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Henry Hazlitt

# Understanding "Austrian" Economics

"Austrian" economics owes its name to the historic fact that it was founded and first elaborated by three Austrians—Carl Menger (1840–1921), Friedrich von Wieser (1851–1926), and Eugen von Böhm-Bawerk (1851–1914). The latter two built upon Menger, though Böhm-Bawerk, in particular, made important additional contributions.

Menger's great work, translated into English (but not until seventy-nine years later!) under the title of *Principles of Economics,* was published in 1871. In the same year, by coincidence, W. Stanley Jevons in England published his *Theory of Political Economy.* Both authors independently developed the concept now known as "marginal utility." (Menger never used the term. Jevons called it "final degree of utility." It was Wieser who first employed the German term *Grenznutzen,* which translates as "marginal utility.")

But as few American or British economists read German in the original, it was years before the real extent of the revolution begun by Menger was realized outside of German-speaking countries. For it was Menger, by recognizing most fully the implications of the marginal-utility concept, who opened up new paths and, so to speak, turned the old classical economics upside-down.

**Goods have no inherent value in themselves. They are valued because they help to satisfy some human want or need.**

Menger insists throughout his work that value is essentially *subjective,* and that therefore economics must be in the main a subjective science. Goods have no inherent value in themselves. They are valued because they help to satisfy some human want or need. A given quantity or unit of a certain good will satisfy a man's most intense desire or need. He may also want a second, third, or fourth increment. But after each unit consumed or employed, his desire or need for a further unit of that good may be less intense, and may finally become completely satisfied.

It follows that each increment of that good at his disposal will have a reduced value to him. But as no unit of the total available quantity of that good can have a greater value in exchange than any other (of the same quality), it follows further that no other unit will be worth more in the market than the "final" unit of the supply. Thus in a given community the exchange value of a given increment of each good will be determined by the relation between its total available quantity and the intensity of the human need or want that it fills.

So far this may seem like little more than a refinement on the old classical doctrine that value and price are determined by supply and demand. It seems merely to state that doctrine in subjective rather than objective terms. But then Menger comes to point out some of its implications. The values of goods are mutually interdependent. Bread is valued because it meets a direct consumption need. Flour is valued because it is needed to bake bread. Wheat is valued because it is needed to produce flour. Plows, seed, land and labor are valued because they are necessary to produce wheat, and so on.

Values are also interdependent because, for example, if one raw material necessary in combination for the production of a final product is missing, that lack reduces the usefulness and value of the other raw materials needed.

Goods wanted and ready for direct use or consumption are called by Menger "goods of the first order." Raw materials and other factors necessary to produce these are called "goods of the second order." Materials, machinery, labor and other factors needed in turn to produce these

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This introduction to the basic concepts and principles of the so-called Austrian school of economics was commissioned by and appears here through the courtesy of *Silver and Gold Report*, Newtown, Connecticut.

goods of the second order are called goods of the third order, and so on. These goods of the second, third, and other "higher" orders are valued because of the consumption goods that they produce.

**The Austrian doctrine holds that the "cost of production" itself is ultimately determined by the value of consumption goods.**

Thus while the classical Ricardian doctrine held that the "normal" value of consumption goods was determined by their "cost of production," the Austrian doctrine holds that the "cost of production" itself is ultimately determined by the value of consumption goods.

These two doctrines can be partly reconciled in the statement that though what a good *has* cost to produce cannot directly determine its value, what it *will* cost to produce determines how much of it will continue to be made. It is the limit that cost of production puts upon the total quantity of a good produced that determines its marginal value and therefore its market price. Thus there is a constant tendency for marginal cost of production and market price to equal each other, though not because the first directly determines the second.

Something should be said also about the sharp distinction between the Ricardian and the Austrian concept of "cost." The Ricardian (and the modern businessman) thinks of cost as a money outlay. But the Austrian economist has a much wider concept, what economists now call "opportunity" costs, or "foregone opportunity" costs. Such costs exist, of course, not only in business but in all our decisions and actions in life. The cost of learning French in any given period is to forego learning German, or to learn less mathematics, or to give up some tennis or bridge, and so on.

Menger emphasizes the importance of time and the role of uncertainty in the whole productive process. He also points out that no single good, no matter how abundant, can maintain life and welfare, but that these depend upon the production of *combinations* of goods of different kinds in the proper proportions. And he points out, finally, that the process of production cannot be expected to go on at an adequate rate unless there is adequate protection of property.

The economic value of goods, to repeat, depends upon their respective quantities in relation to the human needs they meet. It does not necessarily depend upon the amount of labor expended in their production. To quote from Menger's *Principles of Economics:* "If there were a society where all goods were available in amounts exceeding the requirements for them, there would be no economic goods nor any 'wealth' (p. 109). . . . Hence we have the queer contradiction that a continuous increase of the objects of wealth would have, as a necessary final consequence, a diminution of wealth (p. 110)".

(In other words, Menger pointed out more than a century ago a basic fallacy in the now-fashionable national income statistics.)

"The value of goods arises from their relationship to our needs, and is not inherent in the goods themselves (p. 120). . . . Objectification of the value of goods, which is entirely *subjective* in nature, has nevertheless contributed very greatly to confusion about the basic principles of our science (p. 121). . . . The importance that goods have for us and which we call value is merely imputed (p. 139).

"There is no necessary and direct connection between the value of a good and whether, or in what quantities, labor and other goods of higher order were applied to its production. . . . Whether a diamond was found accidentally or was obtained from a diamond pit with the employment of a thousand days of labor is completely irrelevant for its value (p. 146)."

Menger goes on to discuss further how higher goods, including capital goods, get their value: "It is evident that the value of goods of higher order is always and without exception determined by the prospective value of the goods of lower order in whose production they serve (p. 150)."

He outlines a theory of interest, but he leaves it vague. On page 156 of *Principles of Economics* he tells us: "We have reached one of the most important truths of our science, the 'productivity of capital.'" But he emphasizes that this productivity occurs only through the passage of time, and that therefore the market value of presently existing and available goods is at a "discount" compared with the expected value of equivalent goods in the future.

### A Time-Preference Theory

This suggests that Menger leaned more toward a "time preference" than a "productivity" theory of interest, though the distinction between these theories was not sharpened and made explicit until the publication of Böhm-Bawerk's *Capital and Interest* in 1884 and his *Positive Theory of Capital* in 1888. Böhm-Bawerk laid great emphasis upon the superior productivity of "roundabout" processes of production, and therefore (after a brilliant demolition of productivity theories of interest) ended by himself offering a theory of interest that combined productivity and time preference. Nearly all "Austrians" today, however, following the lead of Frank A. Fetter and later of Ludwig von Mises, support a pure time-preference theory.

To return to Menger: His *Principles of Economics* next presents a "theory of exchange." In this he points out that men do not buy from or sell to or exchange with each other merely because of a "propensity of men to truck and barter," as implied by Adam Smith, but because each man seeks to maximize his satisfactions by exchanging what he values less for what he values more. In this way the satisfaction of all is increased. Exchange is thus an integral part of the whole process of production. What is being produced is value. Menger's whole theory of price, to repeat, is developed on the basis of "the subjective character of value."

The final chapter of Menger's *Principles* is on "The Theory of Money." This does not explicitly discuss such subjects as interest rates or inflation, but deals solely with fundamentals, especially the origin and evolution of money. "Money is not the product of an agreement on the part of economizing men nor the product of legislative acts. No one invented it (p. 262)." It developed out of barter. Because it so seldom happened that A and B each had and was willing to offer exactly what the other wanted, triangular and indirect barter began to take place. Men first offered their specialized goods for more "marketable" goods more widely wanted, in the hope that they could exchange these, in turn, for the particular goods that they themselves wanted. As a result these more "saleable" goods became still more saleable because of this extra demand. The most saleable of all finally became "money." Historically, all kinds of goods have served as money, though it later came down to coins of precise weights of copper, silver, or gold.

Money is not a "measure of value," though it is legitimate to call it a measure of price. It is the only commodity in which all others can be evaluated without roundabout procedures. It is the most appropriate form in which people can save and store part of their wealth. The right of coinage has generally been left to governments, even though "they have so often and so greatly misused their power (p. 283)."

I may have seemed to devote a disproportionate amount of space to Menger, but the special contributions of Austrian economics can be most clearly realized, it seems to me, if we begin by dwelling in some detail on those of its originator.

Menger's first important successor as an "Austrian" economist was Friedrich von Wieser, who, beginning in 1884, published several books elaborating, rounding out, and refining Menger's theory of value, clarifying especially problems of cost, "imputation," and distribution.

**It was the analysis of Austrian economics that made Böhm's refutation of Marx so conclusive. No refutation based on the assumptions of the old classical economics could have been as devastating.**

The next great successor was Eugen von Böhm-Bawerk, whose trailblazing contributions in *Capital and Interest,* in 1884, and the *Positive Theory of Capital,* in 1888, have already been referred to. In addition, Böhm-Bawerk wrote a brilliant demolition of Marx's *Das Kapital* in 1896, in a comparatively short work first translated into English under the title *Karl Marx and the Close of His System.* In this essay Böhm-Bawerk exposed particularly the fallacies in Marx's labor theory of value and his "exploitation" theories, which the latter had derived as a supposed corollary from errors of Ricardo. It should be emphasized that it was the analysis of Austrian economics that made Böhm's refutation of Marx so conclusive. No refutation based on the assumptions of the old classical economics could have been as devastating.

After the passing of its three founders—Menger, Wieser, and Böhm-Bawerk—Austrian economics fell for a long time into eclipse. It was not so much refuted as neglected. English-speaking economists began devoting themselves to such matters as mathematical treatment of problems of "general equilibrium." The Austrian view was revived mainly by one man, an Austrian by birth as well as an "Austrian" by conviction—Ludwig von Mises (1881–1973). He made his influence felt both by his written works and by his oral teachings. Among his early distinguished students and followers were Gottfried Haberler, Fritz Machlup, Oskar Morgenstern, Lionel (now Lord) Robbins, and, most influential of all, F. A. Hayek (b. 1899).

Ludwig von Mises was prolific, but his principal contributions were made in three masterpieces. These were *The Theory of Money and Credit,* first published in German in 1912, *Socialism: An Economic and Sociological Analysis,* also first published in German in 1922, and *Human Action,* which grew out of a first German version appearing in 1940, but was not published in Mises' own rewritten English version until 1949.

## Mises on Human Action

Though there is now a gratifying number of able young American economists writing in the Austrian tradition, *Human Action* still stands as the most complete, powerful, and unified presentation of Austrian economics in any single volume. Mises always generously acknowledged his indebtedness to his predecessors. He recalled in a short autobiography (*Notes and Recollections,* 1978) that around Christmas, 1903 he read Menger's *Principles of Economics* for the first time. "It was the reading of this book," he wrote, "that made an 'economist' of me."

It would carry me to too great length to itemize and explain all the contributions to economics that Mises made, and I will content myself with mentioning only two. He was the first to prove that it was impossible for socialism to undertake "economic calculation"; and he made one of the most important contributions of any economist toward solving the problem of "the trade cycle."

Because Mises so uncompromisingly rejected government interventionism in all its forms, he acquired the reputation of a "laissez-faire extremist" during most of his lifetime, and was scandalously neglected by the majority of academic economists. But because Hayek elaborated his own ideas in a more conciliatory form, his writings attracted more attention from the academic world, and he leapt into prominence in 1931 with his own contribution to the theory of the trade cycle, *Prices and Production,* along lines similar to Mises'. The result is entitled to be called the "Mises-Hayek" theory.

Hayek is also a prolific writer, but though he has written volumes on money, on the trade cycle, on inflation, and on *The Pure Theory of Capital* (1941), he has never attempted a comprehensive book on economic principles. Of late years he has turned his attention mainly to the realms of politics, ethics, and law, and has written profound and widely-discussed treatises on *The Constitution of Liberty* (1960) and a three-volume work on *Law, Legislation and Liberty,* completed in 1979. He has been more widely influential in his own lifetime than was Mises, and was awarded the Nobel Prize in Economics in 1974.

**Today's zealous group of younger "Austrian" economists are exploring a whole range of economic problems with a new vigor.**

Today's zealous group of younger "Austrian" economists, though all acknowledging their great debt to Mises, do not treat his *Human Action* as the final word on the subject, but are exploring a whole range of economic problems with a new vigor. Murray Rothbard (b. 1926), a student of Mises, produced a two-volume treatise, *Man, Economy, and State* (1962), along Misesian lines, with notable clarity of exposition, and making important contributions of his own, pointing out the fallacies, for example, in the prevailing theories of "monopoly price."

Israel M. Kirzner (b. 1930), professor of economics at New York

University, another former Mises student, although he has not undertaken a comprehensive book of "principles," has explored individual problems in five separate volumes: *The Economic Point of View* (1960), *Market Theory and the Price System* (1963), *An Essay on Capital* (1966), *Competition and Entrepreneurship* (1973), and *Perception, Opportunity, and Profit* (1979). His work is distinguished by great scholarship, systematic thoroughness, and precision of statement. He has brought further illumination to every problem he has dealt with.

Finally, no reference to individual writers would be adequate that did not include Professor Ludwig M. Lachmann (b. 1906). Though he is one of the most original and profound among living Austrian economists, his work has not yet nearly achieved the recognition it merits. Among his principal books are *Capital and Its Structure* (1956; republished in 1978), *The Legacy of Max Weber* (1971) and *Capital, Expectations, and the Market Process* (1977). His writings are notable for their emphasis on the role of expectations and for their thoroughgoing application of a "radical subjectivism."

Restrictions of space permit me merely to list the names of half a dozen of the now increasing group of important "Austrian" economists: S. C. Littlechild, Gerald P. O'Driscoll, Jr., Mario J. Rizzo, Hans Sennholz, Sudha R. Shenoy, and Lawrence H. White. But so arbitrarily short a list must omit a number of names unjustly.

**The "Austrian" economists, more consistently than those of any other school, have criticized nearly all forms of government intervention in the market—especially inflation.**

The "Austrian" economists, more consistently than those of any other school, have criticized nearly all forms of government intervention in the market—especially inflation, price controls, and schemes for redistribution of wealth or incomes—because they recognize that these always lead to erosions of incentives, to distortions of production, to shortages, to demoralization, and to similar consequences deplored even by the originators of the schemes. But personal value judgments of government policy are of course not an essential part of Austrian theory.

The present vigorous Austrian School is not content merely to keep re-expounding the principles developed by Menger and Mises, but is addressing itself constantly to new problems, or a more thorough probing of old ones. This is dramatically evident in a recent volume, *New Directions in Austrian Economics* (1978), edited by Louis M. Spadaro, with contributions from eleven writers. Professor Spadaro himself, in his concluding essay, outlines some of the still unresolved problems that Austrians ought to explore. In some sense, however, practically all eleven contributions do the same thing.

I have heard it said (by an economist of another school) that there is no such thing as Austrian economics; there is only good economics or bad. But in the same way we could say that there is no such thing as Ricardian economics, Marxist economics, Keynesian economics, and so on. This sort of statement, though true in one sense, is false in another. It is fallacious in implying that if anything is classified in accordance with one characteristic, it cannot be classified in accordance with any other. It is like saying that there are no such persons as Americans or Japanese; there are only men and women. Those who call themselves "Austrian" economists give themselves this label because of its historic origins; but they happen also to believe that its fundamental theses are true, and offer more promise than any other for further progress in economic science.

Perhaps something should be said about the chief differences today between Austrian economics and what we may call "orthodox" or "mainstream" economics. The difficulty here is that "mainstream" economics itself would be hard to define. Economists are still divided into a number of recognizable "schools"—neoclassicists, Keynesians, the Chicago school, the Lausanne school, and so on. The limits of space forbid me to go into the distinguishing doctrines of each of these schools. But one outstanding difference of the Austrians from all of these lies in their method of reasoning. The Austrians emphasize methodological *individualism*. That is, they not only begin by emphasizing human actions, preferences, and decisions, but *individual* actions, preferences, and initiatives. Mainstream economists are concerned with "macroeconomics," with averages and aggregates; and those of the Lausanne school, trying to reduce economics to an "exact" science, and therefore seeking to quantify everything, are obsessed with complicated mathematical equations that try to stipulate the conditions of "general equilibrium."

### Equilibrium a Useful Concept, Though Never a Reality

Now "general equilibrium" is defined by these economists (when it ever is) in highly abstract and obscure phrases; but for laymen it might be defined as a condition in which all the tens of thousands or millions of commodities and services are being turned out in the exact quantities and proportions in which they are relatively wanted by producers or consumers, so that there are no "shortages" or "surpluses." All prices reflect costs, and there is no more profit in making one commodity than any other. (In fact, there is no "pure" profit at all.) These economists admit that at any moment this condition does not exist, but they contend that there is a constant long-run *tendency* toward equilibrium, because when there is an unusual profit in turning out some one product, producers will turn out more of it, and when there is a loss in turning out some other product, producers will make less of it, or transfer to making something else.

Now the concept of equilibrium (or much better, the Mises concept of an "evenly rotating economy") can have great usefulness as a tool of thought. We are often better able to analyze the problems of change if we begin with the fictitious assumption of a state of affairs in which certain changes are hypothetically eliminated. But this is a purely imaginary construction, a useful fiction. It should never be confused with reality.

While a true "equilibrium" between the marginal cost of production and the market price of any one commodity is a condition that is seldom reached, even momentarily, a "*general* equilibrium" in the relative production, supply price and demand price of *all* commodities and services is a condition that is *never* reached, even for an instant of time.

**Neoclassical economists seem obsessed today with setting up complicated algebraic equations, but it is difficult to specify precisely what their x's and y's stand for.**

The concept itself is extremely nebulous. Neoclassical economists seem obsessed today with setting up complicated algebraic equations stipulating the conditions of equilibrium or functional relations under "perfect competition" and the like, but it is difficult to specify precisely what their x's and y's stand for. They cannot refer to physical quantities, because you cannot add apples to horses, or a ton of gold watches to a ton of sand. One might add or compare quantities times prices, but what would be the meaning of the total, or any of the parts that make it up? The price, even of one commodity, differs from hour to hour, place to place, and transaction to transaction. The value of the currency itself fluctuates and constantly changes its exchange ratio with commodities. If we simply add or compare "values," then we must recognize that values are purely subjective. They are impossible to measure or to total because they differ with each individual.

If we pass over these fundamental difficulties, where do we arrive? Even if we assume that there may be a persistent long-run *tendency* toward general equilibrium, we must admit that there is also a persistent short-run and long-run tendency toward the persistence of *disequilibrium*.

This is not only because there is a tendency of entrepreneurs, in increasing or reducing production in response to market and profit signals, to overshoot the mark, but because individual entrepreneurs, so far from making merely automatic responses, are constantly gaining new knowledge, alert to new opportunities, changing methods and reducing production costs, improving products, innovating—turning out entirely new products or inventions. And consumers too are constantly learning, changing tastes, and demanding new products to meet new wants. So Austrian economists seldom speak of market equilibrium, but of the market *process*.

My own suspicion is that the enormous attention now being devoted to stipulating the mathematical conditions of "general equilibrium" is a pursuit of a will-o'-the-wisp, of questionable help in solving any real economic problem.

But space forbids me to go into too many detailed contrasts. Let me sum up briefly the main Austrian theses once again, this time not in my own words or in Menger's, but in those of two prominent living "Austrians."

"Beginning in the 1870's in Vienna, Austria," writes Professor Kirzner, "the school was distinguished by its emphasis on the *subjective* elements in economic analysis, on the significance of *time* in production processes, and on the role of *error and uncertainty* in economic phenomena." (His italics.)

The summarization by Professor Lachmann is remarkably similar: "The first, and most prominent, feature in Austrian economics is a radical subjectivism, today no longer confined to human preferences but extended to expectations. . . . Secondly, Austrian economics displays an acute awareness of the many facets of time that are involved in the complex network of interindividual relations. . . . In the subjective revolution of the 1870's the first step in the direction of subjectivism was taken when it was realized that value, so far from being inherent in goods, constitutes a relationship between an appraising mind and the object of its appraisal." (*New Directions in Austrian Economics*, pp. 1–3.)

All the rest of Austrian economics follows from these basic insights. Let me conclude with my own opinion that any economic analysis that fails to embody such insights cannot be entirely sound.

## RECOMMENDED READING

Those who have no previous acquaintance with Austrian economics, and would like a short and simple text written along Austrian lines, might begin with *Essentials of Economics* by Faustino Ballvé (126 pages; Irvington-on-Hudson, N.Y.: Foundation for Economic Education). A more advanced, and quite recent introduction (1979) specifically explaining the Austrian point of view, is *The Fallacy of the Mixed Economy,* by Stephen C. Littlechild (85 pages; San Francisco, Calif.: Cato Institute).

Surprisingly, the original *Principles of Economics,* first published in 1871 by Carl Menger, the founder of Austrian economics (328 pages), still makes an excellent, very readable, and not too technical introduction to the school's basic principles.

Of course, *the* authoritative and most complete work on modern Austrian Theory is *Human Action,* by Ludwig von Mises (907 pages, first published in 1949, third revised edition published in 1966 by Henry Regnery Company, Chicago). Some may find this difficult reading. A very clear two-volume work written thirteen years after *Human Action* by a student of Mises is Murray N. Rothbard's *Man, Economy, and State* (Mission, Kan.: Sheed, Andrews and McMeel, 1962, 987 pages).

For the reader interested in the latest developments in Austrian economics I can highly recommend two books: One is *The Foundations of Modern Austrian Economics,* edited by Edwin G. Dolan, which contains contributions by half a dozen writers (1976, 238 pages, Kansas City: Sheed & Ward, Inc.) The other is *New Directions in Austrian Economics,* edited by Louis M. Spadaro (1978), 239 pages, with contributions by eleven writers. (Kansas City: Sheed, Andrews and McMeel, in cooperation with the Institute of Humane Studies at Menlo Park, Calif., and with Cato Institute.)

Most of these foregoing books have already been mentioned in the text. The reader may also profitably consult others mentioned there, especially the volumes by Kirzner and Lachmann.

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Hans F. Sennholz


# Standards of Living Are Falling

IT is a sad fact that most Americans have become poorer during the 1970s. They can no longer afford the amenities and luxuries to which they had grown accustomed. Many consumer goods are getting smaller or cheaper in quality although their prices continue to soar. We are urged to "conserve" and make do with less. Our new economic motto is "more conservation," which is a euphemistic term for "more poverty." Other industrial countries in Europe are experiencing similar difficulties. Their economies are stagnating or lingering in recession. Inflation is raging and unemployment is rising.

To most Americans the deterioration of living conditions is all the more incredible as their inborn optimism is calling for an ever brighter future. Surely, our history textbooks tell us of hard times during the major wars in American history or during the Great Depression. But they are not yet comparing our present situation with similar calamities in the past. And yet, some similarities are beginning to emerge.

The Great Depression was accompanied by a disintegration of the world economy. Economic nationalism ran rampant, cutting off channels of trade and commerce and impairing the world division of labor. According to most economic historians, this disintegration was an important cause that aggravated and prolonged the Great Depression. After World War II the trade barriers erected during the 1930s were gradually dismantled, which led to a phenomenal improvement in world economic conditions. For a quarter of a century it provided us with ever more materials and supplies. Total output of goods and services rose

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rapidly and our standards of living improved steadily. During the 1970s unfortunately, governments the world over turned back the clock as they gave new life to economic nationalism, especially in the developing countries, and brought radical changes of which most Americans are not yet aware.

## Transfer to OPEC

In 1973–74 an Arab oil embargo and a doubling of oil prices thereafter dealt a devastating blow to all industrial countries. Since then sizable increases in the price of OPEC oil added new uncertainties to an already cloudy outlook.

The net effect was a *massive shift of income and wealth* from the industrial countries to oil-producing countries. OPEC revenues rose sharply, as did production costs in industrial countries. The oil price increases not only dampened economic expansion in such countries as Japan and West Germany, but even brought it to a sudden halt in many others. The effect of this shift of income and wealth was alleviated somewhat since much of OPEC unspendable income was recycled into investments in both government securities and private banks in the United States and Europe. While OPEC countries were growing richer and the industrial countries becoming poorer relative to the world, the day of truth was postponed through rising indebtedness of the latter. In fact, OPEC lending not only obscured the shifting, but even helped to finance massive U.S. Government deficits for health, education and welfare that consumed capital en masse. In short, it helped to finance the American decline.

Government spokesmen always blame the sharp increase in petroleum prices for the rampant inflation that has engulfed the U.S. But economists are pointing out again and again that the ultimate impact of the oil price increase depends on the reaction of individual governments. In countries that refrain from deficit spending and monetary expansion, there is little or no inflationary impact at all. Increased spending by consumers on petroleum products necessarily leads, because of limited incomes, to reduced spending on other goods and to lower prices. Surely, the people in Japan and Switzerland suffered losses in income and wealth as a result of rising petroleum prices. But many other prices fell as other spending declined.

In the U.S. all prices rose at various rates because massive federal deficits were monetized, that is, the federal debt was used to increase currency in circulation. This was carried out essentially by the purchase of Treasury obligations by the Federal Reserve System, thus releasing Federal Reserve notes into circulation or creating bank reserves that permitted commercial banks to expand their credit even further. Obviously, the federal government alone conducted the inflation and orchestrated the credit expansion. But it is extremely eager to point the finger of blame at someone else.

In fact, the federal government greatly aggravated the situation and accelerated the wealth transfer by shackling and crippling the domestic industry so that the U.S. became ever more dependent on oil imports. In 1972, before OPEC intervened, we were importing some 6 to 7 per cent of our needs. Today we are importing nearly 50 per cent. No policy sinisterly designed to promote the transfer of income and wealth to OPEC could have been more effective than that conducted by the U.S. Government.

On August 15, 1971, the Nixon Administration imposed comprehensive price controls that were generating the first energy shortage. The Ford and Carter Administrations perpetuated the controls and made matters worse with complex systems of allocation and distribution. In 1977 the Carter Administration created a new U.S. Department of Energy merging the Energy Research and Development Administration, the Federal Energy Administration and the Federal Power Commission. It introduced a comprehensive national energy plan that emphasized conservation rather than production, and imposed the biggest single tax in U.S. history, the Windfall Profits Tax. It is surprising indeed that domestic production, reeling under such heavy blows, continues to meet one-half of our petroleum needs.

**From Producers to Almsmen**

Almost without exception governments are tempted to treat the symptoms while they eagerly ignore or even foster the causes. To fight the symptoms is always rewarding politically. It may even alleviate the problems in the short run although it does not solve them. It merely postpones the hour of reckoning.

The economic expansion during the 1950s and 1960s permitted interventionist governments to develop massive transfer systems that favored some people at the expense of others. The federal government became a giant transfer agency that extracted ever more revenue from the economic activities of the working people and bestowed its largess to a growing army of almsmen. From 1946 to 1980 nondefense spending rose from just $15.2 billion a year to an estimated $433.2 billion. (*The Budget of the United States Government,* Fiscal Year 1981, p. 613)

Despite the staggering burdens of government the American economy proved to be surprisingly resilient as long as some capital could be formed and economic activity be expanded. But it was a fatal mistake to conclude that the economy could withstand any and all burdens which government chose to place on it.

A tax burden that is heavy during periods of expansion becomes destructive during stagnation and decline. When OPEC began to raise our costs of production, the load of federal levies became increasingly painful. To counteract or even offset the detrimental effects of OPEC machinations, instant tax relief would have been in order. But lo and behold, the federal government was not to be outdone by foreign extractions. It raised its own from \$208.6 billion in 1972 to an estimated \$523.8 billion in 1980. Its annual extractions now exceed the oil import expenses by one thousand per cent.

The effects of this double-barrelled attack on economic activity could be readily seen. The returns of capital investments, that is, business profits, fell to scanty levels. Many enterprises suffered losses which mostly were hidden by the thick veil of inflation. Surely, some business profits stated in shrinking dollars continued to rise, permitting governments to extract ever higher levies. But in terms of purchasing power and real wealth many businesses merely struggled along or even deteriorated. They formed no new capital for expansion or modernization, built no new facilities, and created no jobs.

The dearth of genuine profits forced business to cut back its expenditures on research and development. Again jobs were lost or fewer were created. When an industry thus falls behind technologically, it may encounter the fierce competition of foreign industries. It may be outproduced and undersold and therefore may shrink even further, causing heavy unemployment of capital and labor. To correct such a dilemma is extremely difficult and painful.

The situation becomes all the more tragic if it involves important industries that are employing hundreds of thousands of workers. For political reasons the government cannot afford to let such industries collapse or wither away. It is expected to come to their rescue. Our steel and automotive industries are examples in case.

The most popular rescue action consists of a dose of economic nationalism. The steel industry in distress demands higher tariff barriers, which would curtail the steel supply and permit it to raise its prices. The automobile industry suffering losses clamors for import restrictions, which would force the American people to buy more domestic cars at higher prices. Foreign trade is to be curtailed, international relations to be severed, and living conditions to be lowered so that the beleaguered industry may be permitted to continue its antiquated operations.

If no tariff protection can be granted because it would violate international treaties, the industrial captains and labor leaders may clamor for financial aid and support. The taxpayers are called upon to support with tax extractions what they do not patronize with their consumption dollars. Of course, the subsidies cannot restore the strength and viability of such industries. They tend to become a permanent burden to society which is impoverished not only by the subsidy but also by its loss of foreign products. In the end, the healthy industries that must carry the burden of support may be infected by the same dilemma, and the subsidized industries in search of ever more reliable support may beg to be taken over by the government. In any case, the people will pay the price in the form of ever lower living standards.

## Cleaner but Poorer

During the 1970s national governments throughout the world pledged a commitment to a cleaner environment. In the United States the administration of Jimmy Carter was especially sympathetic to the pleas of environmentalists. It sent wide-ranging environmental policy statements to Congress and made concrete legislative proposals to impose more air and water pollution controls, and regulate strip-mining, wilderness preservation, and energy.

At this place we need not dwell on the ideological causes that gave rise to the policy. But we must observe that in nearly all cases of environmental concern, the blame was laid on business concerns and the individual enterprise system. And governments always felt called upon to correct the situation through massive expenditures and severe production restrictions. (Cf. "Controlling Pollution," *The Freeman*, Feb. 1973, pp. 67–77)

The federal Environmental Protection Agency (EPA) is demonstrating great perseverance against American industry. It not only is issuing countless guidelines but also setting rigid effluence limitations for many classes of enterprises. The Agency's persistence received support and encouragement by a number of favorable court decisions that made U.S. corporations install many millions of dollars worth of wastewater recycling equipment and other anti-pollution devices. In nearly every case the U.S. district courts and the U.S. Supreme Court ruled in favor of EPA and strengthened its hand in dealing with industrial pollution.

It is difficult to estimate the total financial burden placed on American industry in order to secure a cleaner environment. Direct costs up to now probably exceed half a trillion dollars. Indirect costs consisting of time and effort spent on cleaning operations, of factories not built and jobs not created because business capital was spent on environmental devices, may amount to a trillion dollars. And this amount may double or triple again if we include all the production that was cancelled or not even attempted because the environmental costs made it unprofitable. Surely, the American people paid a high price for any improvement in their environment.

Environmental costs are business costs like any other costs that limit economic undertakings. Governments imposing new costs are limiting economic production, eliminating jobs and reducing incomes. It is dishonest to ignore the costs and deny the consequences.

## The People Must Choose

A representative government like ours tends to reflect the choices of the people. During the 1970s the American people charted a course of policies that led to economic stagnation and gradual impoverishment. The facts are undeniable and indisputable. But most Americans probably acted and voted in utter ignorance of the costs and consequences of their choices, which affords us new hope for the future.

The surprising results of the recent election seem to indicate that many Americans are awakening to the challenge of the future. They are rejecting the road of the 1970s and instead are opting for a new beginning. If this means that they are choosing prosperity rather than stagnation, employment rather than doles, the road into the future is very clear: The federal energy policies must be reversed completely and the wealth transfer to OPEC be discontinued immediately. We must overcome and restrain the public hostility toward investment returns and business profits that are building plants and factories, creating jobs and raising wages. The countless restraints and restrictions on business activity and creative energy must be rescinded without delay. And finally, environmental improvements must be weighed against all costs, direct and indirect. If the costs exceed the benefits they must be reduced or removed. The federal bureaucracy which has been sitting in judgment of such matters has failed conspicuously. It must be disbanded promptly, and all environmental issues returned to the courts of law.

It is difficult to reverse public policies that are deeply rooted in popular ideas and beliefs. But it is possible through honest information and education.

Benjamin A. Rogge

# The Case for Economic Freedom

MY economic philosophy is here offered with full knowledge that it is *not* generally accepted as the right one. On the contrary, my brand of economics has now become *Brand X*, the one that is never selected as the whitest by the housewife, the one that is said to be slow acting, the one that contains no miracle ingredient. It loses nine times out of ten in the popularity polls run on Election Day, and, in most elections, it doesn't even present a candidate.

I shall identify my brand of economics as that of economic freedom, and I shall define economic freedom as that set of economic arrangements that would exist in a society in which the government's only function would be to prevent one man from using force or fraud against another—including within this, of course, the task of national defense. So that there can be no misunderstanding here, let me say that this is pure, uncompromising *laissez faire* economics. It is not the mixed economy; it is the unmixed economy.

I readily admit that I do not expect to see such an economy in my lifetime or in anyone's lifetime in the infinity of years ahead of us. I present it rather as the ideal we should strive for and should be disappointed in never fully attaining.

Where do we find the most powerful and persuasive case for economic freedom? I don't know; probably it hasn't been prepared as yet. Certainly it is unlikely that the case I present is the definitive one. However, it is the one that is persuasive with me, that leads me to my own deep commitment to the free mar-

**Benjamin Arnold Rogge, 1920–1980**

WE miss the presence of this most eloquent spokesman and practitioner of freedom but give thanks for the legacy of his ideals and example.

Dr. Rogge had been at Wabash College in Crawfordsville, Indiana since 1949, serving variously as teacher of economics, academic dean, director of the Wabash Institute of Personal Development, and Distinguished Professor of Political Economy.

He was in international demand as a speaker and the author of numerous articles. *Can Capitalism Survive?* is a collection of his speeches and essays, published in 1979 by Liberty Press of Indianapolis.

Ben Rogge became a Trustee of The Foundation for Economic Education in 1958 and was Chairman of the Board from 1960 through 1962. He often lectured at FEE seminars. One of his favorite topics, "The Case for Economic Freedom," appeared in *The Freeman* in 1963 and is here reprinted as appropriate testament to his guiding ideals.

ket. I present it as grist for your own mill and not as the divinely inspired last word on the subject.

### The Moral Case

You will note as I develop my case that I attach relatively little importance to the demonstrated efficiency of the free-market system in promoting economic growth, in raising levels of living. In fact, my central thesis is that *the most important part of the case for economic freedom is not its vaunted efficiency as a system for organizing resources, not its dramatic success in promoting economic growth, but rather its consistency with certain fundamental moral principles of life itself.*

I say, "the most important part of the case" for two reasons. First, the significance I attach to those moral principles would lead me to prefer the free enterprise system even if it were demonstrably less efficient than alternative systems, even if it were to produce a *slower* rate of economic growth than systems of central direction and control. Second, the great mass of the people of any country is never really going to understand the purely economic workings of *any* economic system, be it free enterprise or socialism. Hence, most people are going to judge an economic system by its consistency with their moral principles rather than by its purely scientific operating characteristics. If economic freedom survives in the years ahead, it will be only because a majority of the people accept its basic morality. The success of the system in bringing ever higher levels of living will be no more persuasive in the future than it has been in the past. Let me illustrate.

The doctrine of man held in general in nineteenth-century America argued that each man was ultimately responsible for what happened to him, for his own salvation, both in the here and now and in the hereafter. Thus, whether a man prospered or failed in economic life was each man's individual responsibility: each man had a right to the rewards for success and, in the same sense, deserved the punishment that came with failure. It followed as well that it is explicitly immoral to use the power of government to take from one man to give to another, to legalize Robin Hood. This doctrine of man found its economic counterpart in the system of free enterprise and, hence, the system of free enterprise was accepted and respected by many who had no real understanding of its subtleties as a technique for organizing resource use.

As this doctrine of man was replaced by one which made of man a helpless victim of his subconscious and his environment—responsible for neither his successes nor his failures—the free enterprise system came to be rejected by many who still had no real understanding of its actual operating characteristics.

## Basic Values Considered

Inasmuch as my own value systems and my own assumptions about human beings are so important to the case, I want to sketch them for you.

To begin with, the central value in my choice system is individual freedom. By freedom I mean exactly and only freedom from coercion by others. I do not mean the four freedoms of President Roosevelt, which are not freedoms at all, but only rhetorical devices to persuade people to give up some of their true freedom. In the Rogge system, each man must be free to do what is his duty as he defines it, so long as he does not use force against another.

Next, I believe each man to be ultimately responsible for what happens to him. True, he is influenced by his heredity, his environment, his subconscious, and by pure chance. But I insist that precisely what makes man man is his ability to rise above these influences, to change and determine his own destiny. If this be true, then it follows that each of us is terribly and inevitably and forever responsible for everything he does. The answer to the question, "Who's to blame?" is always, "*Mea culpa,* I am."

I believe as well that man is imperfect, now and forever. He is imperfect in his knowledge of the ultimate purpose of his life, imperfect in his choice of means to serve those purposes he does select, imperfect in the integrity with which he deals with himself and those around him, imperfect in his capacity to love his fellow man. If man is imperfect, then all of his constructs must be imperfect, and the choice is always among degrees and kinds of imperfection. The New Jerusalem is never going to be realized here on earth, and the man who insists that it is, is always lost unto freedom.

Moreover, man's imperfections are intensified as he acquires the power to coerce others; "power tends to corrupt and absolute power corrupts absolutely."

This completes the listing of my assumptions, and it should be clear that the list does not constitute a total philosophy of life. Most importantly, it does not define what I believe the free man's *duty* to be, or more specifically, what I believe my own duty to be and the source of the charge to me. However important these questions, I do not consider them relevant to the choice of an economic system.

Here, then, are two sections of the case for economic freedom as I would construct it. The first section presents economic freedom as an ultimate end in itself and the second presents it as a means to the preservation of the noneconomic elements in total freedom.

## Individual Freedom of Choice

The first section of the case is made in the stating of it, if one accepts the fundamental premise.

*Major premise:* Each man should be free to take whatever *action* he wishes, so long as he does not use force or fraud against another.

*Minor premise:* All economic behavior is "action" as identified above.

*Conclusion:* Each man should be free to take whatever action he wishes in his economic behavior, so long as he does not use force or fraud against another.

In other words, economic freedom is a part of total freedom; *if freedom is an end in itself, as our society has traditionally asserted it to be, then economic freedom is an end in itself, to be valued for itself alone and not just for its instrumental value in serving other goals.*

If this thesis is accepted, then there must always exist a tremendous presumption against each and every proposal for governmental limitation of economic freedom. What is wrong with a state system of compulsory social security? It denies to the individual his *freedom,* his right to choose what he will do with his own money resources. What is wrong with a governmentally enforced minimum wage? It denies to the employer and the employee their individual freedoms, their individual rights to enter into voluntary relationships not involving force or fraud. What is wrong with a tariff or an import quota? It denies to the individual consumer his right to buy what he wishes, wherever he wishes.

It is breathtaking to think what this simple approach would do to the apparatus of state control at all levels of government. Strike from the books all legislation that denies economic freedom to any individual, and three-fourths of all the activities now undertaken by government would be eliminated.

I am no dreamer of empty dreams, and I do not expect that the day will ever come when this principle of economic freedom as a part of total freedom will be fully accepted and applied. Yet I am convinced that unless this principle is given some standing, unless those who examine proposals for new regulation of the individual by government look on this loss of freedom as a "cost" of the proposed legislation, the chances of free enterprise surviving are small indeed. The would-be controller can always find reasons why it might seem expedient to control the individual; unless slowed down by some general feeling that it is immoral to do so, he will usually have his way.

## Noneconomic Freedoms

So much for the first section of the case. Now for the second. The major premise here is the same, that is, the premise of the rightness of freedom. Here, though, the concern is with the noneconomic elements in total freedom—with freedom of speech, of religion, of the press, of personal behavior. My thesis is that these freedoms are not likely to be long preserved in a society that has denied economic freedom to its individual members.

Before developing this thesis, I wish to comment briefly on the importance of these noneconomic freedoms. I do so because we who are known as conservatives have often given too little attention to these freedoms or have even played a significant role in reducing them. The modern liberal is usually inconsistent in that he defends man's noneconomic freedoms, but is often quite indifferent to his economic freedom. The modern conservative is often inconsistent in that he defends man's economic freedom but is indifferent to his noneconomic freedoms. Why are there so few conservatives in the struggles over censorship, over denials of equality before the law for people of all races, over blue laws, and so on? Why do we let the modern liberals dominate an organization such as the American Civil Liberties Union? The general purposes of this organization are completely consistent with, even necessary to, the truly free society.

Particularly in times of stress such as these, we must fight against the general pressure to curb the rights of individual human beings, even those whose ideas and actions we detest. Now is the time to remember the example of men such as David Ricardo, the London banker and economist of the classical free-market school in the first part of the last century. Born a Jew, married to a Quaker, he devoted some part of his energy and his fortune to eliminating the legal discrimination against Catholics in the England of his day.

It is precisely because I believe these noneconomic freedoms to be so important that I believe economic freedom to be so important. The argument here could be drawn from the wisdom of the Bible and the statement that "where a man's treasure is, there will his heart be also." Give me control over a man's economic actions, and hence over his means of survival, and except for a few occasional heroes, I'll promise to deliver to you men who think and write and behave as I want them to.

### Freedom of the Press

The case is not difficult to make for the fully controlled economy, the true socialistic state. Milton Friedman, professor of economics at the University of Chicago, in his book, *Capitalism and Freedom,* takes the case of a socialist society that has a sincere desire to preserve the freedom of the press. The first problem would be that there would be no private capital, no private fortunes that could be used to subsidize an anti-socialist, procapitalist press. Hence, the socialist state would have to do it. However, the men and women undertaking the task would have to be released from the socialist labor pool and would have to be assured that they would never be discriminated against in employment opportunities in the socialist apparatus if they were to wish to change occupations later. Then these procapitalist members of the socialist society would have to go to other functionaries of the state to secure the buildings, the presses, the paper, the skilled and unskilled workmen, and all the other components of a working newspaper. Then they would face the problem of finding distribution outlets, either creating their own (a frightening task) or using the same ones used by the official socialist propaganda organs. Finally, where would they find readers? How many men and women would risk showing up at their state-controlled jobs carrying copies of the *Daily Capitalist?*

There are so many unlikely steps in this process that the assumption that true freedom of the press could be maintained in a socialist society is so unrealistic as to be ludicrous.

### Partly Socialized

Of course, we are not facing as yet a fully socialized America, but only one in which there is significant government intervention in a still predominantly private enterprise economy. Do these interventions pose any threat to the noneconomic freedoms? I believe they do.

First of all, the total of coercive devices now available to any administration of either party at the national level is so great that true freedom to work actively against the current administration (whatever it might be) is seriously reduced. For example, farmers have become captives of the government in such a way that they are forced into political alignments that seriously reduce their ability to protest actions they do not approve. The new trade bill, though right in the principle of free trade, gives to the President enormous power to reward his friends and punish his critics.

Second, the form of these interventions is such as to threaten seriously one of the real cornerstones of all freedoms—equality before the law. For example, farmers and trade union members are now encouraged and assisted in doing precisely that for which businessmen are sent to jail (i.e., acting collusively to manipulate prices). The blindfolded Goddess of Justice has been encouraged to peek and she now says, with the jurists of the ancient regime, "First tell me who you are and then I'll tell you what your rights are." A society in which such gross inequalities before the law are encouraged in economic life is not likely to be one which preserves the principle of equality before the law generally.

We could go on to many specific illustrations. For example, the government uses its legislated monopoly to carry the mails as a means for imposing a censorship on what people send to each other in a completely voluntary relationship. A man and a woman who exchange obscene letters may not be making productive use of their time, but their correspondence is certainly no business of the government. Or to take an example from another country, Winston Churchill, as a critic of the Chamberlain government, was not permitted one minute of radio time on the government-owned and monopolized broadcasting system in the period from 1936 to the outbreak of the war he was predicting in 1939.

### Each Step of Intervention Leads to Another

Every act of intervention in the economic life of its citizens gives to a government additional power to shape and control the attitudes, the writings, the behavior of those citizens. Every such act is another break in the dike protecting the integrity of the individual as a free man or woman.

The free market protects the integrity of the individual by providing him with a host of decentralized alternatives rather than with one centralized opportunity. As Friedman has reminded us, even the known communist can readily find employment in capitalist America. The free market is politics-blind, religion-blind, and, yes, race-blind. Do you ask about the politics or the religion of the farmer who grew the potatoes you buy at the store? Do you ask about the color of the hands that helped produce the steel you use in your office building?

South Africa provides an interesting example of this. The South Africans, of course, provide a shocking picture of racial bigotry, shocking even to a country that has its own tragic race problems. South African law clearly separates the whites from the nonwhites. Orientals have traditionally been classed as nonwhites, but South African trade with Japan has become so important in the postwar period that the government of South Africa has declared the Japanese visitors to South Africa to be officially and legally "white." The free market is one of the really great forces making for tolerance and understanding among human beings. The controlled market gives man rein to express all those blind prejudices and intolerant beliefs to which he is forever subject.

**Impersonality of the Market**

To look at this another way: The free market is often said to be impersonal, and indeed it is. Rather than a vice, this is one of its great virtues. Because the relations *are* substantially impersonal, they are not usually marked by bitter personal conflict. It is precisely because the labor union attempts to take the employment relationship *out* of the marketplace that bitter personal conflict so often marks union-management relationships. The intensely personal relationship is one that is civilized only by love, as between man and wife, and within the family. But man's capacity for love is severely limited by his imperfect nature. Far better, then, to economize on love, to reserve our dependence on it to those relationships where even our imperfect natures are capable of sustained action based on love. Far better, then, to build our economic system on largely impersonal relationships and on man's self-interest—a motive power with which he is generously supplied. One need only study the history of such utopian experiments as our Indiana's Harmony and New Harmony to realize that a social structure which ignores man's essential nature results in the dissension, conflict, disintegration, and dissolution of Robert Owen's New Harmony or the absolutism of Father Rapp's Harmony.

The "vulgar calculus of the marketplace," as its critics have described it, is still the most humane way man has yet found for solving those questions of economic allocation and division which are ubiquitous in human society. By what must seem fortunate coincidence, it is also the system most likely to produce the affluent society, to move mankind above an existence in which life is mean, nasty, brutish, and short. But, of course, this is *not* just coincidence. Under economic freedom, only man's destructive instincts are curbed by law. All of his creative instincts are released and freed to work those wonders of which free men are capable. In the controlled society only the creativity of the few at the top can be utilized, and much of this creativity must be expended in maintaining control and in fending off rivals. In the free society, the creativity of every man can be expressed—and surely by now we know that we cannot predict who will prove to be the most creative.

You may be puzzled, then, that I do not rest my case for economic freedom on its productive achievements; on its buildings, its houses, its automobiles, its bathtubs, its wonder drugs, its television sets, its sirloin steaks and green salads with Roquefort dressings. I neither feel within myself nor do I hear in the testimony of others any evidence that man's search for purpose, his longing for fulfillment, is in any significant way relieved by these accomplishments. I do not scorn these accomplishments nor do I worship them. Nor do I find in the lives of those who do worship them any evidence that they find ultimate peace and justification in their idols.

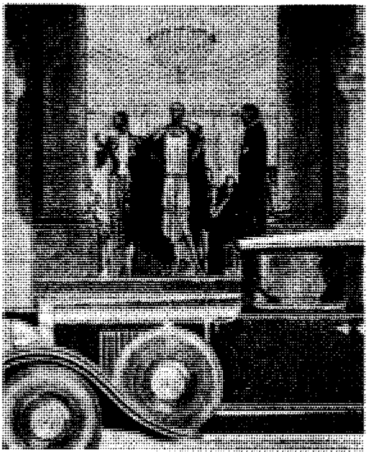
I rest my case rather on the consistency of the free market with man's essential nature, on the basic morality of its system of rewards and punishments, on the protection it gives to the integrity of the individual.

The free market cannot produce the perfect world, but it can create an environment in which each imperfect man may conduct his lifelong search for purpose in his own way, in which each day he may order his life according to his own imperfect vision of his destiny, suffering both the agonies of his errors and the sweet pleasure of his successes. This freedom is what it means to be a man; this is the God-head, if you wish.

I give you, then, the free market, the expression of man's economic freedom and the guarantor of all his other freedoms.

William H. Peterson

# In Defense of Millionaires



*A common caricature of the "very rich."*

MILLIONAIRES are proliferating in Tennessee, and that is both good news and bad news.

In 1979, according to the U. S. Trust Company of New York and its annual wealth survey, 11,705 millionaires resided in Tennessee. As of September 1, 1980 the survey has the number of millionaires bounding up to 13,230, giving Tennessee more than its pro rata share of the 574,342 millionaires in the nation.

In terms of millionaire density—the number of millionaire residents per thousand of state population—Tennessee has a 2.95 total—practically three millionaires for every thousand Tennesseans—man, woman and child.

First, this proliferation is bad news because a millionaire, like that old gray mare, "ain't what she used to be." Inflation, in other words, is breeding a new caste of millionaires who, because of a runaway inflation rate, have seen a sharp appreciation in the *nominal* value of their personal holdings and investments such as oil stock, defense investments, gold, silver, platinum, antique furniture, diamonds, jewelry, real estate and especially farmland. (Farm states show the highest millionaire densities.) The upshot is that thousands of Tennesseans and other Americans are realizing the Horatio Alger dream of piling up a cool million dollars in personal assets. But in terms of, say, 1940 dollars that million dollars would be more like $200,000 or so. Indeed, if inflation keeps escalating, everybody will be

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a "millionaire" before very long but a rather pauperized one.

The further bad news is that envy and social harassment still dog the millionaire. Look at our plays and novels, our movies and television programs. Millionaires are usually if not always portrayed as venal, grasping, shallow men and women. The TV phenomenon of "Dallas," which I confess I greatly enjoy, is about par for the course. As a character in F. Scott Fitzgerald's *The Rich Boy* put it: "Let me tell you about the very rich. They are different from you and me. They possess and enjoy early and it does something to them, makes them soft where we are hard, and cynical where we are trustful in a way that, unless you were born rich, it is very difficult to understand."

Even some church officials get into the act: "Ours is a world in which wealth is superabundant, exists beside and depends upon, the poverty and starvation of countless of God's human children. Some humans devour the resources of the earth while innumerable others languish in want and despair. The church must stand within that struggle, making its voice heard in behalf of the powerless and the forgotten. It must point out the superfluous wealth is an abhorrence to God in a world where, for the majority, economic failure, means permanent disaster."

The war against wealth has taken more extreme forms: the holocaust of Jews in Germany, the liquidation of Kulaks in Soviet Russia, the slaughter of the Ibo tribesmen in Nigeria, the killing of nearly a million overseas Chinese in Indonesia, the massacre of whites in Uganda. To be sure, in all these cases there were factors besides that of an anti-wealth mentality.

A subtler form of that mentality lies in the progressive income tax, which Karl Marx and Friedrich Engels expressly called for in their *Communist Manifesto* as a means of making "inroads upon the old social order, and . . . revolutionizing the mode of production." Today the progressive income tax is especially nefarious in our inflationary age, cutting ever more deeply into the ability of everybody, especially salaried people, to reach the nirvana of millionaire status.

As it is, the top 50 percent of income earners pay 93.5 percent of the Federal income tax bill, according to the 1978 figures compiled by the Tax Foundation of Washington, D.C. And of course, with mounting inflation, this concentration of the tax burden at the upper end of the income spectrum is on the increase.

Thus the irony of the progressive income tax is at least two-fold: First, through "bracket-creep," the effective federal income tax bite is making upward mobility in *real* income terms harder and harder.

Secondly, millionaires and other high income earners are blunted in their ability to inadvertently serve the poor. The rich, you see, have a function in society not unlike that of the honey-seeking bee spreading pollen as it flits from flower to flower. Millionaires, in other words, are savers and investors par excellence, and thus they are our chief creators of capital formation, which is the raison d'etre of the well-being of our society—public sector and private sector, rich and poor but especially the poor. Inflation and the progressive income tax thus become harsh regressive taxes on "the underprivileged."

Further, envy of the rich is mostly misbegotten. Many believe that the rich exploit their wealth from the poor, that one man's profit involves another man's loss, that Corporate America rapes the environment, that the consumer stands helplessly before "shared monopoly," that the poor become poorer and poorer and so on.

To meet all these and other arguments of what Ludwig Mises called "the anti-capitalist mentality" is impossible in terms of time and space. Enough to say that the consumer—mostly the little fellow—is sovereign if not dictatorial in the marketplace, that the marketplace is strictly voluntary in contrast to the coercion involved under socialism, that both parties in an exchange profit, that if Reggie Jackson, Sophia Loren and many entrepreneurs are millionaires their wealth is most willingly bestowed on them by consumers, including the poor, for coming up with better and better goods and services at lower and lower cost.

But, lo and behold, some good news for the poor: Their secret friend, the millionaire, is acquiring some powerful friends of his own in the court of public opinion. For example, according to Thomas Sowell, the brilliant black UCLA economist, the rich, like the poor, have become a full-fledged "Social Problem." Dr. Sowell worries that forthcoming tax reform could conceivably stalk "the rich in their tax shelters," and he would have none of that.

Again, Nobel laureate Milton Friedman calls for wiping out all progressivity in the federal income tax. He advocates a low flat rate—under 20 percent—on all income above personal exemptions with no deductions except for strict occupational expenses. Such a flat rate tax, he argues, would yield Uncle Sam more revenue than the present unwieldy structure with all its loopholes, special privileges and deadening impact on personal incentive and capital formation.

Meanwhile, let's hear it for millionaires—the poor's unknown, unloved, envied, socially harassed, politically abused and much misunderstood friends.

Ernie Ross

# The Impossible Task of the FED

THE FEDERAL RESERVE *has* an impossible task? Of course it does. But it's seldom mentioned. Most everyone just assumes that this autonomous government agency "on line" since 1914 has a job to do and should, well, simply *do* it. It's not that easy. The Fed does indeed have a job which it is *expected* to do. In fact, given modern politics, it has several. However, there is a profound difference between being expected to do a job and being *able* to.

On the surface, to the layman, the Fed's job might appear unequivocal: take care of the nation's money supply in such a way as to help America. As the fiftieth anniversary edition (1967 revised version) of *The Federal Reserve System: Purposes and Functions,* issued by the system's Board of Governors, succinctly put it, "The principal function of the Federal Reserve is to regulate the flow of bank credit and money." (p. 4) While this seems straightforward enough, the Fed's monetary manipulation to serve the national interest is a means to a number of ends. In the modern U.S.A., the Fed is expected to prevent banking crises, facilitate commerce ("at high levels of employment," as the Board put it), cover government deficits and fight inflation. The trouble is, manipulation toward one or more of these ends almost always contradicts another. They don't mesh!

There is perhaps no better example of this than the Fed's issuance of credit to cover the deficits of Congress. As monetary experts know, unless Congress raises taxes, the Fed is virtually forced to expand the money supply to pay for deficits. This is regarded as essential in order to protect the credit rating of the nation. Monetary expansion means more dollars will chase fewer goods; the dollar's value is lowered.

While the initial surge of new money may benefit some, often high-profiled, politically well-connected industries (most recently, synthetic fuels, solar energy, automobiles, housing and aerospace), the eventual effect of devalued currency on

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the economy cannot rationally be regarded as a factor which facilitates commerce; it slows commerce (and lowers employment). Inflation takes purchasing power away from businesses as it takes it away from everyone. Persistent inflation, such as we have had since the late 1960s, makes it more expensive to run government, too, thereby increasing chances Congress will deficit spend even more.

So, while attempting to help the nation meet its debts in the short run, the Fed has in the long run actually damaged business and private employment and increased the operating costs of government (especially state and local governments, which cannot fall back on the power to issue their own credit). As this happens, the Fed quite obviously must abrogate its responsibility to fight inflation! Conversely, if the Fed cuts the money supply, it abrogates short run responsibilities to cover Congressional deficits and stimulate depressed businesses (and employment) through lowered interest rates on borrowing.

After years of overlooking it, the newly more economically aware national press is noticing this dilemma. As *Newsweek's* Harry Anderson remarked just prior to the November general elections, "Regardless of who is the next President, the pressure on the Fed seems sure to intensify as the budget deficit swells. . . . Any Federal deficit must be financed through borrowing, and unless the Fed meets the new demand by creating more money, interest rates could be pushed to ruinous levels as private and public borrowing compete for funds. . . . In fact, the battle between the nation's fiscal and monetary authorities is a no-win situation for the economy. If the Fed caves in and finances immense budget deficits, the inflationary implications would be vast. If the Fed does not, a fragile recovery—if in fact it has arrived—will be slower than almost all the forecasts predict." (Oct. 13, 1980, p. 88)

### Bailing Out Banks Subsidizes Bad Investments

Another example of the failure of Fed purposes to mesh is apparent in bank bailouts. What, in the name of preventing banking crises, does bailing out banks accomplish long term? Whether by means of credit subsidies, loan guarantees or perhaps forced mergers with other stronger banks (the method makes almost no economic difference), banks require bailing out primarily because they have made bad investments. The policy of bailing out banks subsidizes bad investments.

True, the Fed may frown upon and chastise the makers of bad investments, but that is not the message that sticks with the banking community—it is not the economic message. The economic message comes through loud and clear from the Fed's action: the rewarding of malinvestments. A reward is exactly what it is. The more the Fed does it, the worse it will get. It's the old incentive principle at work—rewards encourage more of the action that is rewarded. Put another way, subsidizing poor investments makes them appear profitable. Could that seriously be regarded as a method of facilitating the nation's commerce? Hardly. Commerce on a national scale gains and retains health only through wise investments.

Nor can the Fed bailout obligation be regarded as a sound banking practice or even a method of preventing banking crises. Admittedly, in the short run it may well appear sound, especially to those banks "pulled out of the fire," to the investors of the banks and to a Fed determined to polish its image as a financial savior. (One must always remember that the Fed is subject to the bureaucratic survival principle: act to serve those who perpetuate your existence, or die.) But one could quite cogently argue that repeatedly making malinvestment remunerative must ultimately lead to banking crises—perhaps on a massive, unmanageable scale.

As banks, including some of the nation's giants, continue operating in this insulated atmosphere of guaranteed bailouts, they become progressively involved in larger and larger unwise, often downright speculative loans. Loans to third world countries—whose political instability makes their solvency highly questionable—are frequently in this category. (See the *Wall Street Journal*'s article last summer on American financial involvement in Zaire if you'd like to read an excellent tale of dubious investment.)

As the unwise investments accumulate, the danger increases that a bailout, or series of them, will be required that is so large the American government will not be able to generate the funds. Not only will we see losses to millions of American investors in banks, we could also see a severe monetary crisis. If the Fed hyperinflates in order to "save" the banks and the savings of American citizens and businesses, respect for the dollar will nosedive along with its value. It's crucial to constantly bear in mind that the dollar is the reserve currency of most of the free world. Therefore, a rapid dollar depreciation could precipitate a world depression.

Consider the depth of the economic contradictions involved in the Fed's various tasks. Manipulating the money supply must serve the masters of Combatting Banking Crises, Covering Government Deficits, Inflation Fighting and Facilitating Commerce. But different manipulations are required to accomplish these ends—depending on the range of one's vision. This means the monetary caretaker function of the Fed is necessarily eroded. Being a caretaker requires that one should ensure no harm comes to that for which one cares. If the Fed's service to multiple masters creates a currency of wild fluctuations, a currency neither business nor consumers can count on, it cannot fulfill what an AP business writer aptly termed the Fed's obligation as the "appointive guardian of the nation's money supply." (Oct. 7, 1980, AP Wire)

In addition, one must take note of what I call "the confusion factor" existent at the Fed. The guardian of the nation's money supply must know clearly what it is to guard; a doubting guardian, a confused guardian, cannot function efficiently and cannot be counted on in times of crisis when his efficiency is critical. With the conflicting functions the Fed is expected to pursue these days, frequently at the expense of the health of the nation's currency, its purpose as a money supply guardian cannot be clear to the agency.

After all, Fed members are human and therefore subject to human pressures and frustrations. Human beings subjected to contradictory orders and aims exhibit lowered efficiency and confusion. While this state of turmoil over objectives makes the Fed's job tougher, it is not what makes it impossible. Rather, the turmoil occurs because the Fed's job is impossible. Nevertheless, the doubts and confusion over purpose do act as a feedback loop, amplifying the difficulties.

### Catering to Expediency

There are people in respectable economic circles who argue that the basic purpose of the Fed is not to act "purely" as a money supply caretaker, or, for that matter, as a caretaker of any single function. They argue, and have argued for over sixty years, that the Fed must also act as a servant of "political necessity," as a caterer to the political "facts of life" in a modern democracy. But what is increasingly apparent even to the man in the street is that the primary fact of life in modern politics is the equivalency of "political necessity" and rampant expediency.

Catering to expediency makes the Fed a neurotic, nervous servant of favor and fancy—no matter how much it likes to regard itself as above all that. If the Fed is not above it all, why bother having a Fed? Surely, elected politicians, bickering and empire-building, could successfully provide a proper Congressional psychology of neurosis in which to manipulate the money supply in a most honorable tribute to frenzied expediency!

Of course, it was precisely such a madhouse political free-for-all Congress intended to avoid when it passed the Federal Reserve Act of 1913 (augmented, eventually, by the Banking Act of 1935). It intended to avoid that kind of mess and what was then seen as the "frenzied" actions of the free market. Congress has not succeeded. It could be no other way. The nature of the task it set for the Fed decades ago and the additional duties demanded of the Fed in more modern times are permeated with contradictions. What seems generally unrealized in modern economic forums is that the creation of the Fed involved not just problems but a fundamental flaw common to all economic tyrannies.

## A Legally Empowered Tyranny

The Fed is an economic tyranny—a democratically created, legally empowered tyranny over the nation's money supply. Whether an economic tyranny takes the broader forms of socialism, fascism and communism or this narrower form of federal monetarism, it holds an error in common: *it seeks to subjugate private, individual or business decision making to state authority.* In fact, private monetary decision making was precisely the economic "frenzy"—i.e., free human action—so unacceptable to the politicians and fellow supporters of federal monetary centralization.

Politicians have long understood that maintaining and expanding state power is incompatible with freedom. The Fed has been used for just such maintenance and expansion—perhaps more than any other government institution created by man. Given that this nation's money supply is crucial to the U.S. economy and to the world economy, that it underlies and affects all transactions of the free world (and much of the unfree world), the creation and perpetuation of the Federal Reserve System is the most gripping, insidious economic tyranny yet accepted. The domains and edicts of such agencies as the Federal Trade Commission, departments of Energy, Education, or Health and Human Services and most other agencies of this government are small potatoes indeed when compared to the realm and power of the Fed.

Yet, most of today's established market economists tacitly support this tyranny. Even the most influential of them, Milton Friedman, in his current bestseller, *Free to Choose,* while documenting a damning case against government economic intervention in general and the Fed's specific malfeasance in the 1930s depression, nevertheless insists that the Fed could have "used wisely the powers that had been granted to it (in order to) perform the task for which its founders had established it." (p. 85) Unfortunately, it is instances of this sort of wishful thinking which divert attention from a proper, contextual focus on the subject.

The issue is not that a government agency *could* have made a right decision in any particular instance, but rather that the *propensity* of government agencies is to make wrong economic decisions. Friedman and his admirers (and even more so the statist economists) forget that the Fed's task is to perform as monetary dictator. The evidence is overwhelming that no government has succeeded for long in productively dictating the actions of any segment of the economy; monetary policy is no exception. Governments have succeeded—notoriously so—in destructively dictating economic actions; monetary policy is no exception.

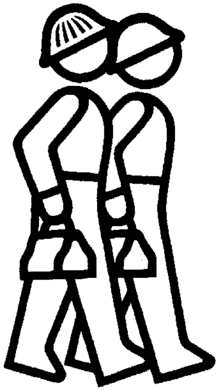
## Abolish the Fed and Privatize Monetary Functions

The case record of the Fed—most notably, its recession-causing sharp monetary contractions after World War I; its inflation in 1927 which created the dangerous speculative market boom; its effort to counter that boom with a panicky, severe contraction which led to the Great Depression; its hand in causing the severe 1937 recession; and its ever-widening post-World War II swings between over-inflation and recession-spawning contractions which have finally merged into "stagflation," plunging the business morale and hopes of American citizens for their future to new lows—is enough by itself to warrant a case for abolishing the Fed. But the fact that the Fed is *by its nature* bound to serve impossible ends must surely add philosophical ammunition to the case.

There is in the long run only one answer to the problem of managing the monetary economy: It should be privatized, with privately coined and printed currency, privately controlled credit systems and private insurance of monetary deposits. Because of the scope of such a revision we would also be forced to consider more seriously privatizing many other government services. For without its own monetary machinery, the government will find the financing of redistributive and vote-buying schemes considerably more difficult.

Privatized monetary functions *do* act as a natural check on the power of government. But the alternative to privatizing the U.S. monetary system, tinkering and fiddling with the derelict government system we have, means keeping a form of tyranny intact. There is only one way to prevent the damages to human liberty which a tyranny inflicts—take away the tyranny. The Fed is such a tyranny. There is no place for it in the future of a free America.

Clarence B. Carson



# The Impact of Unionism

UNIONISM is not a theory of economics, nor does it have one. It is, as I have said, an ethical theory, buttressed by a religion-like ideology. Its theory is that individual workers cannot get their just deserts in an open market, that they must combine and use coercion to get their due. Yet the primary impact of unionism is on the economy, though it extends outward to have effects on all social relations. Underlying the thrust of unionism, then, there must be at least an implicit economic theory.

So there is. It is a theory that is uncovered by positing what it is necessary to believe in order to explain doing what unions do. What unions do is to act to reduce the supply of workers available. They organize some of the workers against the other workers and attempt to monopolize the available jobs. Now it is sometimes supposed that the labor theory of value provides the unionist contact with economics. But the labor theory of value does not provide an economic explanation for the unionist effort to reduce the supply of labor.

If labor were the source of all value, it still would not follow that it would be socially desirable to reduce the supply of labor. On the contrary, it would appear that it would be socially desirable to use every smidgeon of labor to the fullest extent possible.[1] It is doubtful, however, that the labor theory of value should be considered as an economic theory; it makes much more sense as a partisan, or sectarian, ethical

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theory. In short, it is best understood as a claim that labor should have all the product of industry. In any case, it does not explain actual union behavior which aims to monopolize jobs rather than to take the whole proceeds of industrial activity.

### Economic Goods Are Scarce

The economic theory necessary to unionism comes into view when we turn the major premise of economics upside down. The major premise of economics is that all *economic* goods are scarce. (Not all economists acknowledge this, but it is nonetheless the premise required for their study.) They are economic goods because they command a price, and they command a price because they are scarce. The minor premise which follows from this, in syllogistic form, is that labor commands a price in the market. Therefore, it is an economic good which is scarce. The scarcity of labor is axiomatic, then, and it is this that makes it a subject of concern for economics.

The major premise of unionism is that *there is a surplus of labor.* Looked at more broadly, the major premise of unionism is a conclusion derived from a major premise of socialism or interventionist economics, namely, that there is a surplus of goods generally. This statement is not made as a universal by its advocates, that is, they do not claim that there has always been a surplus of goods or that it is everywhere the case. Rather, it is described as an historical condition and attributed to industrialization. (Not, it should be noted, as a worthy development, but as a problem, because the goods are not evenly distributed.)

This major premise of socialism—that there is a surplus of goods produced, or producible in highly industrialized countries—was stated dramatically by Karl Marx and Friedrich Engels in 1848. They said, "In these crises there breaks out an epidemic that, in all earlier epochs, would have seemed an absurdity—the epidemic of over-production. . . . Because there is too much civilization, too much means of subsistence, too much industry, too much commerce."[2]

### Over-Production a Problem

This concept of a surplus of goods has had vigorous proponents among Americans of the historical school of economics, usually called institutionalists. The leaders of this school have included John R. Commons, Stuart Chase, Thorstein Veblen, and John Kenneth Galbraith. Stuart Chase, for example, declared that the United States turned the corner and achieved a condition of abundance in 1902. "Abundance," he said, "is self-defined, and means an economic condition where an abundance of material goods can be produced for the entire population of a given community."[3] Rexford G. Tugwell maintained, in the 1930s, that "there is no scarcity of production. There is, in fact, a present capacity for more production than is consumable, at least under a system which shortens purchasing power while it is lengthening capacity to produce."[4] Chase offered documentary evidence for what he conceived of as the capacity for over-production (written in 1931, note, when they may have been more convincing):

> American oil wells are capable of producing 5,950,000 barrels a day, against a market demand of 4,000,000 barrels, according to the figures of the Standard Oil Company of New Jersey.[5]
>
> The real problem [in coal] is excess capacity. The mines of the country can produce at least 750,000,000 tons a year, while the market can absorb but 500,000,000 tons.[6]
>
> American shoe factories are equipped to turn out almost 900,000,000 pairs of shoes a year. At present we buy about 300,000,000 pairs. . . . Yet if we doubled shoe consumption . . . one-third of the present shoe factory equipment would still lie idle. . . .[7]

Three decades later, in different conditions, Vance Packard stated the position of the surplus of goods succinctly:

> Man throughout recorded history has struggled—often against appalling odds—to cope with material scarcity. Today, there has been a massive breakthrough. The great challenge in the United States—and soon in Western Europe—is to cope with a threatened overabundance of the staples and amenities and frills of life.[8]

If there were a surplus of goods generally, it would follow that there is a surplus of labor. As early as 1893, John R. Commons held that there was a "chronic excess of labourers beyond the opportunities for employment."[9] Stuart Chase spelled out the position in the 1930s:

> What threatens to continue unabated, in good times and bad, is technological unemployment. . . . In four years oil refineries increased output 84 per cent, and laid off 5 per cent of their men while doing it. Tobacco manufacturing output climbed 53 per cent in the same period, with 13 per cent fewer men at the end. . . .
>
> It can mean only one thing. An equivalent tonnage of goods can be produced by a declining number of workers, and men must lose their jobs by the thousands—presently by the millions.[10]

## Emphasis on Consumption

The general premise of a surplus of goods leads to consumer or consumption economics, i.e., to measures promoting the consumption of goods. The premise of a surplus of labor provides the basis of an implicit economic theory for unionism which is nowhere spelled out but which is everywhere practiced by unionists. It is the theory undergirding the practices of reducing the available supply of labor.

The unionist theory of a labor surplus is a self-fulfilling prophecy when it is put into practice. That is, labor unions tend to create the very conditions they posit, namely, labor surplus, or, more precisely, unemployment, underemployment, and low-paid work for non-union workers. But before explaining why, it needs to be made clear that labor is scarce. This has been affirmed already in terms of economics, but there is a more basic axiom than the one cited. It is this. Human wants are insatiable, but the means for satisfying them are limited (scarce). Human labor can be used in innumerable ways to satisfy human wants. Therefore, labor is scarce—essentially and permanently.

I can make the same point in a much more homely fashion, one which brings us in the vicinity of everyman's experience, and one which will get us much closer to the effects of labor unions. There is more work to be done than there is ever time or energy to do. It is certainly true around my house, and from all I have ever learned it is true for others as well. As I write this, there are dozens of tasks I can think of that need doing. The roadway to my house needs some repair; the lawn needs mowing; the lawn needs fill in places, reseeding, and fertilizer generally; the trees will need pruning when the time comes. The place where the water pipe enters the house from the well needs blocking up, because it freezes in very cold weather. I have been intending for more than two years to paint the exposed concrete blocks in the foundation of my house. Several rooms inside the house need a new coat of paint. It is time to spread lime on my garden in preparation for next year. My car would benefit greatly not only from being cleaned and washed but also from a good waxing. And this list only scratches the surface of all the work awaiting either my own attention or that of someone whom I could afford to employ. More broadly, there are numerous goods I would like to have for myself or my family—ranging from a yacht and swimming pool to clothing and exotic foods—if I only had the means to pay for them. And every one of my wants would require more or less labor to satisfy it.

In short, I have a *surplus* of wants and a *scarcity* of means for satisfying them. That condition is sufficiently near universal that no one has ever bothered to make a survey to determine if it is unanimous.

### Price a Crucial Factor in Satisfying Wants

Equally important, we do not feel all our wants with equal intensity. We have priorities as to which of them we would satisfy with what outlay of our limited means. For example, my desire for a yacht is of such low intensity that I am by no means certain that I would rush to buy one if 50-foot yachts were selling for $100. On the other hand, if new automobiles were selling for $25 each, I would stop what I am doing and lay in a stock of them immediately. *Price,* then, is a crucial factor in my decisions about satisfying my wants. And, the price of labor is a factor in the price of virtually all the goods I want.

What this means, practically, is that all who can work so as to satisfy some human want can find employment—somewhere, at some price. The full employment of all who are willing to work is the norm for human societies. Price is the crucial variable, however, for full employment. This is so both because of the great range in intensity of wants and the range of human capacity, ability, and skill in satisfying wants. Indeed, individuals differ from one another and vary as to the extent to which they can perform all the tasks which have an effect on the quantity and quality of their output. That is, they differ in temperament, power of concentration, intellectual penetration, endurance, strength, skill, and so on. The basic means for making adjustments for differences in intensities of wants and different individual abilities are in price and working arrangements (not "working conditions," for as that phrase is ordinarily used it is simply an aspect of price).

The thrust of unionism is to establish downward price (wage) inflexibility and to raise ever higher the level below which wages cannot go. This means that wages cannot be adjusted to changing demand (intensity of want) or to the lower productivity or different work patterns of some workers. More directly, it means that unions cause unemployment, and the more widely they are established the greater the unemployment. They price workers out of the market, thus causing endemic unemployment.

It might be supposed that the connection between labor unions and unemployment could be easily demonstrated empirically. All that should be necessary would be to match the figures of increasing union membership and recognition with unemployment figures. That it is not so simple will become apparent by examining an instance, and the reasons for its complexity will lead us to the broad and sustained impact of unionism.

### Unions and Unemployment

Perhaps the best period for an historical case study of the effect of unions on unemployment was 1935–1939. The Wagner Act was passed in 1935. In 1936, there was a 10.1 per cent increase in union membership over the preceding year. In 1937, the greatest jump in membership for a single year in the twentieth century occurred; it was a whopping percentage increase of 53.9.[11] The main thrust for this increase came from the CIO under the leadership of John L. Lewis. As one writer describes this surge: "At the end of two years of activity, in December, 1937, the C.I.O. boasted a membership of 3,700,000—composed of 600,000 miners, 400,000 automobile workers, 375,000 steel workers, 250,000 ladies' garment workers, 175,000 clothing workers, 100,000 agricultural and packing house workers, 80,000 rubber workers. The day of labor giants had dawned."[12]

There followed a drastic increase in unemployment. According to one compilation, unemployment stood at about 7½ million in 1937. In 1938, it rose to 11 million, and in 1939 was still lingering around 9½ million.[13] A stock market crash of considerable dimensions occurred beginning in the middle of 1937. One economic historian explains these events in this way. There had been an increase of aggregate labor income at the expense of profit income. This had resulted primarily from the unionization which increased wages of manufacturing laborers rapidly. "A main factor," he says, "on the industrial side in bringing the revival of 1935–1937 to a close was this startling increase in wages, due . . . to a tremendous burst of activity by trade unions under the Wagner Act—a rise in wages unmatched by a corresponding rise in the productivity of labor."[14] Or, technically, in terms of marginal utility theory, the higher union wages made many workers marginal who had been employed, and they lost their jobs.

Described in this way, there appears to be very nearly a *prima facie* case that unions caused the unemployment. Unfortunately, there were other developments during the same period which may have contributed to the unemployment and which certainly muddy the waters of causation. Many were leaving the farms seeking industrial employment, such as, from the Dust Bowl, and some of these added to the rolls of the unemployed. There were changes in governmental fiscal policies which probably had some effect. Here is a succinct summary by an historian: "In June, 1937, Roosevelt . . . slashed spending sharply. He cut WPA rolls drastically and turned off WPA pump-priming. At the very same time, Washington collected two billions in new social security taxes. The government had not only stopped priming the pump but was even 'taking some water out of the spout.'"[15] Benjamin Anderson has challenged this explanation,[16] but it is plausible that the higher wages combined with a slacking off of inflation would have contributed to the unemployment.

### Minimum Wage Laws

Government further aggravated the situation in 1938 by the passage of the Fair Labor Standards Act. This established minimum wages and maximum hours in many industries, resulting in higher wages and shorter hours for some workers. The effect of the minimum wage is the same in kind as a union wage. So far as it works to raise wages above the market level it will result in unemployment.

These latter developments illustrate the point that now needs to be made. Unions are not simply empowered by government, they are aided and abetted by a host of government programs which, on the one hand, conceal or confuse the effects of unionism and, on the other, aggravate them. Union contracts, plus government enactments, would—in fact, do, when viewed from the angle of potential employment—cause massive unemployment, but most of these effects are concealed from public view by a host of other programs. Most, if not all, of this should be attributed to unionism, for governments generally act on unionist premises and the public at large tends to accept union goals, even when they may deplore certain union tactics.

To grasp the full impact of unionism, it may be helpful to view it in the light of the Greek fable of Procrustes. It is said that the countryside was inhabited by assorted petty tyrants and marauders. "One of these evil-doers was called Procrustes, or the Stretcher. He had an iron bedstead, on which he used to tie all travellers who fell into his hands. If they were shorter than the bed, he stretched their limbs to make them fit it; if they were longer than the bed, he lopped off a portion."[17]

### The Cost of Fringe Benefits

The thrust of unionism is to make a Procrustean bed, into the confines of which all who would work must fit. The most obvious of the confines is price. By making prices of labor (wages) downwardly inflexible, only those who can produce at a level that would make it worthwhile for an employer are likely to find work. This price inflexibility extends much beyond what is ordinarily called wages. It includes employer contributions to retirement plans, Social Security, unemployment compensation, hospitalization plans, workmen's compensation, and so on. Indeed, these "fringe benefits" have become so expensive that many employers find it less expensive to pay overtime to those already employed than to take on new people. (This is so because there may be little or no fringe benefit payments for the overtime work.) "Overtime" has become a way of life for many industrial workers. Indeed, it is sometimes considered one of the "perks" of the job, and some workers make obligations based on the expectation of it. The supreme irony of this is to be seen in all the verbiage that historians have lavished on the supposedly horrible conditions of work in earlier times when people worked long hours and six- and seven-day weeks.[18]

The thrust of unionism to make a Procrustean bed in which all who would work must fit is much broader than is suggested by downward price inflexibility. Unions and government exert pressure for uniform pay scales, for raises in pay according to seniority, and for objective job definitions. Indeed, the pressure of unionism is to have work as highly structured as possible, to have it done under managerial supervision and control, to have payment based on time worked, to have it performed within factories or factory-like surroundings, to require of every worker within a job classification that he do as much, or as little, as all others, in short, to have it done under conditions that are optimal for unionization.

### Home Workshops Opposed

This pressure may best be illustrated, perhaps, by unionist opposition to work being done in the home. Unionists and their sympathizers attached odium to such arrangements by characterizing it as a "Sweating System." In the argot of Americans, a "sweat shop" is a factory where intolerable working conditions prevail. That is not at all the origin of the idea of "sweated labor." It originated as a term of derogation, or was so used by unionists, for work done in the home.

The *Encyclopedia Britannica* describes the "Sweating System" as being closely "associated with contracting. Individual workers or groups of workers contract to do a certain job for a certain price." The work is then performed in the home, home workshops, and the like. The same source says that the "sweating system grew in the United States during the Civil War, when soldiers' wives were employed to make uniforms with the relatively newly developed sewing machines." Unionists attacked the system with all the energy they could muster. The *Britannica* says that "In the United States most of the pressure to eliminate sweating was applied by organized labor."

Industrial homework has long since been virtually eliminated in the United States by a combination of union and government effort. Unions had considerable success in getting it eliminated in such undertakings as clothing making and cigar making. It became virtually illegal in some states, for Jack Barbash notes that when the New York legislature considered a bill for "partial legalization of industrial homework," it was vigorously opposed by the New York Federation of Labor.[19] At any rate, much homework was made impractical by minimum wage prescriptions (based on an hourly rate, as they were, employers would be unwilling to pay when they could not check), prescriptions as to working conditions, by zoning laws, and such like.

### Problems of Organizing

The unionist motives for opposition to home work are not difficult to surmise. It would probably be nearly impossible to organize such workers. The conditions of proximity and association would not exist for developing class consciousness among them. They could do the work less expensively than it could be done in the factories; thus making it difficult to organize factory workers engaged in similar pursuits. Thus, unionists stigmatized such work arrangements as inhumane and oppressive.

Though there are many other aspects of it, the above examples suggest the outline, at least, of the Procrustean bed made by unionism. It is a bed far short of the size that could accommodate the potential work force of the country.

Those workers who do not fit within its confines are lopped off. For one thing, most workers who cannot fit into factory-like requirements as to hours of work are largely eliminated from consideration for employment. Many who have small children to attend to and household tasks to perform would undoubtedly like part-time employment in the home. An employer who sometimes had large numbers of letters to be individually addressed told me that the first time he advertised for such help applicants tied up his office telephones for days. The next time he had occasion to advertise, he gave only a box number, but he still received hundreds of written applications from people wishing to do work in the home.

### Governments Intervene

Governments have assisted in numerous ways in lopping off potential willing workers. Compulsory school attendance and child labor laws largely eliminate children from most employment. Prolonged schooling much beyond the ages of 16 to 18 has kept many young people off the labor market. States subsidize technical and college education on a vast scale. The community and junior colleges founded in unprecedented numbers in the 1950s and 1960s were the most dramatic instances of such an effort. The G.I. Bill of Rights was the largest of the Federal efforts along this line, but it has in more recent times been supplemented by both Federal and state scholarship and loan programs.

Social Security and other retirement programs enable many at the other end of the age scale to stay off the labor market. Aid to dependent children and other welfare programs provide support for many mothers and older children without their holding jobs. Social Security provides such support, too, in cases where a covered mate has been disabled or died. Unemployment compensation relieves some of the pressure from union- and government-induced unemployment. Indeed, ingenious workers can cut their work time by perhaps as much as one-half or more by working from time to time, getting laid off or having the job discontinued, and drawing unemployment compensation. Some do, but in the nature of the programs there is no way to determine how much of it is deliberate.

My concern is not with the motives which led legislators to enact these and other such programs. The effects are the same whatever the motives, and the effects are the reduction of the available labor supply. And there is bountiful evidence that both unions and governments act upon the premise that there is a surplus of labor.

Even all the efforts that are made at reducing the labor supply by lopping it off do not succeed in reducing the supply so that it will fit into the Procrustean bed for jobs. There are usually still millions looking for employment, or claim that they are. There is a major effort, then, to "stretch" the jobs to fit the available labor supply. Unions are famous, or infamous, for job stretching. It is sometimes called "featherbedding." The way this is usually done is in work rules in union contracts. Here are some examples:

1. Limitations on supervisory personnel performing production work—for example, a Rubber Workers's union provision: "Members of factory management shall not perform work which is normally assigned to direct workers. . . ."
2. Limitations on assigning work outside of an employee's classification, as for example a Meat Cutters' union provision that weighers and wrappers may not "platter" meat cuts in self-service counters.
3. Requirement for minimum number of employees on a job: for example, the Motion Picture operators demand for two men in projection booth.
4. Rules regulating the use of labor-saving methods and machinery. . . .
5. Rules protecting union's jurisdiction: in New York theatres "Carpenters will build a platform, but the covering is prop man's. A hat (worn) is costume but the same hat (unworn) is a prop. A table is moved by prop men, but the lamp on it is sacred to electricians. . . ."[20]

Governments, too, have made efforts to "stretch" jobs, provide temporary jobs, and "stretch" the money supply to fit the Procrustean bed they have helped to create. The most general effort by the United States government to "stretch" jobs has been the mandated 8-hour day, 40-hour week. That effort has met with mixed success, however, as already noted, because overtime pay is often not a sufficient penalty to prevent longer hours, in view of the effective penalties involved in hiring other workers. Thus, government programs are often initiated with the idea of providing more jobs. The role of the unions in this is suggested in the following:

> Unions seek to enlist the aid of government in providing more jobs in the industries in which their members are employed; or to protect job opportunities from being impaired in their industries. . . . [Among these] are the interests of the building trades unions, which have been among the most energetic supporters of government action for a major low-cost housing program; and the metal trades unions for a shipbuilding program."[21]

## Inflation to Offset Impact of High Wages on Employment

The most prolonged effort at "stretching" has been in stretching the money supply—i.e., inflation, to offset the impact of high union wages on employment. It is doubtful that most unions could survive for long without progressive increases in the money supply. The continually higher monetary wages on which their success depends would produce such levels of unemployment (even if all other programs to reduce labor supply were in effect) that union workers would no longer be employed.

Further, Friedrich A. Hayek has pointed out that if government is committed to full employment, "current union policies must lead to continuous and progressive inflation. . . . If labor insists on a level of money wages too high to allow of full employment, the supply of money must be so increased as to raise prices to a level where the real value of the prevailing money wages is no longer greater than the productivity of the workers seeking employment. In practice, this necessarily means that each separate union . . . will never cease to insist on further increases in money wages and that the aggregate effort of the unions will thus bring about progressive inflation."[22] He has ably described the process of "stretching" that goes on.

Unionist policies flow from a misconception of reality. Labor is essentially scarce in reality. Unionists operate on the premise that there is a surplus of labor. The result is an apparent contradiction. Unionism produces both a labor shortage and unemployment (a labor surplus?). The reason for this is before us. Many potential employers cannot find workers to do the work they would

**Unemployment and Unionism**

IN ITS TENDENCY toward mass action and indifference to the interest and choice of the individual, trade unionism gives its leaders tyrannical authority over members and nonmembers alike.

Modern trade unionism, by the use of force, not only distorts the wage market, causing unemployment or inflation, but also interferes with the liberty to work, to trade, and to associate. Such action frequently makes it impossible to enter a wage contract voluntarily; the right to abstain from working becomes the obligation to take part in strikes against one's will; and the right to associate becomes the obligation to join this or that union. Coercive force, instead of being reserved exclusively to the government for the protection of the life, liberty, and property of the citizens, is employed by these organized groups to attack many of those same fundamental individual rights.

**ALBERTO BENEGAS LYNCH**

hire done at a price they are willing to pay. (It is commonly observed today, "You can't find workers to do this, that or the other.") Wages are too high to pay for low-priority and low-productivity work. On the other hand, many people cannot find employment at the artificially established high wages.

## Institutional Unemployment Plus a Shortage of Labor

The impact of unionism is as broad as the economy over which it holds sway, and even broader than that. It leads to institutional (or structural) unemployment and an endemic labor shortage. It requires massive government intervention to conceal the worst of its ravages. Unionism—labor unions plus accommodative government action—intervenes in the market at its most sensitive point. It makes rigid what needs to be most flexible to meet continually changing conditions. It causes unemployment, labor shortages, promotes inflation, higher prices, less productivity, and leads to fewer goods and services for everyone.

Who are labor unions organized against? They are organized against all who work, and all who benefit from work. They are organized against non-union workers most obviously, for these are often turned away from the gates, may not be able to find employment, and, if they do, may have to accept lower wages. In some respects, unions are organized against their own members, some of whom may be compelled to join or pay dues, the most industrious of whom may be held back to the level of the less productive, and some of whom lose their jobs when the union wage prices them out of the market. They are organized against employers. They are organized against consumers. Above all, they are organized against the weakest members of society, those who cannot fit into the structure of employment—the young, the old, the lame, the halt, and the blind.

## —FOOTNOTES—

[1]Marxists, however, are not necessarily being inconsistent in promoting unionism. They are making warfare on capitalism by obstructing production generally. Once in power in a country, they regularly subdue the labor unions.

[2]*The Communist Manifesto* in Eugen Weber, ed., *The Western Tradition* (Boston: D. C. Heath, 1959), p. 609.

[3]Quoted in Charles S. Wyand, *The Economics of Consumption* (New York: Macmillan, 1937), p. 54.

[4]Rexford G. Tugwell, *The Battle for Democracy* (New York: Columbia University Press, 1935), p. 7.

[5]Stuart Chase, *The Nemesis of American Business* (New York: Macmillan, 1931), p. 88.

[6]*Ibid.*, p. 89.

[7]*Ibid.*, p. 79.

[8]Vance Packard, *The Waste Makers* (New York: David McKay, 1960), p. 7.

[9]John R. Commons, *The Distribution of Wealth* (New York: Reprints of American Classics, 1963), pp. 84–85.

[10]Chase, *op. cit.*, pp. 15–16.

[11]Irving Bernstein, "The Growth of American Unions," *Readings in United States Economic and Business History*, Ross M. Robertson and James L. Pate, eds. (Providence: Brown University Press, 1965), p. 363.

[12]Joseph G. Rayback, *A History of American Labor* (New York: Macmillan, 1959), p. 355.

[13]Gilbert C. Fite and Jim E. Reese, *An Economic History of the United States* (Boston: Houghton Mifflin, 1965, 2nd ed.), p. 599.

[14]Benjamin M. Anderson, *Economics and the Public Welfare* (New York: D. Van Nostrand, 1949), pp. 444–46.

[15]William E. Leuchtenburg, *Franklin D. Roosevelt and the New Deal* (New York: Harper & Row, 1963), p. 244.

[16]Anderson, *op. cit.*, pp. 439–44.

[17]Thomas Bulfinch, *The Age of the Fable* (New York: The Heritage Press, 1942), p. 154.

[18]There is a factory near where I live in which many of the workers work 7 days one week and 6 days the next by regular alternation. In another factory, it is not unusual to work 12 or 16 hours (called "working a double") some days. It would be an error either to suppose that workers resent the long hours or that the decision to work overtime is voluntary. Often enough, the willingness to do so is a condition of continued employment.

[19]Jack Barbash, *The Practice of Unionism* (New York: Harper & Bros., 1956), p. 261.

[20]*Ibid.*, pp. 167–68.

[21]*Ibid.*, p. 247.

[22]Friedrich A. Hayek, *The Constitution of Liberty* (South Bend, Indiana: Gateway, 1972), p. 280.

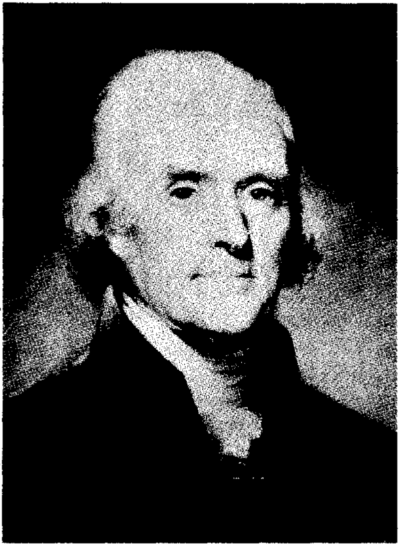
**Thomas Jefferson**

# Freedom of Conscience

THE ERROR seems not sufficiently eradicated that the operations of the mind, as well as the acts of the body, are subject to the coercion of the laws. But our rulers can have authority over such natural rights only as we have submitted to them. The rights of conscience we never submitted, we could not submit. We are answerable for them to our God. The legitimate powers of government extend to such acts only as are injurious to others.

But it does me no injury for my neighbor to say there are twenty gods, or no God. It neither picks my pocket nor breaks my leg. If it be said his testimony in a court of justice cannot be relied on, reject it then, and be the stigma on him. Constraint may make him worse by making him a hypocrite, but it will never make him a truer man. It may fix him obstinately in his errors but will not cure them. Reason and free inquiry are the only effectual agents against error. Give a loose rein to them, they will support the true religion by bringing every false one to their tribunal, to the test of their investigation. They are the natural enemies of error, and of error only. . . .

Were the government to prescribe to us our medicine and diet, our bodies would be in such keeping as our souls are now. Thus in France the emetic was once forbidden as a medicine, and the potato as an article of food. Government is just as infallible, too, when it fixes systems in physics. Galileo was sent to the Inquisition for affirming that the earth was a sphere; the government had declared it to be flat as a trencher, and Galileo was obliged to abjure his error. This error, however, at length prevailed; the earth became



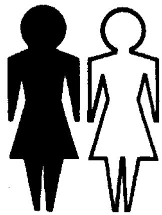
Courtesy Princeton University

Thomas Jefferson (1743–1826), first Secretary of State, second Vice President, and third President of the United States. Jefferson was born in Virginia and trained as a lawyer, but his interests were too broad and his talents too diverse to be confined to a single profession. He was a linguist, mathematician, architect, inventor, essayist, planter, diplomat, statesman, and one of the most prolific correspondents of all times. Paul L. Ford published what became the standard collection of his Writings in 9 volumes in the 1890s. This selection is extracted from Notes on the State of Virginia (Philadelphia: Prichard and Hall, 1788), pp. 169–71.

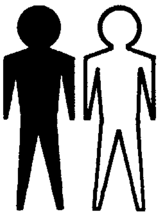
a globe, and Descartes declared it was whirled round its axis by a vortex. The government in which he lived was wise enough to see that this was no question of civil jurisdiction, or we should all have been involved by authority in vortices. In fact, the vortices have been exploded, and the Newtonian principle of gravitation is now more firmly established on the basis of reason, than it would be were the government to step in and to make it an article of necessary faith.

Reason and experiment have been indulged, and error has fled before them. It is error alone which needs the support of government. Truth can stand by itself. Subject opinion to coercion: whom will you make your inquisitors? Fallible men; men governed by bad passions, by private as well as public reasons. And why subject it to coercion? To produce uniformity. But is uniformity of opinion desirable? No more than of face and stature. Introduce the bed of Procrustes then; and, as there is danger that the large men may beat the small, make us all of a size by lopping the former and stretching the latter. . . . Reason and persuasion are the only practicable instruments. To make way for these, free inquiry must be indulged; and how can we wish others to indulge it while we refuse it ourselves?

George C. Leef



# The Economics and Politics of Discrimination



IT is widely believed that capitalism, to the extent that it is still allowed to function, is responsible for our problem of racial discrimination. Blacks, Hispanics, and other ethnic groups are seen to be "underutilized" by business, and therefore many people conclude that the cause must be that businessmen are guilty of racial discrimination. Having arrived at this conclusion, the solution is simple and obvious: Merely compel businesses to hire more individuals from these groups. Mandate "affirmative action" programs, "goals" or quotas in hiring and promotion, enforce these with a federal bureaucracy and the courts, and everything will be fair and equal. A closer examination will show, however, that racial discrimination, far from being caused by capitalism, is in fact the result of governmental interferences with capitalism. We shall see that the proper response to the problems of blacks and other ethnic minorities in society is not more governmental coercion, but to eliminate that which we now have.

Businessmen are in business to make money. They are engaged in a continuous struggle to increase revenues and decrease costs. The first crucial point we must grasp is that racial discrimination imposes costs upon businessmen who practice it. For example, purchasing decisions are generally made upon the criteria of least cost and best service. If a businessman refuses to deal with a black supplier who could offer the lowest price and/or best service, he has imposed additional costs upon himself. Similarly, to refuse to hire

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qualified persons because of their skin color means that the businessman must devote more time and resources to searching for a person to fill the job, and perhaps having to settle for a less well qualified candidate.

### The Price of Prejudice

Not many businessmen prefer prejudice to profits. As economist Milton Friedman puts it, "A businessman or an entrepreneur who expresses preferences in his business activities that are not related to productive efficiency is at a disadvantage compared to other individuals who do not. Such an individual is in effect imposing higher costs on himself than are other individuals who do not have such preferences. Hence, in a free market, they will tend to drive him out." (*Capitalism and Freedom,* pp. 109–110)

In theory, therefore, we would expect to find little discrimination in a free market because of the self-interest of businessmen. This theory finds strong support from historical evidence. First, the Jim Crow laws of the states of the South specified that certain jobs in industry could be done only by white workers. But if the industrialists were intent upon discriminating, why did this preference have to be enacted into law? The answer is that to preserve the status of the white worker, there had to be a legal restraint upon employers. In the absence of the law, competition from nondiscriminating employers would have urged all to hire and promote blacks and whites on the basis of economic value, not race.

A second piece of evidence comes to us from South Africa, and again shows the power of business competition to reduce racial discrimination. The reason for the adoption of the policy of Apartheid in the 1930s was that white workers were incensed that so many blacks were being hired and were competing with them in pay and promotions. Therefore, they persuaded the government to restrict the better-paying jobs to whites only. Once more, we see that business was the enemy of discrimination, government the cause.

Further evidence on the relationship between capitalism and discrimination is found in the considerable affluence many "free persons of color" in the antebellum South were able to achieve. These were free blacks who had no political power at all, but could own property and do business as they wished. For example, in pre-Civil War New Orleans, free Negroes owned one-fifth of the total taxable property in the city. (*Race and Economics* by Thomas Sowell, p. 40) Thus, even while the government discriminated against these people, according them no political power, capitalism gave them economic power restricted only by their abilities to satisfy the wants of consumers.

## Conditions Have Changed

Next, let us examine the experience of other ethnic groups which have migrated to the urban centers of the United States in search of economic progress. Jews, Italians, Chinese, Irish, Japanese, and many others settled here and were usually despised and subjected to legal harassment for decades after their arrival. Nevertheless, members of these groups have been highly successful in moving into the mainstream, and frequently into the highest strata of American life. Discrimination did not keep them depressed. Why were they able to advance whereas today's bottom-of-the-ladder minorities seem to be permanently stuck there? Have conditions changed in some way which would explain the difference? The answer is yes.

The great influx of blacks into the cities began after World War II. Prior to that time, most of the country's black population had lived on farms in the rural South. With the movement to the cities, the process of economic advancement began for the majority of the black population, just as it had for the Jews, Italians, Chinese and others in the previous century. What factors are militating against blacks now that did not hinder the progress of the earlier groups? A rather large number of such factors could be identified, but I wish to concentrate on three of the most significant.

## Minimum Wage Laws

The first difference to which we can point is the existence of minimum wage laws. The minimum wage came into existence as a part of the Fair Labor Standards Act, passed during the New Deal. It sets a wage floor below which an employer may not pay. The stated reason for this law was to raise the income of poor workers. (The real reason was that labor union leaders hoped that it would stifle competition from lower-wage areas, such as the South. For this reason, the minimum wage bears a kinship to the Jim Crow laws discussed above.) What the legislators either did not see or chose to ignore is that the amount of one's pay depends upon his economic value to his employer. If the law says that you, the employer, cannot pay anyone less than $2.00 per hour, you are not going to hire people who, because of lack of skills and work experience, cannot produce at least $2.00 worth of revenue per hour for you.

What the minimum wage does, then, is to prevent people from getting a start. It prevents a person from going to an employer and saying, "I know I don't have any job skills, and I don't have a work record to prove my reliability, but I'm willing to start at a low wage. All I would like is a chance." That is exactly how the earlier immigrant groups began their climb up the economic ladder; but today that option is gone. Because they cannot find work, millions of young blacks, Hispanics, and others remain unemployed and unemployable. Frequently they turn to crime; if not, a life of indolence on welfare awaits them. It is not capitalism that caused this. It is the government.

## New Businesses Thwarted

A second reason why economic advancement is more difficult today than it was for ethnic groups in the past is the obstacles which have been placed in the way of entrepreneurs who desire to open businesses. In the last century, one of the chief sources of employment for newly-arrived Jews, Italians, Chinese, and others, was in small businesses started by other members of their own ethnic group. Opening a bakery, tailor shop, or laundry was easy. If you could come up with the monthly rent, you could get a storefront location; if you wanted to hire someone, you simply put him on the payroll. There were virtually no government regulations, licenses, taxes, or inspectors.

Things are vastly different today, of course. The would-be entrepreneur is now faced with a maze of costly paperwork, usually requiring the high-priced services of lawyers and accountants before he can even make his first sale. There are also numerous taxes which he must collect and pay, and volumes of regulations with which he must comply. No wonder that more than eighty per cent of new businesses fail every year, and that many who might have attempted to start new businesses are deterred by the slim prospects for success. So here is a second reason why economic advancement is more difficult today—the hindrance of small business. Is this the fault of capitalism? No. It is the fault of government.

## Educational Shortcomings

Lastly, let us consider education. In the previous century, schools concentrated on the "3 R's." The student who completed work at even the junior high school level was equipped with the language and math skills he needed to function in the business world. Jewish immigrants made particularly good use of the educational opportunities available to them, quickly rising in such verbal-oriented professions as banking and the law. In contrast, what can we say about the possibilities of learning the language and math skills one needs to succeed in business today? It is close to impossible to learn them in the typical inner-city school.

The environment in such schools is not conducive to learning, replete with disturbances and distractions from students who are there only because they are forced to attend.

Even without the problems of violence, unruliness, apathy, and drugs, it would still be nearly impossible for today's inner-city high school student to learn the skills needed in business, for the simple reason that those skills are not being taught. The public education bureaucracy no longer attaches much importance to such matters as precision in speech and writing. Rather than teach the mental discipline necessary for intelligible sentence structure and critical analysis of written passages, contemporary "English" courses usually revolve around getting the student to express how he "feels" about something he has attempted to read. Young people routinely graduate from such schools without even the reading and writing skills of the third grader of the nineteenth century. Is business to be blamed for not hiring as insurance adjustors people who have great trouble in reading and writing reports, or not hiring as cost accountants people who struggle with addition and subtraction? Clearly not. The blame is to be placed upon the government which runs the public education monopoly.

The foregoing analysis has discussed only a few of the important ways in which the government has made it difficult for blacks and other groups now attempting to improve their economic condition to do so. The elimination of these governmentally-erected barriers to progress is the only true solution. The minimum wage should be repealed. The plethora of taxes, regulations, and paperwork which now prevent the formation of small businesses should be swept away. The monopoly which public schools enjoy ought to be broken through the granting of tuition tax credits to parents who choose to send their children to private schools. Eventually, tax-supported schools should be phased out completely. This is the course of action which will enable minority group members to develop and sell the skills for which businesses compete.

## Why Coercive Affirmative Action Programs Cannot Succeed

But what of the other "solution" to this problem, namely affirmative action programs to compel the hiring of minority group members? Should that policy not be used to speed the process? The answer is no, for three reasons.

First, to compel an employer to hire according to government dictates violates the employer's freedom of contract and association.

Good ends do not justify bad means.

Second, it is no favor to the unqualified individual to obtain a job in which he will be constantly pressured and frustrated by his lack of preparation for it.

Third, the history of governmental activism on behalf of specified minority groups leads one to conclude that this course makes matters worse rather than better. The economist Thomas Sowell has pointed out that economic advances for blacks have slowed or retrogressed during periods of greatest governmental efforts to assist them. (*Race and Economics,* pp. 51–55) Moreover, Sowell also finds that there is an inverse relationship between the extent of a group's economic progress and the extent of its political power. Blacks, Irish, and American Indians, groups which have relied heavily upon political power to improve their conditions, have advanced the most slowly, while Jews and Orientals, who never had much political power and thus had to rely upon their individual abilities, have done by far the best. Therefore, either by diverting attention from the true solutions, arousing antagonism, or both, the current policy of governmental activism is likely to make matters worse.

### Let Self-Interest Take Its Course in the Open Market

In this brief essay, I have argued that the belief that racial discrimination is the fault of prejudice-blinded businessmen who refuse to hire minority group members is entirely wrong. There is probably no institution in society where color is as irrelevant as in the free market. In the commercial world, making money is what counts, and discrimination gets in the way of doing that. Many ethnic groups have come to this country and met poverty and prejudice. In the past, such people were able to advance economically by acquiring the skills which made them valuable to businessmen. Unfortunately, conditions are different now. Due to a variety of governmental actions, those ethnic groups which are presently attempting to rise in the economy have had the deck stacked against them. Instead of following the foolish course of believing that the way to rectify the undesirable results of past governmental interferences with freedom is through yet more interferences with freedom, we must see that the only escape from our difficulties is to let freedom work. Do so, and a lot of self-interested businessmen will make short work of racial discrimination.

# *Wealth and Poverty*

THE Reagan triumph is the political culmination of a movement that has been thirty years in the making. But we are not yet home free. Washington, D.C., is riddled with a conflict of "buts" even as the guard is changing. Every assent is coupled with a dissent. Yes, we must cut taxes, BUT not at the expense of unbalancing the budget. Yes, we must reduce the cost of welfare, BUT not by pushing anybody below the poverty line. Yes, we must go back to capitalism, BUT labor cannot be despoiled of its gains—and it would risk too much in unemployment if a corporation the size of Chrysler were allowed to fail.

It is too much to hope that we will escape at least two or three years of dubious political battle, but maybe the key to America's future exists somewhere outside of Washington. True enough, we need some help from a Reagan regime dedicated, even though the BUTs abound, to getting the government off the peoples' backs. We need at least a diminution of inflation. But benign neglect would help, too. The creative society (Reagan used to talk about that in California) depends on the free play of a social power that is not constrained by the politicians.

Luckily, at this juncture, we have a seminal book, George Gilder's *Wealth and Poverty* (Basic Books, 10 East 53rd Street, New York, N.Y. 10022, 306 pp., $16.95), that could be to the Age of Reagan what Stuart Chase's *A New Deal* and George Soule's *The Planned Society* were to the Age of Roosevelt.

What Mr. Gilder has done in vital and vivid style is to smash all the models that have treated capitalism as something that is destined to modulate into socialism, with or without the help of Marxian conflicts. He does not deny that the big corporations often become bureaucratized, preoccupied with problems of marketing a given product when the world is really clamoring for something new. Galbraith is right, he says, in observing the existence of a technostructure that resists change. But in a brilliant chapter on "the entrepreneurial future" Mr. Gilder shows how the small entrepreneurs continue to swarm in. Change, despite the Biggies, is what we get.

The infiltration comes even when investment capital is hard to come by. There is the phenomenon of California's Silicon Valley, for example, where, as Gilder says, "worlds indeed unfold in grains of sand." The sand refers to the silicon chip, something no bigger than a fly, that will store thousands of bits of information for computer use. The silicon chip owed nothing to either the government or huge IBM—it began with "a second-rank camera firm, Fairchild," and "achieved its crucial breakthrough in 1971 at a tiny firm, Intel." It is "not only a product but also a producer of science . . . with multifarious industrial and commercial uses . . . from astrophysics to medicine." And on the heels of the microprocessor are coming other new technologies—lasers, for example, and the photovoltaic cell.

The point that Mr. Gilder is making is that it is men and ideas, and common faith or "animal spirits," that continue to create jobs and plenty. Mr. Gilder does not rely on statistics to prove his contentions, but when he does invoke them he uses them tellingly. Between 1969 and 1976 smaller firms created 7.4 million new jobs. This was at a time when the businesses on *Fortune's* list of one thousand largest corporations were experiencing practically no growth at all.

### The Moral Case for Capitalism

Mr. Gilder's case for capitalism is fundamentally a moral case. It is based on giving. The enterpriser can't know that he has a market waiting for him. He ponies up the energy, the brains and the capital, and in an act of faith floats them out into the unknown. "The essence of his giving," says Mr. Gilder, "is not the absence of all expectation of return, but the lack of a predetermined return."

As a "supply side" economist, Gilder goes back to Say's Law of Markets. Supply creates its own demand by releasing claims on goods into the marketplace in the form of wages, interest, dividends and outlays for raw materials. People may not even know they want something until they see what is being offered, but when they see it the money is already there to buy it. Purchasing power cannot be created apart from supply, for any paper claims in excess of the money that supply calls into being will have an inflationary effect.

Mr. Gilder does his painting in bold strokes for the most part. But he is also good at miniature brush work. In his chapter on "the nature of wealth" he centers on a small community in the Berkshires, where there are few "natural resources." He tells about a Lebanese family who arrived in Lee, Massachusetts, with few dollars and fewer words of English. The family bought an abandoned shop beside the road. Every day the father of the family drove over to the Connecticut Valley, a hundred miles away, to load up with vegetables, which he bought cheaply. With the help of six children the roadside shop prospered. Today, the family owns the biggest office building in town, a large clothing store, and what amounts to a small shopping center at the original shop site. In the same town of Lee a man named Kelley parlayed a business of making scratch pads out of refuse paper into a variety of businesses. And another man, named Sprague, turned a small patrimony into a huge conglomerate which began with a chicken hatchery in Iran.

By focusing on the Berkshire town of Lee, Massachusetts, Mr. Gilder is telling us how England and Japan, Taiwan and Hongkong, all of them relatively barren islands, became wealthy without having any natural resources that might be called riches. Saudi Arabia does have riches in its oil. Whether it will ever become wealthy in the Berkshire-British sense is a question. Wealth begins as a state of mind and a state of will.

### The Senseless War Against Wealth

Only in the "zero sum" thinking of modern "liberals" does wealth create poverty. In the real dynamic world one man's fortune is a boon to all. The savings of the rich create jobs for the poor. So the "war against wealth," as Mr. Gilder sees it, is senseless. We tax the producer to pay for a welfare that keeps women and dependent children locked into dingy ghetto life, with the men taking off because they can't stand the feeling of being unneeded as breadwinners. As long as welfare payments to women are a cut above what a family can earn in the market, the government, says Gilder, will continue to cuckold men.

This is strong stuff, and no politician, even in the Age of Reagan, is going to succeed in abolishing welfare. But we can hope that supply side economics, helped by tax cuts that will give productive people something to play with, will float a few families off the relief rolls. Meanwhile the new atmosphere in Washington may make some of Mr. Gilder's observations on welfare seem less hard-hearted than they would have seemed in the days of the Great Society. When Mr. Gilder says that "aid for families with dependent children makes more families dependent and fatherless," or that "unemployment compensation promotes unemployment," he isn't being mean. He is merely being accurate about the "moral hazards" of some of our best intentions. What he is saying is that the Welfare State has become counterproductive. It is time for something new and more inventive.

## BLACK AMERICA AND ORGANIZED LABOR: A FAIR DEAL?

by Walter E. Williams, Loren A. Smith and Wendell W. Gunn
(The Lincoln Institute for Research and Education, 1735 DeSales, N.W., Suite 500, Washington, D.C. 20036)
60 pages ▪ $5.00 paper

*Reviewed by Allan C. Brownfeld*

THE importance of this slim volume is not to be measured by the number of pages it contains, but by the potency of the ideas it releases. The sponsor of this study, The Lincoln Institute, was set up in 1978, to assess the impact of public policy issues on the black community. Two of the authors are black, and all three offer persuasive arguments for the thesis that the free market economy provides the best hope for bringing minorities into the nation's economic mainstream. Their case against welfarism and unions is devastating, and marks one more bit of evidence of the growing disillusionment of black Americans with the liberal establishment.

Unions have all but eliminated competition in the labor market, locking those at the bottom—mainly members of minority groups—into a situation of hopelessness. Organized labor, pursuing its narrow interests by means of the powers conferred upon it by government, has the power, in many parts of the country, to determine who shall be employed and who shall be denied work. This unpleasant truth is emphasized by Senator Hayakawa in the Preface he contributes to this book. "Racial exclusion is not simply a part of union history but remains a reality today. In 1967, for example, statistics on black membership in some major craft unions were as follows: electricians, 1.6 per cent; ironworkers, 1.7 per cent; plumbers, 0.2 per cent; and sheetmetal workers, 0.2 per cent. In 1979, 58 per cent of local unions reporting to the Equal Employment Opportunity Commission had no black members at all."

Professor Williams, one of the nation's keenest economists, furnishes other considerations: "A considerable part of the activities of the labor movement . . . has been that of attempting to thwart competition among workers. One of the ways this has been done is through the use of union political power to lobby for laws that confer monopoly power on labor unions."

He continues: "To the extent the union is successful in negotiating wages that are higher than those which employees would obtain in the absence of monopoly power, unions must also devise means of entry restrictions. The reason is simple: the higher wages will attract entry by workers from other sectors of the economy. If others were permitted freely to enter the unionized labor markets, the increased supply of labor would mean less employment and downward pressure on wages. . . Whatever the purpose for granting unions the sort of monopoly power they now possess, the result is weak minority participation."

Labor unions support programs such as welfare, food stamps, unemployment benefits and a host of other "maintenance" devices, Dr. Williams argues, so that those who are unemployed as a result of market restriction policies will remain docile: "If the alternative to not working were starvation, it would present a socially volatile climate. Thus it is very probable that labor unions will lead the support for income subsidy programs which represent a redistribution of income from society at large to those who have restricted the labor market in the first place. They *disguise* the true effects of market entry restrictions caused by unions and other economic agents by casting a few crumbs to those denied jobs in order to keep them quiet, thereby creating a permanent welfare class."

Wendell Gunn does not condemn union officials, most of whom are sincere; but he does criticize union policies, which bring about unforeseen consequences. "For black workers, who have been denied their basic right to work in many fields by the actions of labor unions over the years, to be forced to join unions against their will . . . is to make a mockery of the civil rights which have, we are repeatedly told, been achieved. Compulsion and coercion are alien to a free society."

Everyone has a stake in the free society, rich as well as poor. But as these essays make clear, the "disadvantaged" have the greatest stake of all.