showed much promise a few years ago was based somewhat on that philosophy, as was the "Open University" sponsored by the British government. While several educational institutions still endorse that concept in various forms, most of the experiments seem inevitably to revert to traditional assignments and grading procedures. Only the mechanical methods of delivery deviate much from the norm, e.g., teaching by TV or the mails or weekend classes on campus and such. Also, more "nonaccredited" teachers may be used.

The closest development to the old Saracen concept of education today is found in various educational "centers" (for the study of something) which are supported by a combination of industry, foundations, universities themselves, religious organizations, and interested individuals—and sometimes by government, directly and indirectly—but which are not positively controlled by an "establishment" of any sort. In these communities of scholars, it is often difficult to determine who is teacher and who is student, and they sometimes change positions overnight. The feature most closely akin to those old Saracen universities is the fact that no examinations are given, no degrees are awarded, and the only academic records kept are the publications of students and teachers.

Those few communities of scholars, however, are essentially outside of the academic system typified by our degree-granting colleges and universities. I do not know of even one accredited educational institution that does not, in one way or another, grade the students who are candidates for degrees; nor can I visualize any acceptable way of avoiding this arrangement in today's world. The grade may be merely pass or fail. And it may be based on independent study or classroom work or various other possible arrangements. But *always,* where academic credit is involved, grades are required. And we teachers—with our inevitable magic marking pencils—are inescapably responsible for awarding the grade. We *must* decide—that is, we cannot possibly avoid deciding—criteria for high grades and low grades. There is simply no way around this arbitrary authority of the teacher (me) over his students (you) in our formalized educational system.

Even so, if you would still like to study with my help, welcome. I assure you that I find students in general most stimulating, that I have a recognizable philosophy of living in our real world, and that I would enjoy sharing with you my extensive experiences (both successful and unsuccessful) in the business world, in the writing and speaking world of communications, and in studying and living abroad and in various sections of the United States. And, of course, I'll be pleased to react to whatever experiences and ideas you care to share with me, publicly in class or privately in my office.

Naturally, I will do whatever I can to help you learn whatever you desire to learn (or must learn) while you are fulfilling the academic requirements for your degree from this university. I will also do all I can to help you earn the highest possible grades. That's important too.

Finally, please remember that I'm not so insecure that I need to put people down. So speak up.

Clarence B. Carson

PERMANENT DEPRESSION

MANY economists, journalists, and publicists spread the view after World War II that we now know how to prevent depressions. The claim was that the government could prevent depression by manipulating the money supply, altering the tax structure, providing employment, and "stimulating" the economy. If these, and like measures, were undertaken judiciously, depressions were supposed to be avoidable.

The evidence is mounting that such is not the case. The United States has been in the throes of depression for most of the 1970s, a depression which threatens to deepen and shows no signs of going away. All the devices which were supposed to prevent depression have been extensively employed, but to little or no avail. In fact, there is good reason to believe that the very measures supposed to prevent depression are prolonging and deepening it. But to grasp the full implications of this we need a new or different concept. I suggest we view what is happening to us as "Permanent Depression." And we may look to Soviet Russia, Communist China, Castro's Cuba to see where that road leads.

Permanent Depression is that condition which exists when there is *involuntary underemployment* of land, labor, and capital to satisfy human wants. Permanent Depression may be great or small. It may be so small that its direct effects would be experienced by only a few people. Or, it may be so massive as to erupt in what will be recognized as a Great Depression engulfing

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Dr. Carson has written and taught extensively, specializing in American intellectual history. His recent series in *The Freeman, World in the Grip of an Idea,* is being published by Arlington House.

peoples around the world. But whether massive or tiny, whether apparent to everyone or knowable only as potentiality, Permanent Depression exists wherever there are obstacles which result in involuntary underemployment of land, labor, and capital to satisfy human wants. It is a depression because less is produced than otherwise might have been. Goods are less plentiful than they might have been. Prices are higher than they might have been. Human wants go unsatisfied, and to the extent that the condition is involuntary it is a depression.

Why not simply "underemployment . . . , " it may be asked? It is true that any underemployment of resources would result in less than full production. But if the satisfaction of human wants is the goal of the activity, voluntary underemployment must be permitted. Saving, leisure, and possession for convenience and enjoyment are human wants—any of which may occasion underemployment. To formulate the matter otherwise would involve the contradiction of sacrificing the wants of some to satisfy the wants of others. So long as the wants of all are in play, there is no reason for describing the resulting condition as depression. Whereas, if the underemployment is involuntary, the satisfaction of wants is clearly being reduced, i.e., depressed.

This brings us, too, to the cause of the Permanent Depression. The cause is implicit in the word "involuntary." The cause is that force has been intruded into human activity so as to place obstacles in the way of production. Force in one form or another is the only plausible explanation of involuntary activity or inactivity. Although the use of force may be variously motivated and be used for any number of objects, it can have only two origins. It must either be exerted by outlaws or through the agency of government. Since it is the business of government to apprehend and restrain outlaws, the proximate cause of Permanent Depression is government, either through failure to perform its function or by positive acts of compulsion.

Discouraging Production

Governments can and do cause Permanent Depression. Indeed, they are directly the usual cause and the only bodies who could make it permanent. Nothing is easier to accomplish than for government to bring on Permanent Depression. All it has to do is to adopt measures which have the effect of discouraging production. A review of the history of the world would show that as soon as any government has consolidated its power over a people—gained a monopoly of power—it has in one way or the other gone about the task of discouraging production. In our era, governments have not only discouraged production but also encouraged consumption, thus deepening and broadening the Permanent Depression. The movement to do this is now world-wide, but let us restrict our account largely to the United States.

For several decades now—indeed, for the better part of a century—the leaders of the United States have been acting on the basis of a profound economic error. It is not a new error, but it has been given impressive academic credentials over the past century. The error can be stated this way, though it is not usually put so bluntly or directly: *The way to prosperity and national felicity is to discourage production and encourage consumption.* Stated so generally and baldly, the fallacy of the proposition may show through. But that is not how we ordinarily confront it. It is usually advanced in some particular application, and down where each of us lives, the proposition has great appeal.

Let me illustrate. Everyman is usually firmly convinced that he knows the solution to his economic problem, if he has one. The problem is this, as he sees it: There are too many producers of the goods he produces or too many providers of the services he provides. Which of us is immune to this notion? I know—don't argue with me on this one—that there are too many writers. No doubt, I would know with equal clarity if I were a real estate salesman that there are too many of those. In like manner, the managers of Chrysler Corporation can see that too many automobiles are being produced. Or, to turn the problem around, there are too few customers for the goods and services we have to offer. The solution is obvious. Have government discourage production—at least that of the others—and encourage consumption—at the least of whatever it is I have to offer.

Say's Law

The error in these beliefs is by no means obvious, certainly not in the particular applications. Yet it is a prescription for Permanent Depression. That measures based on the error would lead to depression was pointed out nearly two centuries ago by J. B. Say. The corrective to the error was stated in what has come to be known as Say's Law.

J. B. Say was a French economist, a contemporary, more or less, of Adam Smith. His economic treatises were published in the early years of the nineteenth century. His works never attained the renown of Smith's. Today he is remembered, if at all, for the economic law which is joined to his name. And even the law has fallen into disrepute among many economists, for reasons that may be apparent when it has been examined. Various claims have been made to its refutation, but that is easier said than done.

Say's Law is usually stated this way: "Production creates its own demand."[1] I know of no general law more infelicitously stated. It is subject to all sorts of misinterpretations. It must be immediately qualified in order to get to its meaning. To wit: The act of production does not create demand. It is only when what has been produced is offered in the market that it becomes demand. Even that is not obvious. Moreover, not just anything that is produced and offered in the market becomes demand. Only those commodities or that labor which is wanted will become demand. Nonetheless, that production creates its own demand may be the most direct and effective way to state the law.

Some propositions which undergird Say's Law need to be stated in order to establish its validity. The most important is this. In the absence of a medium of exchange, or money, if you will, supply *is* demand and demand *is* supply. This can be readily demonstrated by a simple barter situation. Suppose that I grow tomatoes and my neighbor grows bell peppers. My family having set up a clamor for bell peppers, I approach my neighbor with the proposal that I will give him twelve of my tomatoes for twelve of his peppers. He consents, and the exchange is made. Clearly, my supply of tomatoes constituted the demand for his peppers. In like manner, his supply of peppers constituted his demand for my tomatoes. It is not difficult to see, either, that it was my production of the tomatoes that created the effective demand for the peppers.

The Use of Money in Trade

It was Say's contention that the use of money in effecting exchanges does not fundamentally alter the situation. Fundamental they may not be, but there can be no doubt that the use of money changes some things. When money is used in transactions, supply and demand assume separate guises. It becomes possible to calculate price levels. Demand comes to be expressed as money and supply as goods. An opening occurs for monetarist illusions that demand can be increased by increasing the money supply. Even so, Say maintained that it is only an illusion that money is ever anything more than a medium through which goods are exchanged for goods. He put it this way: "Money performs but a momentary function in this double exchange; and when the transaction is finally closed, it will always be found, that one kind of commodity has been exchanged for another."[2]

John Stuart Mill noticed that

there is another difference which comes into play when money is used. There is, he said, "this difference—that in the case of barter, the selling and buying are simultaneously confounded in one operation; you sell what you have, and buy what you want, by one indivisible act, and you cannot do the one without doing the other. Now the effect of the employment of money, and even the utility of it, is, that it enables this one act of interchange to be divided into two separate acts or operations; one of which may be performed now, and the other a year hence, or whenever it shall be most convenient." The seller "does not therefore necessarily add to the *immediate* demand for one commodity when he adds to the supply of another."[3]

The Timing of Trade

What occurs may be described this way. The demand which arose from a product at some time in the past is transferred into money in which it may be said to reside until another purchase is made. But this is a never ending process, so long as the money remains in circulation, so that at any given time some of the demand resides in the medium through which exchanges are made. None of this changes the validity of the fundamental axiom, as Mill affirms: "Nothing is more true than that it is produce which constitutes the market for produce, and that every increase of production . . . creates, or rather constitutes, its own demand."[4]

Say's Law impressed and was accepted by many of the greatest economists of the past two centuries. David Ricardo affirmed and applied it. John Stuart Mill, as just noted, accepted it as axiomatic. Say's works provided an important part of the foundation for Frederic Bastiat's writing. Amongst our contemporaries, William H. Hutt has declared "that the Say Law stands once again inviolate as the basic economic reality in the light of which all economic thinking is illuminated."[5] Moreover, it is a self-evident truth whose validity may be tested and proved by all who have some understanding of the world in which we live.

"Production creates its own demand." We have now arrived at the point, perhaps, where we can affirm the importance of the word "production" in the statement of the law. However misleading it may be on first encounter it is nonetheless the key to the significance of Say's discovery. Production is the road to prosperity, the law informs us. If there is a fall off in demand, the way to increase it is to increase production. If supply is declining the way to signal demand is by production.[6] The only limit on the degree of potential prosperity, Say was telling us, is whatever limits there may be to productivity of what is wanted.

The way to create Permanent Depression can now be restated. It is to act on the premise of the reversal of Say's Law. Reversed, it can be stated this way: Consumption creates its own supply. Although no one to my knowledge has phrased the proposition that way, it is the necessary premise for much that is believed. The notion of a general overproduction of goods is premised upon it. In like manner, it is the underlying premise of all notions that the economic problem is to stimulate consumption. So far as programs to discourage production and encourage consumption have an economic premise, it is the one arrived at by reversing Say's Law.

Barriers to Commerce

Even a brief survey of government programs will give some indication of how deeply involved the United States is in discouraging production and encouraging consumption. Indeed, such policies are not entirely new in this country. The protective tariff was a fixture in the United States in the latter part of the nineteenth century. Although proponents of the protective tariff have often advanced it as a device to encourage production, it does not have that effect. So far as it works, it discourages domestic production by denying some of the foreign market to American products. If domestic producers are enabled to supplant foreign producers as a result of the tariff the true significance is that Americans produce less, and at higher cost, than if their resources had been directed to that production which Americans could do most efficiently. Foreign loans, much used in the twentieth century, have the economic effect of encouraging foreign consumption at the expense of domestic, and discouraging production for the domestic market.

But it is in the twentieth century that so many devices have been adopted to encourage consumption and discourage production. Since it would take a massive catalogue to detail them all, it will be possible here to touch only on some of the broad categories.

All redistributionist programs, whatever the motives for enacting them, have the effect of encouraging consumption and discouraging production. This is so whether it is school lunch programs, food stamp programs, urban renewal projects, CETA, government operated educational institutions, welfare payments, or what have you. Redistribution takes away from potential saving and investment and allots the money where it is likely to be spent for consumption. Thus, it discourages production by making it more difficult to accumulate capital with which to produce. The progressive income tax is not only a redistributionist measure but also one which patently discourages production and, depending on how it is spent, encourages consumption. All payments made to the idle have the effect of discouraging production and making the recipient a consumer only.

Inflationary Distortions

The effects of inflation—increase of the money supply—are somewhat more complex. On the face of it, much of the increased money supply is an encouragement to production, for it may be spent on plants, machinery, and productive equipment. But this is misleading. Inflation encourages the consumption of capital or productive equipment, not production as such. It sends false signals into the market by leading to a general rise in prices, leading to indiscriminate increases in production, many of which are unwarranted. Inflation, then, tends to encourage consumption, encourage indiscriminate production, and hence to discourage the concentration on producing what is most wanted, which is that portion of production which contributes most to prosperity.

Price controls have the general effect of encouraging consumption and discouraging production. And such controls are rampant in the United States today. Minimum wages, whether established by law or by unions, whether called minimum wages or salaries or wages prescribed in a civil service structure, are price controls. Moreover, wage price controls discourage production. They do so, in the first place, by reducing the number who might be employed in production—causing unemployment. In the second place, where the unemployed are paid, either in unemployment compensation or as welfare, there is an encouragement to consumption unmatched by production. Maximum prices are widespread today, on domestic oil, on much of transportation, on milk, on gas, and for hundreds of other goods and services. So far as these prices are below what they would be in a free market, they discourage production and encourage consumption.

Many sorts of government controls discourage production without themselves encouraging consumption. Government monopolies discourage production. The monopoly which the United States Postal Service has over the delivery of first class mail, for example, prevents others from entering the field and providing the service. The virtual monopoly which governments have of schooling discourages others from entering that field. Indeed, all government licensure and franchising discourages production. "Licensure," Milton Friedman has said, "is a special case of a much more general and exceedingly widespread phenomenon, namely, edicts that individuals may not engage in particular economic activities except under conditions laid down by a constituted authority of the state."[7] Such activities are usually justified on the grounds that they protect the public by maintaining standards, but whether they do or not, by restricting entry they discourage production.

Costly Regulations

Government regulation of industry, whatever its aim, discourages production. Quality controls, environmental controls, safety regulations, prescriptions for labeling, and so on are just so many difficulties in the way of producing goods. Government prescribed record keeping and reporting to government are discouraging to production. They raise the cost of producing and keep from the market myriads of products.

Generally speaking, governments in the United States do not avowedly aim to discourage production today. For a while in the 1930s, and to a lesser extent in the 1940s and 1950s, there was a conscious effort to limit production. Nowadays, however, production, *per se,* is not the avowed object of government control. It is even usually admitted, perhaps reluctantly, to be a good thing. But the government does often avowedly encourage consumption and by so doing proclaims that consumption, in effect, creates its own supply and leads to prosperity.

J. B. Say wrote precisely to the point. He said "that the encouragement of mere consumption is no benefit to commerce; for the difficulty lies in supplying the means, not in stimulating the desire of consumption; and we have seen that production alone, furnishes those means. . . . For the same reason that the creation of a new product is the opening of a new market for other products, the consumption or destruction of a product is the stoppage of a vent for them."[8] He goes on to point out, of course, that the consumption of a product is not an evil, for it is the end for which the production was done. But then, neither does the consumption itself contribute one whit to any further commerce.

It is an evil, however, he said, when consumption begins to exceed production. What then happens: "the demand gradually declines, the value of the product is less than the charges of its production; no productive exertion is properly rewarded; profits and wages decrease; the employment of capital becomes less advantageous and more hazardous; it is consumed piecemeal . . . because the sources of profit are dried up. The labouring classes experience a want of work; families before in tolerable circumstances, are more cramped and confined; and those before in difficulties are left altogether destitute."[9]

That is an apt description of what is happening in the United States today, though it was written nearly two hundred years ago. We are inclined to ascribe our difficulties today to inflation. Undoubtedly, inflation is an important part of our difficulty, but it is not at the root of the trouble. Our trouble stems from acting as if consumption creates its own supply, from turning Say's Law upside down. We have been encouraging consumption and discouraging production. Every effort in that direction contributes to the breadth and depth of a Permanent Depression. When restrictions on production have proceeded far enough Permanent Depression emerges as the kind of depression we recognize from the past. Except, the underlying Permanent Depression may have been transmuted into a visible permanent depression.

Say's Law points away from Permanent Depression. It points toward, if not Permanent Prosperity, at least to as great prosperity as is possible for man. What is government's proper role in this prosperity? John Stuart Mill put it this way: "The legislator has to look solely to two points: that no obstacle shall exist to prevent those who have the means of producing, from employing those means as they find most for their interest; and that those who have not at present the means of producing, to the extent of their desire to consume, shall have every facility afforded to their acquiring the means, that, becoming producers, they may be enabled to consume."[10] In short, government should remove its obstacles to production and take what measures are appropriate to it to facilitate production. Then, all may consume at will, and as they will, what they have produced themselves, or acquired from others with their production.

—FOOTNOTES—

[1]For a more complete statement of its implications, see Henry Hazlitt, *The Failure of the New Economics* (New Rochelle, N.Y.: Arlington House, 1973), pp. 35-37.

[2]J. B. Say, "Of the Demand or Market for Products" in Henry Hazlitt, ed., *The Critics of Keynesian Economics* (New Rochelle, N.Y.: Arlington House, 1977), p. 15.

[3]John Stuart Mill, "On the Influence of Consumption on Production" in *ibid.*, pp. 41-42.

[4]*Ibid.*, p. 44.

[5]Svetozar Pejovich and David Klingaman, eds., *Individual Freedom: Selected Works of William H. Hutt* (Westport, Conn.: Greenwood Press, 1975), p. 141.

[6]No one is relieved by Say's Law from applying intelligence to production, of course. It is necessary to determine what is wanted and to go about producing it efficiently if production is to become effective demand and profitable.

[7]Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 138.

[8]Say, *op. cit.*, pp. 20-21.

[9]*Ibid.*, p. 22.

[10]Mill, *op. cit.*, p. 26.

Barbara H. Bryan

Free Market: Elementary, My Child

Interventionist?

Who me—Free Market Mama?

Confession being good for the soul, I'll have to admit that I almost slipped—consciously at that—into an interventionist role.

And, candidly, had the reverse order of the following story occurred, I would have.

It happened when a 25-cent toy stamper (it inked pairs of black feet on any surface it touched) went through a price rise of some 1100 per cent within a few hours in our home.

The stamper was given to Jim Dixon by his grandmother. His buddies were enchanted when he decorated them with little black feet.

Barbara Hauser Bryan is a mother "mostly" and free-lance writer in Roanoke, Virginia.

Their mothers may have been somewhat less delighted, but Jim Dixon was a trendsetter with fellow first graders. Therefore, the item had even more appeal.

Jim is a special friend and favorite of my three sons. They are with him in Sunday School and around the neighborhood. Last year he and Callan were in kindergarten together. Russ (Callan's twin) was in first grade with him this year. Big Brother Eason, a second grader, also thinks Jim is cool. The stamper represented the last word to all of them.

So when Russ came home and announced that he had just purchased the stamper for one dollar, I noted that he had made a willing exchange in a "seller's market." He

Left to right, Callan, Mom, Russ (standing) and Eason.

could not have been happier. Jim realized he had struck a good bargain, so we all grinned.

About an hour later, Callan emptied his piggy bank and told me that he had to have enough money for 28 pieces of bubble gum. He said he only had enough "cents" for 23 pieces.

Assuming that he wanted everyone (20 classmates, hmmm?) in his class to have a piece, I offered him a window-washing job for a dime. Using the best of Tom Sawyer technique, he engaged Nicky and Wilson forthwith and managed it with great dispatch.

Soon he left with his full complement of cash. The story extends slightly because the convenience store clerk quite accidentally shortchanged him. With his finest eyes-just-above-the-counter aplomb he returned to the store and evened the score. Soon the bubble gum had been turned over to its new owner.

That person, it turned out, was his twin brother Russ, who for the bubble gum and two one-dollar bills released title to the stamper.

The story might have ended there. Nobody was interested in my suggestion that we telephone Jim's grandmother to ask where she had bought the feet stamper. Big Brother, usually shrewd and definitely well-heeled, entered the picture.

Simply because of his status as first-born, he had amassed a much fatter passbook savings account than his siblings. And, frankly, he gets a little horsey about his couple of hundred extra dollars.

Anyway, supply and demand being what they were that day, he and Callan wound up in a fascinating trading session. When we sat down to dinner, they had already agreed that Eason would fork over three dollars for the one-of-its-kind (at least in our house at that minute) item.

Knowing beyond question that he held all the cards, Callan savored his rare upper hand by playing wishy-washy. He said he might change his mind. He thought about upping the ante. He even said he might trade back with Russ and get his money returned.

We noted with three dollars he could repay himself and buy *more* than 28 pieces of gum. Eason was becoming nervous.

(At that point they counted the bubble gum and Russ The Casual learned that he had been shorted by three pieces which Callan admitted to sharing with his fellow window washers.)

My only intervention was to compliment them on their practice of free market economy. We did discuss supply and demand—*and* rampant inflation. And, I did suggest that a bargain struck should be honored. Translated: Callan shouldn't weasel out if Eason really wanted to pay that exorbitant figure—with his educated eyes open.

Had the reverse occurred—Eason preying upon Callan who would have hoodwinked Russ who would foist the stamper off on Jim—I would have envisioned all kinds of repercussions. And I probably would have intervened to save *my* face and to keep peace with the Dixons.

As far as I can tell, all four boys in the story are still smiling.

Jim's banker father must be proud of him. Russ and Callan have worked out a rental agreement with Eason so that they still have access to the black feet—for 10 cents an hour. Eason guards the thing with his life.

And Mom?

Well, so far I've found black feet stamped all over my car's Virginia license plate, the top of our living room fan, our back door neighbor's usually spotless child's face ("He *said* he wanted it there!") and the front of the bathroom door.

Perhaps I may end up paying for permitting that demonstration of "free" enterprise.

If we can get the point across with elbow grease, scrub on!

If You Make a Promise, Keep It

IDEAS ON LIBERTY

SOCIAL chaos has no better ally than broken promises. Children not brought up to keep their word will be the authors of treaties written not to be observed; they'll run for office on bogus platforms, cancel gold contracts, use the political means to expropriate property; they'll sell their souls to gain fame or fortune or power. Not only will they fail to be honest with their fellow men; they will not even heed the dictates of their own conscience. On the other hand, children brought up to keep their promises will not go back on their bond. Integrity will be their mark of distinction!

LEONARD E. READ

It must bring Leonard Read a lot of quiet satisfaction to see that the methods he has extolled in his many books have had their effect. He believes in the power of the example—in his new book, *The Freedom Freeway* (Foundation for Economic Education, $6.00), he quotes Albert Schweitzer: "Example is not the *main* thing in influencing others. It is the *only* thing." The Read example is to work on the perfection of his own understanding and to carry on from there in both writing and speaking. He says our times demand statesmen, but he leaves active politics to others. The average politician is not a prime mover; it is the man of ideas, working for the long pull, who is the final influence on government.

At the recent European regional meeting of the Mont Pelerin Society in Spain, Leonard Read, a thoughtful observer who limited himself to a single succinct speech about private education, had the living endorsement he wanted for his way of exercising social leverage. The final Mont Pelerin session was an impromptu discussion of Margaret Thatcher's chances for turning England back to the freedom philosophy of Cobden and Bright and Adam Smith. Mrs. Thatcher, who campaigned for the restoration of incentives, has her opportunity to transcend politics for statesmanship. But she would never have become Prime Minister on a freedom philosophy platform if it hadn't been for four individuals who happen to be Mont Pelerin members and devotees of the Read mode of conduct. They are, respectively, Professor Friedrich Hayek who was the Mont Pelerin founder, Antony Fisher, Ralph—or Lord—Harris, and Arthur Seldon. They were all in the room together at the Madrid and Salamanca sessions in Spain.

Over the years the four had formed a Readean chain. In 1946, when the British were turning their backs on Winston Churchill in favor of adopting the Labor Party socialism of Major Clement Attlee, Antony Fisher, then out of the Royal Air Force, went to Professor Hayek for advice about getting into politics. Hayek, fresh from writing *The Road to Serfdom,* gave Fisher some things to think about that seemed paradoxical. The way to affect politics, he said, was to stay out of politics. Work on ideas, Hayek told Fisher; get them into the marketplace.

Ideas at Work

So Fisher worked on ideas. He first took the practical precaution of making a considerable sum of money in the chicken business, one of the few businesses that had been overlooked by Attlee's planners. Then he subsidized an organization called the Institute of Economic Affairs in London, putting the effervescent Ralph Harris in charge to overwork himself until he managed to find a compatible sidekick, Arthur Seldon. For the better part of thirty years Harris and Seldon issued a stream of freedom philosophy publications. The IEA pamphlets often seemed to fall on stony ground. But Margaret Thatcher read them, and so did Sir Keith Joseph, now England's Secretary of State for Industry. IEA ideas became the new Conservative agenda. And one of the first things Mrs. Thatcher did on attaining office was to make Ralph Harris a Lord.

It was as if four men had acted out the sequence that is suggested in the essay on "Resolution: A Freedom Imperative," which is one of the many good ones in the new Read book. "In what respect is freedom a problem?" Read asks in this essay. "Personal experience has given me the answer. For 45 years my principal aim has been to understand and explain how freedom works its wonders . . . The dedicated aim—resolution—of many people working for freedom has resulted in thousands of tiny break-throughs. . . ." And, after some characteristically humble words about how little he knows, Read says what he does know: "Our end—the Blessings of Freedom—is but the flower of good seeds we plant; our objective has no other means of attainment. Your and my role? Exemplarity! 'Example is the school of mankind; they will learn at no other.' "

Like most of us in this benighted twentieth century, Leonard Read had to come by his wisdom the hard way. He seldom gets personal, but once in a while autobiography intrudes in a Read essay. He confesses in "Perseverance: A Key to Freedom," that in 1929 he was taken in by Herbert Hoover's demand for wage and price controls. That was Republican doctrine at the time. In the subsequent New Deal days, when Franklin Roosevelt acted on Hoover's advice, Read, as Manager of the Western Division of the U.S

Chamber of Commerce, supported the N.R.A., with its wage and price controls in all the big industries that had enrolled under the banner of General Hugh "Iron Pants" Johnson's Blue Eagle. It was Fascism of a peculiarly American sort, but the U.S. Chamber of Commerce and the National Association of Manufacturers accepted it. "Copycat Read!" so the Old Self Read says of the Young Self Read of 1933.

Copycats of Socialism

Leonard Read mentions some of his fellow copycats of the early Thirties. One of them, described as a "brilliant economic thinker" in general, advocated rent control—"A naive position he later overcame." Another, a "so-called conservative President of the United States," endorsed the Harvard professor, a "mentor" of the younger Read, who wrote: "Government must do for the people that which they cannot do for themselves." "This specious counsel," says the mature Read, "spawned countless copycats and made a substantial contribution to the socialistic mess we are now experiencing." Few people, so Read reflects, can do much of any single thing for themselves. But the division of labor steps in to make government action quite unnecessary. The mature Read wonders how "the 16,000,000 elected or appointed officials—federal, state and local—who doubtless know even less than the rest of us, will do for us what we cannot do for ourselves! If this isn't politico-economic balderdash, pray tell, what is?"

It is characteristic of Leonard Read that when he quotes an intelligent remark or bit of poetry or pertinent aphorism, he always names the person he is quoting. The name index of *The Freedom Freeway* would do justice to a Ph.D. in philosophy. But when Read tells us about his fellow copycats of New Deal socialist days, he mercifully fails to identify them. Read doesn't believe in getting people's backs up. Good psychology suggests to him that if you attack a person by name, or otherwise subject him to embarrassment of any kind, it is more difficult to convert him to what Russell Kirk calls Right Reason.

So Leonard Read's books become soft sells. The quality of his phraseology is not strained, it falleth as the gentle rain from heaven. Read follows what is an operationally sound technique, one which, in the hands of his British counterparts, has brought the Conservatives—really, the classical liberals—back into the seats of power. The same technique will, in time, send the necessary signals to Washington, D.C.

When he has finally achieved his aim and no longer has any worries about getting people's backs up, I hope Leonard Read will write an autobiography that names names. He can tell fascinating stories about people who have made gaudy mistakes in judgment. He tells about keeping a journal. Does he name names in that? For one, I would like to know. Meanwhile, I am quite content to absorb Leonard Read on such subjects as the "socialization" of sin (socialism itself), and the "menace of meddlers." Read may not name his sinners or his meddlers, but he is surely convincing about the evil of the unnamed culprits' deeds.

RESTORING THE AMERICAN DREAM

by Robert J. Ringer, with a Foreword by William E. Simon
(Published by QED; distributed by Harper & Row, Publishers: New York) 1979
320 pages ■ $12.50 cloth

Reviewed by Roger R. Ream, Director of Seminars, The Foundation for Economic Education, Inc., Irvington-on-Hudson, New York

HORROR stories about waste and fraud in government are nothing new. Proponents of a free market economy have always been the most vocal in explaining the destructive nature of government intervention, be it printing press money, regulation of business, tariffs, or whatever else government does beyond its proper role of protecting every individual's right to life, liberty, and property. Still, it is always encouraging when someone lucidly exposes the emperor without his clothes.

Recently, we have had several superb accounts warning of the dangerous power the state has amassed during the 200 years since our Founding Fathers created a government of "limited and enumerated powers." One such warning was *A Time For Truth* (reviewed in *The Freeman*, August, 1978), former Treasury Secretary William E. Simon's candid account of his experiences in Washington.

The latest warning of the threat presented by a concentration of governmental power comes from Robert J. Ringer in his new book, *Restoring The American Dream*. Ringer, author of two previous bestsellers, sees in today's government many resemblances to the collectivist states of George Orwell's *1984*, Aldous Huxley's *Brave New World*, and Ayn Rand's *Atlas Shrugged*. "Today one feels the ether of these books in the air," he writes. "Rational people know that there is something wrong. There is tension and uncertainty. There is ill will. There is fear. . . . Government-inspired nothink and doublethink have desecrated the American Dream."

The book is frightening, but contains a glimmer of hope. It is frightening when Ringer forcefully describes the grim realities and consequences of the transition from government by the people to government for the benefit of those in power. He exposes the tactics used by government to maintain and expand control over people: ". . . democracy, though it has many disadvantages for powerholders, seems to be the most practical way to maintain control, because it gives the illusion of consent."

There are various ways, Ringer points out, by which a democratic government may reinforce its control; the most successful being inflation. Government can hide the costs of the generous benefits it grants potential voters by creating new paper money rather than levying direct taxes. Government officials then blame workers and businessmen for the unpleasant consequences of this inflation—higher prices and a lower standard of living. This enables the politician to have his cake and eat it too—he takes credit for granting benefits to voters (even though consumers are forced to pay for them in the form of higher prices) while continually pointing the finger at business and labor for the painful consequences of inflation. As Ringer says, ". . . inflation is the one government scheme, above all others, that must be demystified if the American Dream is to be restored."

Ringer's reason for hope is borrowed in part from Simon's book. It is the belief that the American people would insist upon positive change "if they understood the situation." Therefore, Ringer's objective is to explode the myths of statism in a manner which enables the layman to understand the basic principles of individual liberty and the threat presented by collectivism.

With respect to inflation (although I believe Ringer would assert the same in regard to the whole interventionist mess) he states, ". . . the only hope that remains is that a great majority of Americans will come to understand the colossal inflation swindle for what it is and insist upon reform. To say the least I rate that a long shot. But at least it's a shot." We must hope Ringer is wrong on the method, for if our task is to get a majority to understand the situation, it will be a most difficult battle to win. In fact, Ringer calls himself "a pessimist trying hard to be an optimist." Fortunately, we have writers of Ringer's ability to state the case in a manner which those outside the intellectual community can comprehend.

By writing for a general audience, however, Ringer has made an unnecessary sacrifice of the philosophical justifications for some of his statements. This is unfortunate, since Ringer has demonstrated an ability to explain complex arguments in a lively and understandable manner. As it is, there are some claims that need either further clarification or additional support to give them legitimacy.

At times Ringer needs to be more precise. It appears as if he has let sentences slip in that cause confusion and seem to be contradicted by passages that follow. For example, Ringer puts great emphasis on what he calls a Natural Law: "each man owns his own life and therefore has the right to do anything he wishes with that life so long as he does not forcibly interfere with the life of any other man" and refers to it throughout the book. However, when first discussing the concept, he develops it as merely "an opinion" which he chose—seemingly out of thin air—as his initial premise. Yet, he goes on from this point and the reader discovers this "opinion" to be a "no-compromise principle."

Furthermore, this Natural Law involves morality. If we seek an end whose "attainment requires a violation of the rights of even one man, then the end has been achieved through immoral action." But wait. Upon further reading we find Ringer slipping a sentence into his discussion on welfare that states, "Rational men realize that there is no such thing as absolute morality." The reader is left asking whether this concept of Natural Law is an absolute moral principle and, if so, how Ringer arrived at it. This confusion is unfortunate, since Natural Law is the foundation for the freedom philosophy Ringer develops. Because this concept is so important, Ringer should clarify what he means by "absolute morality" and develop the justification for his "Natural Law" premise. This is particularly important if he hopes the lay audience for which he is writing will grasp this basic premise.

These shortcomings, however, are more than outweighed by the clarity, excitement, and provocative nature of the book. You wish every government bureaucrat would read it. Ringer offers a variety of suggestions of what can be done to restore the American Dream. The most important is to ". . . be consistent on the issue of human freedom." In other words, don't give up freedom for the tempting handouts offered by expedient-minded politicians.

Bill Simon dedicated his book, in part, "to my children, so that they can never say, at some future time 'why weren't we told?' " Ringer, like Simon, has cleared away the camouflage disguising government's true nature. The message is clear. Because we have books like *Restoring The American Dream* we can never say at some future date, "Why weren't we told?"