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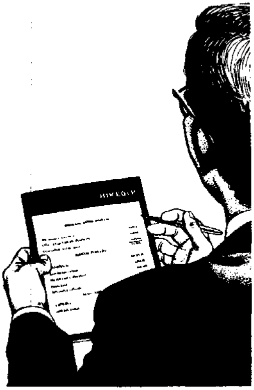
Arnold W. Johnson

THE FUNCTIONAL ROLE OF PROFITS



THAT a considerable amount of anti-business sentiment exists in certain segments of our society is a fact well known. Also, well known, is the existence of concurrent: (a) agitation against *profits* and the *free enterprise system* and (b) agitation promoting attempts to more heavily tax the profits earned by corporations. One of the candidates in the 1972 presidential campaign, for example, called for an 82% excess profits tax on all corporate income exceeding 1970 earnings. More recently, the government of Manitoba proposed a tax on the mining industry:

1) A basic royalty of up to 33.33% of the value of mine production.

2) An incremental royalty tax of up to 50% of the net value of production above "average profits" for the five years ending with 1973.

3) A "basic surcharge" of up to 100% of production exceeding operating levels authorized by the provincial government.

Still more recently, Prime Minister Trudeau required Canadian corporations to trim their profits by 5%—this action being significantly modified in 1976 when Prime Minister Trudeau expanded his wage-price control system and decided that all profit margins must be reduced 15%.

In France's presidential election (May 10, 1981) the French electorate voted for Francois Mitterrand—and his platform calling for: a) the nationalization of banks, insurance companies, and selected major industries, b) more social egalitarianism via such programs as substantial taxes on personal property, increased taxation of the incomes of the rich, a reduced work week, a higher minimum wage, and so on.

Arnold W. Johnson, Professor of Accounting (Emeritus), New York University, now lives and writes from Boca Raton, Florida.

Mitterrand's platform obviously possesses ominous overtones for the future of free enterprise in France.

What is the meaning of actions like these—actions which are pointed in the direction of harassing and penalizing the profits earned by corporations? Individually and collectively, as concerned citizens, we should be greatly disturbed.

The profit-and-loss system (i.e., the free enterprise system) of the United States is our expression of freedom. Private profit cannot be extinguished without extinguishing, also, personal freedom. Profit, in the last analysis, is simply an expression of liberty—that is, the freedom to work in one's own way and *to do it better than someone else*. The resulting benefit (i.e., profit) redounds to the advantage of the individual and our economic society in general. Profit is the well-spring and the determinant of production—and it is also the well-spring of jobs.

It follows, accordingly, that all of us should be staunch *defenders* and *expositors* of the profit and loss system. We should aggressively *champion* the profit-and-loss system and we should also be able to *explain* it with tutorial understanding.

To impose upon corporate businesses an artificial "earnings ceiling" measured by the yardstick of "a fair amount of profit" (a term difficult to define) would inject into the economic fabric a debilitating force potentially powerful enough to ultimately destroy the delicate balance which, in a capitalistic society, determines what and how much shall be produced. The same conclusion is also the consequence of unrealistic labor-union demands.

The Regulated Economy?

If governmental "controllers" (i.e., governmental "regulators" of American business) should become the active administrators of American business, *what then*? Will this consequence bring with it the sacrifice of a free market capitalistic economy in favor of a command or socialistic economy?

The system of free enterprise, the very core of which is the profit motive, is surely the one fundamental basis for our having achieved the highest standard of material living ever attained by any nation in the history of the world. It seems strange, indeed, that the system of free enterprise (which has shown such demonstrable social benefit) should be:

1) *Challenged* by individuals and organizations espousing economic systems which are not only patently inferior but, importantly, are unproven and untried as well. These advocates seem to favor a devitalizing system of Big Brother government—a government which owns, controls, or acts as miner, manufacturer, seller, shipper-and-transporter, banker, insuror, accountant,

taxing authority, societal decision-maker, and so on.

2) *Penalized* by, or threatened with, punitive rates of income taxation, labor prices, and controls.

Our economic liberty can be easily lost by choking private business with the weeds of governmental intervention. This is but to say that private business is being increasingly stifled by the massive requirements of governmental red tape.[1] "Government is destroying the individual incentives which are the well-spring of economic growth".[2] Never should it be forgotten that it is the men and women of free enterprise who have taken the risks and created the wealth which government can only consume.

Government regulation (in 1977) cost consumers $100 billion or about 25% of the entire Federal budget. About $85 billion was the cost of compliance-to-regulation. To General Motors the cost-of-compliance was $1.3 billion.—*Common Cause*, Vol. 6, No. 4, April 1980.

The defense of the profit-and-loss system, unfortunately, is somewhat complex, somewhat difficult to explain, and somewhat difficult for significant blocks of people to understand. In any discussion of the profit-and-loss system, it is well to recognize certain postulates:

1) Profits are *essential* to our economic way of life. Profits represent payment for the beneficial use of capital—and capital, in large amounts, is needed by society for the generation of the production[3] needed for fulfillment of the demands of consumers.

2) It is a truism that too many of our citizens do not really understand the functional role of profits. Too many of them seem not to understand that a given business *must* earn a profit as justification for its very existence. (For any given business, the incurring of successive operating losses coupled with significant increases in debt portrays a deteriorating economic position,—a position which, in turn, points to the conclusion that the business itself will likely not exist for long. When the factors of deficits and debt are those of the federal government, the malaise permeates the entire business community.)[4]

3) Profits must be explained not only to our associates but to people generally. People must be made to understand that profits are a social good—that profits are the fuel which makes the wheels of industry turn *efficiently*, the furnaces burn *efficiently*, the assembly lines hum *efficiently*—all contributing to the creation of profit, employment, production and, collectively, to the material betterment of society generally.

4) If free enterprise, highly productive, efficient and profitable, should falter, the inevitable sequen-

tial threat becomes *nationalization* with all of its inefficiencies. England has shown that nationalization produces monopolies and deficits. Stripped of the discipline provided by competition and by the entrepreneur's zest for profit, nationalization of English industry has generated high costs, decreased production, and alarming deficits—in 1975 nationalized industry lost $2 billion of which the average worker's share was $87.

5) In and of itself government is nonproductive.[5] The only valuable money that government can disburse is that collected or received by borrowing. In the last analysis, *government can give to some people only that which it has taken from others.* A corollary to this statement is: Government cannot spend money without decreasing the amount of capital which otherwise would be used by the private sector for the generation of profits and the spawning of jobs sequential to the process of profit pursuance. Another corollary is the following fact: inflation (like that of the 1970s) severs the vital cord between the effort-and-ability of businessmen and their achievement of a compensating reward (i.e. profit).

Summary

Profits in our society are important as an index of the success of individual businesses and of the American economy as the composite collection of all individual businesses. *Profits* are important

- to the maintenance of job security. Nothing is as hurtful to jobs as the inability of a given business to earn a profit.
- to the process of obtaining new investments of capital.
- as proof of the economic justification for the existence of a given business or industry.
- because it is the pursuit of profit that spurs the production-of-wealth process and the concomitant fulfillment of consumer demand.

All of us should understand the *functional role of profits.* All of us should be ready explainers of the profit system to all who will listen. If people understand how the profit system works, they will not be fooled by anti-profit propaganda. However, as previously stated, people generally do not really understand the functional role of profits. And the anti-profit forces are often very voluble.

What is our responsibility? *Only those who really understand the functional role of profits are qualified to explain them.* We must assume the responsibility of explaining the profit system. We must make the explanation so logical and so interesting that people will listen, make it so clear and convincing that they must and will understand.

> IN a country where capital is scarce and business leadership talent is in short supply, profits will and must command a larger share of the national income than in a country where both capital and talent are relatively abundant. The failure to recognize this fact is the single most important deterrent to economic growth in the under-developed countries of the world today. The governments of those countries, inspired in part by the anti-profits bias of both the socialists and the modern liberals, have tried to keep profit levels low, or have punished or nationalized the high-profit firms.
>
> **BENJAMIN A. ROGGE, "Profits"**

In short, as participants in and beneficiaries of the system of free enterprise, it is our responsibility to understand the functional role of profits; and, further, it is our responsibility to uphold, defend, and improve the procedures of our free enterprise system and all of the freedoms resting upon it. *Never should it be forgotten that the system of free enterprise is the cornerstone of our whole political structure.*[6]

Forfeiture by Default

Never should it be forgotten, further, that free enterprise (i.e., capitalism) is the only kind of economic system compatible with individual liberty. Concurrently, *we should constantly remind ourselves that no freedom has ever been maintained when its advocates have been passive and apathetic in its defense.*[7] Passivity is an invitation to disaster because failure to defend our system of free enterprise is a failure to defend economic freedom and personal liberty. *Freedom* is not free. And "failure to defend free enterprise" is a non-act which forfeits (by the process of default) the economic debate which free enterprise involves. Further, it invites "professional critics" and demagogues to press their claims for the substitution of uncontrolled spending and compassionate rhetoric in place of economic common sense. They seem not to understand for example, that government cannot borrow or spend its way to prosperity or solvency. They seem, also, not to understand that a declining economy which gives increasing acceptability to the practice of taking from the productive in order to support the willingly nonproductive can have one result only: a poorer United States of America because of a decline in the amount of material production per capita.[8]

All of us should be staunch and well-qualified understanders of our profit-and-loss economy and, also, should be equally staunch and well-qualified expositors, defenders, and improvers of the free enterprise system—the system under which this nation lives.

This action is obligatory—if we wish a third century of capitalism to materialize. We must accelerate our efforts to understand, preserve, and improve the most productive economic system ever generated in all of the history of mankind.

—FOOTNOTES—

[1]". . . There are now no fewer than 87 Federal entities that regulate U.S. business, and to complete the 4,400 different forms they dispense requires 143 million man-hours of executive and clerical effort each year. The regulators are proposing so many new rules that the *Federal Register* has ballooned in size to nearly 70,000 pages annually . . . Economist Murray L. Weidenbaum of the Center for the Study of American Business at Washington University, has estimated the total annual bill at $103 billion. . ." *Newsweek*, June 12, 1978, p. 86.

See also: *Time to Control Runaway Regulation* by Murray L. Weidenbaum, *Reader's Digest*, June 1979, pp. 98–102.

"There are 88,200,000 Americans supported by government . . . yet there are only 71,900,000 Americans (employed by the private sector) to foot the bill by paying taxes on their productive earnings."—*Tax Target, Washington* by Gary Allen, p. 19.

[2]Policy paper, Center for Research in Governmental Policy and Business, The University of Rochester, May 1976.

[3]When a business fails to earn a profit, "there are no dividends for stockholders. There are no quality products or services for customers. There are no jobs for employees. And there are no taxes to support the increasing number of things our citizens now take for granted: educational facilities for our children and ourselves, protection against fire, protection against crime, protection against illness, to name but a few of the public services paid for by corporate taxes as well as the individual income taxes that you and I pay."—*Dimension*, May 1968, p. 12.

[4]According to a report of the National Taxpayers' Union, 1980, each citizen's share of the federal debt ($9.03 trillion) was over $112,000.

[5]"The Department of Energy . . . will cost taxpayers $10.6 billion in its first year (and more in succeeding years)." This cost "is greater than the total amount of money that will be spent this year by all of the oil and natural gas producers in the United States for drilling and exploration. *And it will not produce one drop of oil or natural gas.*"—*American Cause*, Vol. III, No. 9, October 1977.

[6]". . . We in this country in the past half century have been moving from a free society and toward an increasing degree of slavery. Not the kind of slavery that Lincoln talked about, but a kind that is no less destructive of the basic greatness and freedom of this country, a slavery in the form of an increasing role of government in our country, of an increasing extent to which we are the subjects and the government the master, instead of the other way around.

"If we continue the trend to a collective economy, a society controlled by government, we shall lose not only our economic advantage but also our political freedom . . ." *Milton Friedman*: Address: National Association of Manufacturers Congress of Industry, 1978.

[7]"All that is necessary for the forces of evil to win the world is for enough good men to do nothing." Edmund Burke, 1739–1797.

[8]"If the road to serfdom—government control and economic decline—is paved with ever-increasing proportions of the earnings of individuals taken by government, then the road to freedom and economic prosperity is paved with savings. It is the lifeblood of investment and economic growth." American Economic Foundation, National and Informational Report, Vol. I, No. 4, April 1980.

Lawrence W. Reed

THE ROLE OF INCENTIVE

THERE's a great deal of talk these days about *incentives*. An incentive is something which incites one to action. It is a spur, a motive, a provocation, a goad, a stimulus. Economists have long understood that the incentive *to act* is the prospect of the action yielding benefits to the actor. Because of that fact, particular incentives and incentive structures explain a very great deal of the economic world which swirls around us.

People respond to incentives and to their opposite, disincentives. An individual will feel compelled to respond favorably to something which promises great personal benefit at low cost or risk. The same individual will tend to turn away from those things which deliver little or no benefit, especially if they do so only at high cost. He will positively shun those things which would set his progress back, much as a hot stove is a disincentive to bare hands. *Human choice is thus influenced by economic incentives and by changes in economic incentives.* Let's take a look at "real world" happenings and see how this might explain some things.

Many people complain today about the poor schooling their children receive in public schools. Declining test scores and a breakdown of discipline in the classroom, even as the costs of schooling rise, bear testimony to the failure of public education. Does this happen because public school teachers and administrators do not wish to provide a quality product? Not really.

There is no reason to believe that public school teachers and administrators are any less desirous than other people that quality education be imparted. They are, however, responding to a peculiar set of incentive structures. I ask the reader, what would *your* performance be like if your business could legally draft customers and compel them, under

Mr. Reed is Assistant Professor of Economics at Northwood Institute in Midland, Michigan. He is director of the college's summer Freedom Seminars. Also he is co-editor of the recent college text, *When We Are Free*.

threat of penalty, to buy your product? Suppose you could go a step further and force even those who do not use your product in any way to pay for it — and to continue paying throughout their productive lifetimes! Not exactly a prescription for creativity and productivity, would you say?

Why doesn't the Post Office deliver a better service? For the same reason! Where is the incentive to do better when you have a legal, subsidized monopoly? Self-interest dictates that humans pursue benefits along the paths of least resistance. Compulsory monopolies just do not light fires under too many people.

One would be hard put to find any individual who would contribute his own money to encourage others to stop smoking and to promote the growing of tobacco at the same time. No one would regard such a contradiction as being in his self-interest. Yet Congress votes to do both. Why? *Because no one spends someone else's money as carefully as he spends his own.* I have every incentive to spend *your* money on *my* projects if I can get your money by taxing you.

Why do industries and labor unions contribute heavily to political campaigns? It isn't always to promote better government for everybody. Such groups have an incentive to contribute if the expected returns (favors, protections, subsidies, immunities, and the like) exceed the value of their contributions. If government could not or would not pay off, the contributions would slow to a trickle.

The charge is frequently heard that British and Swedish workers have become lazy. They don't work as hard as they used to. Studies indicate, however, that when these same workers migrate to America, they work harder! The reason for the difference is that the incentives for work in America, in spite of high taxes, are greater than in Britain or Sweden, where taxes are even higher. *If one encourages something, one gets more of it and if one discourages something, one gets less of it.* That applies to work as much as it does to any other activity.

Nowhere is this more poignant than in the Soviet Union. There, 97 per cent of farmland is cultivated "collectively." The output of the collective farms belongs to the State. The other 3 per cent of farmland is in the form of private plots, whose owners are allowed to sell their produce in a relatively free market. The productivity per acre on the private plots, which account for as much as a third of all agricultural output in the country, is estimated to be 35 to 40 times higher than that on the collectively-farmed land. Workers on the collective farms are not genetically or mentally inferior to those who have private plots. In fact, in many instances, they are the same people! The different incentive structures of collective and private farming explain the situation fully.

What about pollution? Why would anyone dump his junk into Lake Erie? Doesn't he know that it doesn't belong there? Well, consider the incentives and disincentives a polluter may face. Dumping junk into the lake undetected may be much less costly than alternative methods of disposal. And since no one "owns" Lake Erie, it may be some time before anyone takes notice and complains.

Cattlemen of the old West were accused of overgrazing on public lands. They would allow their animals to strip the land bare, leaving it vulnerable to erosion, and then move on. This was land they temporarily leased from the government or acquired free by government grant. With no incentive to maintain the capital value of the land, their actions were perfectly rational. The same men seldom exhibited such callous behavior toward property they bought and paid for and therefore owned outright.

Incentives explain so many of life's events: why higher prices call forth greater supply and why lower prices do not; why racism is tempered in a free market wherein profit-seeking businessmen search for the best labor at the lowest cost; why drug "pushers" appear when drugs are made illegal and then must sell at high prices; why students work harder in a class where excellence is rewarded and failure is penalized; why capitalist economies do better than socialist economies; why some people quit working and go on welfare; and so forth and so on.

Finally, those who seek to improve economic life in America today would do well to learn the importance of incentive. In order to stimulate improvement, the disincentives for individual improvement must be abolished. In *The Wall Street Journal,* David M. Smick recently wrote:

> Growth involves ideas and thus is unpredictable. All we can provide is buoyancy—that sense of economic boundlessness where a person can, with energy and initiative, take a new idea as far and as high as he or she wants. If we can keep that initiative from being stifled, as it is today by an inefficient tax and regulatory system, people may once again follow their dreams. Allow entrepreneurs and potential entrepreneurs across-the-board worthwhile returns on their effort and they will start taking risks. Our entire economy will gain in production and jobs, and the nation will regain the energy and opportunity and spirit upon which its greatness depends.*

Incentive—nothing less than the interest one has in his own improvement—will mold the future just as surely as it shaped the past.

*David M. Smick, "What Reaganomics is All About," *The Wall Street Journal,* July 8, 1981, p. 20.

Gary North

Trickle-Down Economics

"It's kind of hard to sell 'trickle-down,' " he [David Stockman] explained, "so the supply-side formula was the only way to get a tax policy that was really 'trickle-down.' Supply-side is 'trickle-down' theory."[1]

* * *

DURING the Eisenhower administration, critics of the Republican Party's economic policies called them the policies of "trickle-down economics." There was even a lyric in a Joe Glazer "folk" song about "trickle-down George" Humphrey, who was the Secretary of the Treasury. Trickle-down economics, the critics said, was based on the theory that tax breaks given to the rich would multiply investment, provide jobs, and eventually create increased income for everyone in the economy. In other words, by "giving" the rich more after-tax income, the government would foster economic growth, because the rich are more likely to invest than the poor, since any additional money in their hands would not have to be spent on necessities.

The critics resented the suggestion that the rich should receive a reduction in their tax rates. They had campaigned long and hard for the "progressive" income tax—the graduated income tax—and they were not happy with any suggestion that the reason why the American economy was not experiencing maximum economic growth was because of the graduated income tax, which in the

1950s extracted a maximum of 91 per cent of "unearned" (investment) income.

Value Theory

It is one of the ironies of history that both the critics and the defenders of reduced tax rates in the highest brackets relied on the same view of income. What we call "welfare economics" was created at the turn of the century by a group of British economists, most notably A. C. Pigou, who misused the crucial economic doctrine of marginal utility. They argued that since each additional unit of income (ounce of gold, dollar, pound sterling, etc.) is worth less to the recipient than the preceding unit of income, we must conclude that it would increase total social utility within a society to impose graduated income taxes. Why? Because the goods bought by the thousandth dollar received by a poor man are worth so much to him, whereas the goods that the millionth dollar will buy a rich man are valued very low by the recipient. The rich man will have purchased all those goods and services that were high on his value scale long before he receives his millionth dollar. Thus, concluded the welfare economists, the civil government can increase total social utility in a society by taking (say) 75 cents of that final dollar away from the rich man and transferring the money to the poor man.

It took three decades for an economist to come up with a theoretically precise rebuttal to this position. Lionel Robbins, who had been influenced by the writings of Ludwig von Mises early in his career, provided the answer. Robbins argued that while it is legitimate for an individual to compare the value to him of the first, second, or *n*th dollar of his own income, it is not legitimate for anyone to make *interpersonal* comparisons of subjective utility.[2] We cannot make scientifically valid statements comparing the subjective value of the second dollar of income (or the millionth) in one person's income with the subjective value of the second, third, or *n*th dollar of another person's income. We cannot even make cardinal (quantitative) comparisons in our own minds—*this* is worth precisely this much more to me than *that*—but only *ordinal* comparisons: this is my first choice, that is my next choice, and so forth.

Common sense may not accept Robbins' conclusion, but such is often the case in matters of economic theory. Science frequently produces conclusions that are in flagrant opposition to common sense. We need to consider an example regarding interpersonal comparisons of subjective value. The millionaire may value his millionth dollar very highly, if he has some investment in mind which requires a high initial payment, or if he regards his income as a kind of measure of his value to society. On the other hand, some mystic or ascetic may not place a high value on his thousandth dollar of income in any given time period.

We do not have a quantitative measure of pleasure or utility; thus, we cannot, *as scientists,* make interpersonal comparisons of subjective utility. Conclusion: it is not scientifically demonstrable that total social utility within a society can be increased by taking 75 per cent of the rich man's income in the highest tax brackets and transferring this money to a poor man (minus 25 per cent for government handling). There is no such thing, scientifically speaking, as total social utility. We cannot add up subjective utilities as if we were adding up a column of figures.

Admittedly, as policy-makers we have to make judgments concerning the advisability of particular economic programs. But Robbins' refutation of welfare economics by means of the argument against the scientific validity of interpersonal comparisons of subjective utility cannot be limited to the narrow case of the graduated income tax. It undermines *all* attempts to "tally up" social utility in the name of economic science. We cannot, as economic scientists, say that *any* policy will increase total social utility. There is no way to measure "total social utility." *So effective is this argument that it denies to economics the legitimacy of making estimates of the total value of any aggregates*. What does Gross National Product mean, anyway, if we cannot assign any value (or meaning) to the columns of figures in a GNP index? If Robbins' thesis is correct—and since 1932, no economist has shown how it might be incorrect—then most of what we know as modern applied economics, including the formulation of economic policy, is an illusion.

Robbins had this pointed out to him by Roy Harrod, who later became Keynes' biographer, in 1938.[3] Incredibly, Robbins capitulated to Harrod and abandoned the obvious and inescapable logic of his earlier argument.[4] But he could never explain where he had been incorrect. He simply wanted to maintain the status of economists as scientific advisors, so he abandoned the logic of subjectivist economics. Somehow, he and Harrod agreed, economists as scientists *can* make assessments of the total social utility of particular economic policies. Somehow, GNP (or other economic statistics) are meaningful. They could not say exactly how, but somehow.[5] It was a matter of faith.

Capital Formation

The *welfare economists* have long argued that if the State extracts a higher percentage of taxes from the upper income brackets, and then transfers this money to poorer members of society, total social utility can be increased. Robbins demolished the scientific validity of this statement, but his argument has never been taken seriously by economists, since it has so many implications that are unfavorable for the practice of applied economics.

On the other hand, *advocates of capitalism* have replied to the socialist critics of the rich with this argument: the rich man has most of the food and clothing he can use, once he gets into the highest income brackets. Thus, he will be more likely to invest higher and higher proportions of his income as his income stream carries him upward. His "necessities" are taken care of early. Then his pleasures are taken care of. Finally, he has money left over. What is he going to do with it? He will be increasingly willing to invest it or give it to charity, the free market economists have argued. The rich man has demonstrated his competence in making investments; thus, he acts as a public benefactor in his capacity as investor.

What if the civil government attempts to extract this money from him? He will then spend more time and effort in seeking out *tax avoidance schemes*. He will be less interested in expanding his income. He will spend more money on luxuries. For example, a person who was in the 98 per cent tax bracket in England, prior to Mrs. Thatcher's election and the reduction of these confiscatory top-bracket tax rates, might have faced the following decision. Perhaps he had $50,000 to invest (or about 25,000 pounds). If he thought he might get 10 per cent on his money—always a guess, given the inescapable uncertainty of the economic future—he could expect an income stream of $5,000 a year. But he would be allowed to keep only 2 per cent, or $100, after taxes. Or he could buy a Rolls-Royce for $50,000—an asset which tends to appreciate over time. What was the real cost of driving his Rolls-Royce for a year (not counting gasoline, insurance, and repairs)? The $100 he would have forfeited. Tell me, if you could drive a Rolls-Royce for $8.30 a month, plus insurance, maintenance, and gasoline, would you consider it? So did a lot of rich Englishmen.[6] This, of course, increased the demand for Rolls-Royces, thereby giving the buyer ownership of an appreciating asset.[7]

Workers Lack Capital

The problem facing British workers is lack of capital investment. This problem always faces all workers, but especially the British worker today. The confiscatory tax rates have driven private capital into high payoff, high-risk investments, into "off shore" (foreign) investments, which are less easily taxed, and into "conspicuous consumption." Is this bad? Economists, as scientists, cannot legitimately answer this question. It is a welfare question. But individual workers seem to want higher income, and higher per capita investment—better tools—is the way we produce increased productivity. (This, at least, is Mises' contention.[8] The problem facing a consistent defender of subjective utility theory is this: How can we divide the abstract idea of total capital—a statistical aggregate—by the total number of workers in a society, and come up with anything meaningful? Prof. Kirzner, Mises' student, has explicitly denied the legitimacy of just such a measurement.[9])

So the defender of the free market argues that Britain's high taxes on the top income brackets are responsible for the low rate of capital formation in Britain. But is this argument correct? And if it is, haven't we granted too much credibility to the socialists' argument that the rich control sufficient capital to influence greatly the wealth or poverty of the average citizen?

Squeezing the Apex

Another problem faced by those who favor high graduated tax rates is this: *there are not that many rich people.* Also, the kinds of wealth that they hold are not generally cash assets, but certificates of ownership in equipment, patented production processes, real estate, and similar capital. These physical assets cannot often be cut into distributable physical units, except in the case of land. These assets provide a *stream of income,* so the things the State can redistribute most conveniently are legal entitlements (certificates of ownership) to the future income streams. But as income-seeking investors begin to see what is happening to their after-tax income streams, they tend not to reinvest. Without reinvested funds, the physical capital base begins to wear out, productivity falls, the income to workers therefore falls, and there is less wealth to redistribute.

Can we make the masses rich by confiscating the wealth of the rich? The socialists have officially argued that significant welfare gains can be achieved for the masses by such policies of wealth redistribution. Those who reject this contention point to the small number of wealthy people in capitalist societies. How can hundreds of millions of people be significantly benefited by extracting the distributable forms of wealth held by the handful of super-rich? Debates then go on concerning the proportion of a nation's wealth held by the richest 10 per cent or 20 per cent or 30 per cent of the population. Is it sufficient to make an impact on the total wealth of society?

If this wealth is held in the form of distributable shares, what happens to the ownership of these shares after the initial distribution is completed? Will men be permitted to buy and sell these shares on an open capital market? If so, what is to prevent the creation of a new class of wealthy owners? Will we not see the advent of "a new class"? Isn't the hierarchy of wealth inescapable in a world filled with people of varying investment talents, organizational talents, and salable skills? Isn't the proper question this one: *What is the most socially beneficial arrangement of ownership, private or socialist?* Which kind of hierarchy produces the greatest benefits? (Problem: we are right back to the question of social welfare, with its requirement that we make estimates concerning interpersonal, subjective utility.)

If the free market economists are correct in their contention that there are not enough rich people to squeeze for the benefit of the poor, then "trickle-down economics" has a problem. *If the wealth of the rich is insufficient to enrich the poor under socialism, then how can the capital owned by the rich be sufficient to enrich the poor under capitalism?* If there is not enough wealth in the top income brackets to "go around," then why are the investment decisions of the rich so important for the economic prosperity of the nation? In short, *what good is a trickle,* whether the State squeezes the rich, or the rich are allowed to keep their income to invest one way or another? Whether the rich pay taxes, or buy tax shelters, or are allowed to keep large chunks of their after-tax income, why should it significantly affect the welfare of the general public? What difference will it make to the man in the street?

Getting Rich

In a *modern welfare State,* there is only one class with sufficient resources to pay for all of the government programs: *the middle class.* In a *modern capitalist economy,* with its tremendous demand for capital—if only to maintain the tremendous existing capital base in the modern economy—there is only one class with sufficient financial resources to maintain the capital base: *the middle class.* Middle-class societies have large middle classes. This is tautological, but significant nevertheless. Middle-class societies have to look to the middle class as the source of permanent, significant social change. Elites have their roles to play, as the sources of innovation, especially in the realm of ideas, but in the final analysis, *the success or failure of a particular elite today depends on the fate of its innovations in the culture of the middle class.*

What good does the wealth of the rich do for society? In a free market society, it serves as a symbol of what efficient, market-serving producers can attain. In a collectivist society, it serves as a symbol of what the ruthless suppression of other people's freedom can attain. It serves as a symbol of what relentless attention to bureaucratic forms, or political intrigues, can attain.[10]

The quest for the egalitarian society has been a familiar one in academic and utopian circles, but the quest is futile. Hierarchies are fundamental to human societies for many reasons, not the least of which are the varying talents of men. In a world of limited resources—where there is greater demand for than supply of certain goods *at zero price*—men must compete for what they regard as their share of the goods. They invariably regard their fair share in terms of certain gifts or skills that they possess: good looks, strength, wisdom, a university degree, ability to forecast the future, commitment to an ideology, or a hundred other possible attributes.

Because men's skills differ, and because they view the legitimacy of property in terms of differing moral or legal principles, they cannot agree on equality as a social goal. Equality of what? Wealth? But what is wealth? Is it capital? But what is capital? Money? Good looks? Strength? *We cannot equalize wealth without equalizing people.* There is no way to equalize people, except by killing them. Men have equal skills only in the grave.

People want to increase their wealth. They say they do, and they frequently act to do so. To increase their wealth, they must invest time, or money, or both in a *future-oriented program of entrepreneurship.* They must begin to forecast the future more accurately. They may be forecasting the future demand of consumers on a particular private market.[11] They may be forecasting political shifts in the wind in some totalitarian society. But they have to deal with an *uncertain future,* with whatever capital they possess at any moment in time.

Responsible Decisions

The free market economy opens the doors of economic opportunity to all those who believe that they can benefit themselves by meeting the future (uncertain) demands of the buying public. The free market society does not say in advance who will be successful in the quest for greater personal wealth, nor does it specify the avenues that will offer the highest return on invested funds. The free market society does not even require that successful entrepreneurs affirm a particular ideology or religion. It does require that men abstain from the use of fraud or violence against each other in their quest for private gain.

The free market society is a consumer-oriented society. Those who produce what consumers are willing and able to buy at a price they are willing and able to pay will prosper. The *lure of profit* is the *control mechanism* that other members of society have over producers. Without the hope of profit and the threat of loss, consumers would lose their leverage over the decisions of potential producers. Yet this leverage is strictly voluntary. Producers are not required by law to produce anything in particular. They are not even required by law to be producers at all. (Vagrancy laws—laws that require people to produce evidence of "gainful" employment—should not be regarded as products of a free market philosophy.) But if they wish to enter the markets as competing producers, they must face *the "whip" of the consumers:* the threat of financial losses.

Consumers Offer Rewards to Prospective Producers

By luring people into the production markets, consumers benefit themselves. They tell prospective producers: "If you are more successful than your competitors in meeting our demands in the future, we will make you rich." *A society which does not allow consumers to make this offer to potential producers thereby discriminates against the interests of consumers.* It takes away the *key element* in each consumer's quest to lure potential producers into the markets that serve his needs, namely, his legal right to make an offer to an entrepreneur, or a class of entrepreneurs, to make (and keep) a profit from serving his, the consumer's, wants.

By allowing people to make profits through market competition, free market societies increase the likelihood that consumers will be able to lure into the markets all those future-oriented producers that the consumers can afford to reward. In fact, given the reality of uncertainty in market action, and the optimism of producers, *more* producers will enter the markets than consumers can actually afford to reward. Some producers will lose money. This involves waste, but uncertainty is the cause of this waste, not the free market. The free market actually reduces waste by removing the least successful forecasters from the marketplace. Losses eventually take their toll.

Producers are made responsible by the carrot and stick of the market. The larger the offer, the larger the number of future-predicting entrepreneurs who will enter into the service of consumers. If a society tells producers that their efforts, if successful, will be met with higher taxes, then some producers will cease bearing the burdens of predicting an uncertain future. *The graduated income tax discriminates against successful entrepreneurs; it thereby discriminates against consumers.* It reduces the lure of profit which consumers would otherwise prefer to offer producers, in order to get them working for consumers.

Squeezing into the Apex

There are no "sure things" in the hard task of predicting future market demand. The consumers are relentless. They keep asking: "What have you done for us lately, and what will you do for us tomorrow? And at what kind of discount?" Producers are constantly misforecasting the market. They sustain losses. Even the best of them fail. The "Fortune 500" of one generation bears little resemblance to those of the following generation. Innovation, shifting consumer tastes, price competition, and a baffling number of other market changes can catapult an unknown company into the economic stratosphere, or toss another firm into the mud.

What benefits consumers is not some utopian (and self-defeating) program to redistribute the wealth of those who occupy a position in the economic apex at any point in time. There will always be an apex. *Any political program strong enough to capture the wealth of those in the apex is also a program which will enable political (or bureaucratic) elites to take the place of those who have lost the political battle.* After all, that is the goal of political elites: to *replace* those who presently occupy the places of wealth and prestige. They adopt political techniques to achieve this replacement.

In too many cases, those presently in the apex adopt political programs in the name of "making the apex responsible," or even "making those in the apex pay their fair share," in order to *lock in their existing position.* They feel the innovators nipping at their heels, and they turn to political coercion to protect their position from market competition.[12] The Federal regulatory apparatus was adopted in the name of democratic justice and consumer protection, but again and again, the chief beneficiaries (and behind-the-scenes promoters) of Federal regulation have been the threatened members of a particular industry or professional association.[13] And once a regulatory commission has been in place for a few years, the loudest opponents of deregulation are the senior officials of the largest firms in the regulated industry.

Thus, what those in the apex fear most is *the threat of their own trickling down* as a result of increased market competition. If they see the possibility of maintaining their long-term positions of power and status by means of political manipulation, they frequently take up the cry against "cut-throat competition," and "unfair exploitation of consumer needs," in order to gain a predictable position in the market. Even if this involves higher taxes or more interference from Federal officials, once they have achieved their market position, they are willing to pay (i.e., to put up with less freedom in general for everyone) in order to achieve a relatively secure share of the market. They lose a portion of their economic freedom—the right to compete on an open market—but they are willing to pay this price because their *proportional share* of this *general loss of freedom* is less (in the short run) than their gains from government protection. Never forget: the market does not pay them to be ideologically pure; it rewards them for making profits. This is one reason why Benjamin Rogge was so pessimistic regarding the future of capitalism.[14]

What benefits the consumers is a social philosophy which affirms the right of all those who wish to compete economically for a place in the economic apex to make and keep their profits. By affirming such a philosophy as a *moral ideal*—and not simply as a technically efficient means of increasing per capita income—consumers cannot be misled into voting for a political program which would substitute political competition for economic competition as the pathway into the apex.

The consumers, by their decisions to buy or not to buy, determine in a free market social order who will go into the apex of wealth, and who will be forced out. If they abandon the social philosophy of the free market, they will find that their economic decisions no longer possess the same influence in calling forth the skills and efforts of suppliers to meet their demands. By abandoning the free market, consumers transfer a portion of their sovereignty as economic actors to the elite corps of bureaucrats who exercise monopolistic power as officials of the civil government. Producers will begin to respond to the *incentives provided by the State,* rather than to the incentives offered in open competition by the consumers. The State will begin to establish the terms by which producers compete for a position in the apex.

Trickle-Up Economics

There are limits on the number of people who can be in the top tenth of the income level. The amount of capital in the whole society is indeterminate. It can be large or small.[15] This depends on the willingness of a society's members to save, and on their ability as economic forecasters (entrepreneurs). This means that only a *minority of entrepreneurs* will be successful in their quest for a place in the economic apex. Only a few will "trickle up" into the highest income or capital levels. Even fewer will remain there, let alone generations of their descendants. They will "trickle up" and "trickle down," depending on their abilities in forecasting future consumer demand and meeting these demands at prices lower, or quality higher, than their competitors.

The issue is not the amount of wealth held by the rich. The issue is rather the *terms* by which they hold such wealth. Are they meeting the demand of consumers, or the demands of bureaucrats? Are they competing in a free market or in an economically controlled political market? Do citizens exercise control over producers directly, by means of their decisions to buy or not to buy, or do they exercise control indirectly, through politics, and then (very indirectly) through the politicians' ability to control the various bureaucracies?

If citizens decide that they should exercise power primarily through political means, they are going to be thwarted continually by the bureaucracy. The great German sociologist, Max Weber, commented on this in the years immediately following the First World War. "Under normal conditions," he wrote, "the power position of a fully developed bureaucracy is always overpowering. The 'political master' finds himself in the position of the 'dilettante' who stands opposite the 'expert' facing the trained official who stands within the management of administration. This holds whether the 'master' whom the bureaucracy serves is a 'people' equipped with the weapons of 'legislative initiative,' the 'referendum,' and the right to remove officials, or a parliament, elected on a more aristocratic or more 'democratic' basis and equipped with the right to vote a lack of confidence, or with the actual authority to vote it. It holds whether the master is an aristocratic, collegiate body, legally or actually based on self-recruitment, or whether he is a popularly elected president, a hereditary and 'absolute' or a 'constitutional' monarch."[16] In short, *the "amateur" politician, who may be out of office after the next election, is no match for the entrenched power of the Civil-Service-protected lifetime career bureaucrat.*

Modern Bureaucratic Methods

The modern bureaucratic system of administration is far more centralized than anything in the past. The old administration by feudal barons or Near Eastern satraps was essentially decentralized. Local income financed such systems of political rule. Only the surplus reached the central treasury. Not so with modern bureaucratic methods. "The bureaucratic state, however, puts its whole administrative expense on the budget and equips the lower authorities with the current means of expenditure, the use of which the state regulates and controls."[17]

Thus, the expansion of State power over market forces has centralized the economy in a way that the free market, because of its decentralized source of financing—the economic power of millions of individual consumers—cannot possibly achieve. On this point, Weber was incorrect and Mises was correct: bureaucracy is different from profit management, since the source of the funding is different.[18] The rise of bureaucracy in private industry is always limited by market pressures, since consumer choices determine the fate of private firms. However, when government regulations begin to replace market demand as the source of a firm's success or failure, the statist bureaucracies steadily recreate in their own image the management structures of private firms.[19]

Conclusions

The hope of people in the economic power of the rich to bring prosperity to a society, whether through redistribution or investment, is a false hope. The hope of a society should be in the willingness of large numbers of future-oriented people to forgo present consumption and to invest. An *upper-class* society is a *future-oriented* society, whatever the present income level of the bulk of its citizens.[20] When we read, for example, that the Japanese invest 25 per cent of their income, we are not reading about a handful of rich Japanese who are future-oriented, but about a large segment of the population of Japan. This, unquestionably, is an important aspect of the "economic miracle" of Japan. The Japanese are future-oriented, and have been future-oriented throughout this century. It has led to the creation of a huge capital base which has improved the productivity of Japanese workers.

What is significant is not that rich people invest a high proportion of their incomes, but that large numbers of citizens maintain a steady investment program, whether in the hope of getting rich personally, or only in the hope of having a comfortable retirement, or leaving an economic heritage to their children. The rich may indeed set the pattern. The example they set as investors is no doubt important indirectly. But until the advocates of free market economics focus their attention on the decisions of the middle class, they will be caught in an intellectual trap set for them by the socialists. They will continue to believe that what the rich minority does with its money will "make or break" an economy. They will continue to have faith in the "trickle-down economy," and the socialists can always use this faith against the defenders of the market.

The critics of the rich can use the emotional appeal of *envy*—the desire that no one benefit from wealth—against the market itself, calling for universal redistribution of private fortunes.[21] They can also appeal to

THE spurious catchwords and fallacious doctrines of the advocates of government control, socialism, communism, planning, and totalitarianism cannot be unmasked except by economic reasoning. Whether one likes it or not, it is a fact that the main issues of present-day politics are purely economic and cannot be understood without a grasp of economic theory. Only a man conversant with the main problems of economics is in a position to form an independent opinion on the problems involved. All the others are merely repeating what they have picked up by the way. They are an easy prey to demagogic swindlers and idiotic quacks. Their gullibility is the most serious menace to the preservation of democracy and to Western civilization.

LUDWIG VON MISES, *Bureaucracy*

jealousy—the naive hope that there really is sufficient wealth held by the rich to increase the per capita income of everyone by a wholesale confiscation of wealth by the State. The "trickle-down" economists are playing into the hands of the socialists, by providing opportunities for both the envious—"No one should enjoy such advantages!"—and the jealous—"Let the less prosperous enjoy a per capita increase in such advantages!"—*to justify the attempted destruction of the economic apex*. And without the lure of the apex, the efforts of the producers will be redirected: from satisfying present and future consumer demand, to satisfying present and future bureaucratic demand (or satisfying black market demand).

This is not to argue that we should not applaud the reduction of taxes in the higher brackets. But our support should be a matter of principle, a defense of the rule of law. No economic group should be singled out as "the enemy of the social good," and therefore subjected to discriminatory taxation. But the defense of lower taxes for the rich should not be made in terms of the supposed creativity and future-orientation of the rich, in their role as investors. It should be made in terms of each man's right to become rich, if he chooses and if he has the ability to do so in competitive markets. Our goal should be the creation of a *nondiscriminatory tax structure* that symbolizes the commitment of voters to the principle of the rule of law, the rights of private property, and the legitimacy of entrepreneurship. Everyone should be permitted to have a shot at the apex. Trickle-down economics, as an explanation of the wealth of nations, is misleading. It is not what the rich do with their money that matters most; it is what the broad mass of citizens do with their money that shapes the wealth of nations.

—FOOTNOTES—

[1]William Greider, "The Education of David Stockman," *The Atlantic Monthly* (Dec., 1981), p. 47. Mr. Stockman is the Director of the Office of Management and Budget.

[2]Lionel Robbins, *An Essay on the Nature and Significance of Economic Science* (2nd ed.; London: Macmillan, [1935] 1962), ch. VI. Reprinted in the United States by St. Martin's.

[3]Roy Harrod, "Scope and Method of Economics," *The Economic Journal,* XLVIII (Sept., 1938).

[4]Lionel Robbins, "Interpersonal Comparisons of Utility: A Comment," *Ibid.,* XLVIII (Dec., 1938).

[5]I have dealt with this theoretical problem at some length in my book, *The Dominion Covenant: Genesis* (Tyler, Texas: Institute for Christian Economics, 1982), ch. 4. The problem of interpersonal comparisons of subjective utility is perhaps the most far-reaching epistemological problem in modern economics.

[6]This example was provided by economist Paul Craig Roberts. It is cited by George Gilder, in his book, *Wealth and Poverty* (New York: Basic Books, 1981), p. 173.

[7]When Prof. Roberts first offered this example in *The Wall Street Journal* (August 1, 1978), the figure he used for a new Rolls-Royce was $50,000. Today, that figure is out of date. It is close to $100,000. Price inflation and high demand have raised the stakes considerably.

[8]Ludwig von Mises, *The Anti-Capitalistic Mentality* (Princeton, New Jersey: Van Nostrand, 1956), pp. 5, 38, 87.

[9]Israel Kirzner, *An Essay on Capital* (New York: Augustus M. Kelley, 1966), ch. IV. See especially page 120.

[10]F. A. Hayek, "Why the Worst Get on Top," Chapter 10 of his book, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944).

[11]Frank H. Knight, *Risk, Uncertainty and Profit* (New York: Harper Torchbook, [1921] 1965). See also Ludwig von Mises, *Human Action* (3rd ed.; Chicago: Regnery, 1966), pp. 289–300.

[12]D. T. Armentano, *The Myths of Antitrust* (New Rochelle, New York, 1972).

[13]Gabriel Kolko, *The Triumph of Conservatism* (New York: The Free Press, 1966). See also Frederic C. Howe, *Confessions of a Monopolist* (Upper Saddle River, New Jersey: Gregg Press, [1906] 1968); Howe, *Confessions of a Reformer* (Chicago: Quadrangle, [1925] 1967).

[14]Benjamin Rogge, *Can Capitalism Survive?* (Indianapolis, Indiana: Liberty Press, 1979), ch. 1.

[15]I think we *can* make estimates regarding the value of capital, in contrast to Kirzner's view, but we make such estimates by means of *assumptions that are not strictly economic in nature.* See my discussion in Chapter 4 of *The Dominion Covenant: Genesis.*

[16]Max Weber, "Bureaucracy," in H. H. Gerth and C. Wright Mills (eds.), *From Max Weber: Essays in Sociology* (New York: Oxford University Press, 1946), pp. 232–33.

[17]*Ibid.,* p. 223.

[18]Mises, *Bureaucracy* (New Rochelle, New York: Arlington House, [1944] 1969).

[19]Gary North, "Statist Bureaucracy in the Modern Economy," in North, *An Introduction to Christian Economics* (Nutley, New Jersey: Craig Press, 1973), ch. 20.

[20]Edward Banfield, *The Unheavenly City Revisited* (Boston: Little, Brown, 1974), pp. 57–59.

[21]Helmut Schoeck, *Envy: A Theory of Social Behavior* (New York: Harcourt, Brace, 1970). Cf. Gary North, *Successful Investing in an Age of Envy* (Sheridan, Indiana: Steadman Press, 1981), ch. 1.

Sheldon Richman

CORPORATE MERGERS: Method or Madness?

THERE is an easy way to tell when a person misses the fundamental point of economics: He or she discusses the subject in the metaphors of warfare and the animal kingdom. This is so common it goes unnoticed. But the significance of using terms of violence to describe voluntary exchange for mutual benefit should not be underrated.

We're familiar with the terms *cutthroat* competition, *predatory* pricing and import *invasion* to describe processes in which people freely offer to trade their property at the best terms they can find. How ironic that such processes are couched in these metaphors, while actual violent processes are called "economic planning."

Nowhere is this more vividly illustrated than in the coverage of and comment on the recent spate of corporate mergers. The Du Pont-Conoco merger last summer set off an hysterical display of economic ignorance that still might find its way into law. Unfortunately, this ignorance is found not only in the writing of journalists and antimarket spokesmen, but in the articles and speeches of business spokesmen who themselves have fallen victim to the confusion.

Typical of the way mergers have been discussed is this opening paragraph from *Newsweek's* July 27 (1981) cover story (the italics are mine):

> One prominent banker called it a *"feeding frenzy,"* and last week, as the biggest takeover *battle* in American corporate history gained momentum, the description seemed right on the mark. Three giant companies—Du Pont, Seagram and Mobil—were *battling* for con-

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Sheldon Richman is editor of *Competition*, published by the Washington-based Council for a Competitive Economy. This article is reprinted from the October 1981 issue of *Competition*.

trol of Conoco, Inc., the nation's ninth largest oil concern, and the bidding was fast approaching the $6 billion level. Meanwhile, other cash-rich corporate giants were eying their own acquisition *targets* and frightened companies scrambled to protect themselves. By the end of the week, the *hunters* and their *prey* had stocked up *war chests* of bank credits worth more than $25 billion—enough to buy Detroit's Big Three automakers with $10 billion to spare—and many analysts predicted that the *marauders* were preparing for a long-term merger binge of unprecedented proportions. "Having had that first taste of *blood*," said Larry Goldstein, chief economist for the Petroleum Industry Research Foundation, "it is hard to believe they will pull back."

To take this sort of writing seriously is to believe that firms are rabid bears preying on defenseless Bambis in a gentle forest, or Attila the Hun pillaging a placid hamlet. If language was ever used to obfuscate and mislead, here it is.

Merger by Consent

Contrary to popular impression, a merger does not occur by one firm eating another against its will. Mergers occur when a firm *buys* a sufficient portion of another firm's stock to enable the first firm to determine the second's management and policies. The key word is "buys." Before a company can buy stock, the owners of the stock must be willing to sell; only the state and muggers think they may acquire property without the owner's consent. To complain about mergers, then, is to complain about the stockholders' freedom to sell their property as they like.

But what about "hostile takeovers"? This misleading term describes mergers in which the management (or some stockholders) don't want a controlling share to be acquired by someone else. It certainly is not hostile to those who find bids on their stock attractive. Economic historian Robert Hessen made an important point about hostile takeovers when he testified in Congress about conglomerate mergers:

> If a company remains privately held, the owners thereby guarantee themselves against a hostile takeover. However, if they go public, that is, if they allow shares of their stock to be traded on public exchanges, then they know that one of the inherent risks of being a publicly traded company is that someone or some coalition of people can buy enough stock to be able to elect one or more directors and ultimately to change the policies and personnel of that company... There is a variety of (private) options to keep a company, even a publicly traded company, from an adverse or hostile takeover without needing to ban conglomerate mergers... There are much more specific remedies which any good lawyer could recommend to a company to protect itself from the possibility of a takeover.

Another thing about mergers that concerns some people is their effect on economic growth. *Business Week*, for instance, declared in a recent editorial that "mergers are not growth." Others say they do not create jobs or make better use of capital. The most fundamental answer to these complaints is, so what? In a free society, people should be at liberty to trade their property without having to justify it to anyone in any terms. But the answer in economic terms goes further. Two parties agree to swap their property only when *each* sees prospective benefits as a result—otherwise the exchange does not occur. Mergers entail the exchange of titles to capital goods, whose price is determined by the market's assessment of their capacity to produce what consumers want most. One company does not acquire the assets of another unless it expects them to be *profitable*, that is, produce things consumers will be willing to pay enough for.

To believe that a transfer of capital goods from one person to another is unproductive is to miss the point of capital goods altogether. They are not merely *physical things*; in economic theory, the essential characteristic of a capital good is its role in someone's *plan*. As New York University economist Israel Kirzner writes,

> A capital good is *not* merely a produced factor of production. Rather it is a good produced as part of a multiperiod plan in which it has been assigned a specific function in a projected process of production. A capital good is thus a physical good with an assigned productive purpose. (*The Foundations of Modern Austrian Economics*, Edwin G. Dolan, ed., p. 137)

It stands to reason that two persons or groups can have different plans for the same capital good; one may be more suited to future consumer demand, (that is, more productive for workers, among others), one less suited. We can't be certain prospectively, only retrospectively. But we do know that the market tends to reward entrepreneurs who successfully forecast future demand. Mere *observers* of the economic scene have little standing to say what is and is not productive activity. If they think they know better, let them bid for the resources and execute their superior plans.

Another concern of merger opponents is conglomerates—firms that make many different products. They have yet to explain why anyone should worry about one firm producing both, say, luggage and yogurt. But in expressing this concern, they expose their hidden agenda. You'll note that these same people vigorously oppose companies' merging with other companies in their own or related industries. This is said to be anticompetitive. If a large company creates a *new* firm in an unrelated industry, it is likely to be accused of either wasteful duplication or unfair competition with the existing firms. In other words, *anything* a company does that breaks with the status quo will likely bring criticism and perhaps an antitrust investigation.

And this is the point! Critics of mergers are defenders of the status quo and opponents of the dynamism inherent in the free market. This makes them, in essence, advocates of privilege, for they would freeze the economic system where it is today, shutting out the aspirants and sheltering yesterday's achievers.

These critics will tell you they only want to preserve competition, but that is not what they will accomplish. Mergers are competitive by nature. Competition is the cooperative process in which entrepreneurs seeking profit try to predict future consumer demand and arrange productive resources accordingly. When the law stops or hampers this activity, it cripples the process and harms consumers.

Freedom to Enter Is the Key

The critics' related worry about market concentration is also off the mark. The interests of workers and consumers do not depend on a specified number of firms or market structure. They depend on freedom of entry, uninhibited by regulation, taxation, inflation, licensing and patents. Moreover, the notion of concentration is inherently arbitrary. It implies that an observer categorizes products, then counts the number of suppliers in each category. But the observer's categories are irrelevant to how consumers, motivated by personal considerations, respond to the array of products before them. Unbeknownst to the observer, consumers may regard seemingly disparate products as substitutes for each other, yanking the rug out from under the concentration doctrine. Consumers, and no one else, ultimately determine the structure of markets; their shifting preferences guarantee that markets are always in flux and that temporary advantage is the most any producer can hope for.

The reasons for the current wave of mergers are many and complex. Undoubtedly, inflation — which makes acquiring existing assets preferable to building new ones—has much to do with it. So does the thick web of regulations and taxes that inhibit smaller firms. So, no doubt, do Reagan administration hints of "leniency" on conglomerate mergers (but not on "horizontal mergers"). The exact reasons are not so important here. The important point is that the market is a decentralized, voluntarist information and decision-making process in which people grapple with uncertainty in pursuit of their well-being. To interfere with this in the name of protecting the people is the cruelest hypocrisy.

John Semmens

Semantic Confusion in Economic Regulation

IN ACCORDANCE with the Motor Carrier Act of 1980, a Congressionally appointed study commission is touring the country to investigate the consequences wrought by partial deregulation. One of the lines of inquiry the study commission is pursuing deals with the semantic confusion that appears endemic to the regulatory task.

It is not surprising that there is a considerable measure of uncertainty concerning the terminology used in economic regulation. The Motor Carrier Act of 1980 is, itself, chock full of terms that are subject to varying interpretations. The Act calls for regulation to achieve "reasonable profit" for carriers, eliminate restrictions that are "contrary to the public interest," pursue "equitable" treatment of interstate motor carriers, and so forth. These terms are not clear-cut directives for specific regulatory rules or requirements. Reasonable men may differ in their opinion of how to "equitably" resolve the issues relevant to the "public interest."

That the Act suffers from ambiguity should not be taken as an indictment of the literary talents of Congress. Legislatures are unable to write unambiguous regulatory laws because of the fundamental impossibility of the task of governing economic activity by statutory means. The impossibility of the task stems from some fundamental economic and political realities.

Statutes are laboriously arrived at expressions of the consensus of a majority of the people's representatives. The difficulty in creating a major piece of legislation makes it impractical to modify statutes except at long intervals. The word statute is derived from the same source as stationary. There is an implied or intended notion of permanence entailed in the creation of a statute. Unlike commodity prices, statutes cannot be revised on a daily or hourly basis.

Because laws must express the consensus of a majority of the peo-

Mr. Semmens is an economist for the Arizona Department of Transportation.

ple's representatives, they are necessarily products of compromise. People's views on what constitutes the public interest differ. Juggling divergent views and interests produces legislation aimed at satisfying numerous objectives simultaneously. Some of these objectives will be mutually exclusive. Laws attempting to accommodate mutually exclusive objectives cannot help being ambiguous.

The Market Affords Options

In contrast to statutes which must say one particular thing about the way an activity is to be regulated, the market proffers numerous options. One Congress must enact one law for all. The market, however, can supply a wide variety of solutions to the varied economic needs of the participants. Law requires uniformity of treatment as a means of promoting equity. People's material needs are very nonuniform. A clear, concise law that specified one solution to nonuniform needs would be grossly inefficient, not to mention fundamentally inequitable.

In addition to being diverse, the economy is also dynamic. Needs change over time. The methods of satisfying needs change as well. New technology revises the ways in which the market can satisfy material needs. The conditions under which economic participants operate to cater to material needs are frequently changing. Supply and demand for the factors of production fluctuate with changes in weather, political tension, consumer taste, and the vagaries of chance.

Economic activity is not a sphere of human undertaking suitable to comprehensive regulation by statutory means. The permanence of statutes is incompatible with the dynamic, diverse nature of economic activity. The existing inaptness of regulatory control over motor carriage inspired Congress to attempt "to reduce unnecessary regulation." Perceptive observers could point out that merely reducing *unnecessary* regulation puts Congress in a difficult spot. The language of the Act would appear to assure that at least some unnecessary regulation will be retained.

The remaining *unnecessary* regulations that have not been reduced are to be enforced by the Interstate Commerce Commission in a "just and reasonable" fashion so as not to "unduly restrain" the market in a way that is "contrary to the public interest." The decisions on equity have been passed on to a Commission made up of men. These men will be asked to render judgments and make rules based upon their opinions of what is just, reasonable, and equitable—matters subject to wide variances in opinion.

Given the latitude granted in the charge to be "just and reasonable," the Commission could make arbitrary rules. The power to regulate is the power to destroy. Denial of a rate change or enforcement of a bureau tariff could force some carriers out of business. If the Commission wanted to, it could use the inherent ambiguity of statutory laws pertaining to motor carrier regulation to ride roughshod over the industry and the consumers who depend on it. If it seeks to be conscientious, the Commission will become bogged down in minutiae trying to determine if rates are or aren't "compensatory," whether they are "discriminatory," and if they are, whether they are permissible as part of a broader scheme of "cross subsidization." When these terms are defined, they are often defined differently. Even if uniformity of definition could be arrived at, the question of whether the defined act is allowable as a "reasonable" practice is still subject to difference of opinion.

The petitioners before the Commission are rarely very helpful in defining terms. Words and phrases are used in a pejorative fashion. They become weapons to batter one's opponents in the hearing process. A petitioner will ask the Commission to disallow a competitor's rates because they are *discriminatory* and show *undue preference* which upsets both *rate stability* and *rate uniformity*. In a future case, the roles might be reversed, and the original petitioner will have to defend the same acts it railed against in an earlier case.

Definitions of these terms are plentiful and inconsistent. There are two reasons for this situation. First, the terms are always situational in nature. Firms employ a double standard. If the other guy does it, it's "discrimination." If we do it, it's "cross subsidization." "Discrimination" is, of course, impermissible. Whereas, "cross subsidization" is socially beneficial. Pricing practices, which a third party would view as similar, will be defined in diametrically opposed terms by contending parties.

Second, the terms are difficult to define because the concepts are more imaginary than real. "Discrimination" and "cross subsidization" are so difficult to define because, like leprechauns, only some people can see them. The fact that few others can see them does not stop some people from espousing, at great length, what they eat, what they wear, and where they live—i.e., leprechauns eat cross subsidies in order to maintain rate uniformity.

Is the task of economic policymaking a hopeless endeavor? Like everything else we've looked at, it depends on how that task is defined. As long as the aim of government economic policy is to intervene in private transactions for the purpose of imposing trade conditions that the transacting parties would not have agreed upon themselves, the task of government's economic policy-making is impossible.

Negotiable Terms

In a market economy, all parties have the freedom to negotiate terms of their own transactions. No one has the authority to impose mandatory trade conditions on anyone else. In such an environment, there is no assurance that the parties can get exactly what they want on their own terms. Losers in the competitive struggle find it easier to blame the "unfair" practices of their rivals than to face the prospect of failure. Economic regulation is a manifestation of this response to unfavorable competitive outcomes. Proponents of government intervention argue that if everyone can be made to conform to "fair" rules, then all can make reasonable profits and survive.

In the absence of government intervention to compel uniformity among competitors, members of the industry are reduced to whatever private agreements they can negotiate. Rate bureaus and traffic pools are an almost ancient device for pursuing private agreements. Private price maintenance agreements rankle antitrust lawyers, while public price regulation is granted greater acceptance. Our public policies ought to be the exact reverse of what they now are. Namely, private price maintenance agreements ought to be allowed, but not legally enforceable. Government enforced price maintenance agreements ought to be abolished.

The old common law practice in which pooling and price fixing were allowed, but not legally enforceable, has much to recommend it. Members of the motor carrier industry claim they need to arrange for rates in concert in order to facilitate interlining. In many instances, this may be true. However, the need to discuss rates and reach agreements for interlining purposes does not require that the agreements attain the force of law, that they be voted upon and collectively imposed on all members of the rate bureau, with the threat of government sanctions for non-compliance.

It is the desire to resort to government coercion that breeds the semantic confusion that Congress is now probing. If no firm were forced to adhere to government imposed economic regulations, there would be no need to wrangle over the meanings of terms like *discrimination* or *cross subsidy*. As anyone familiar with actual business operations must know, the real cost of a particular service is much more complicated than the mere sum of the obvious factors. Firms may legitimately employ apparent below-cost pricing as part of a market penetration strategy, as a loss leader, as a connecting link in a longer route, as a portion of a larger shipment, and so on. There is no way that a third party can objectively assess a rate between transacting parties as "non-compensatory." Neither can the seeming difference in rates between similar moves be objectively labeled as "discriminatory." In short, the prices charged in voluntary transactions are nobody else's business but the parties to the transaction.

Suggested Remedies

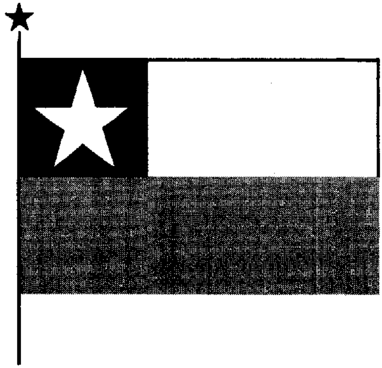
Problems with economic policy will persist as long as the alternative remains of resorting to force of law to compel trade conformity. Collusion and price fixing would be insignificant if there were no legal barriers to entry. Because the public sector has sought to intervene in private economic activity, assorted minor market imperfections have been replaced by substantive difficulties.

To address the specific question of where we go from here, let us suggest the following semantic remedies. The government should define any private voluntary economic transactions as "just and reasonable." Any voluntary economic act between consenting adults should be considered "equitable" and "in the public interest." Government should concern itself with preventing the employment of coercion by criminal organizations or individuals. This is the sphere wherein government can exercise its legitimate police powers. Protecting the public from overt and covert coercion in business practices is the most productive realm for government action.

Semantic confusion stems from the lack of focus on what public power can accomplish and on the inherent incompatibility of attempting to control dynamic economic activity through static statutory means. If the government seeks to control millions of transactions through regulatory rules, public policy will fail to achieve either justice or efficiency. If the legal effort is focused on maintaining a free market system, it can succeed. Creating the legal forms which will protect all free market transactions is a clear and attainable mission. It is free of semantic clutter and accounting headaches. That the Interstate Commerce Commission should have to examine cost accounting systems, revenue data, industry profitability averages, and the like in an attempt to promote equitable regulations is a laborious and futile exercise.

The government really needs to ask only one basic question: Is an economic transaction voluntary? If it is, government has no role to play. If it isn't, the coercive act should be prosecuted as would any other act of extortion. In this way, government would perform the function for which it was established in this country: defending the people's freedoms.

Hans F. Sennholz



FREE MARKETS IN CHILE

EVER SINCE September 1973, when a military junta seized power in Chile, the world has been treated to the rare spectacle of an unexpected restoration of the market order by military fiat. Socialism with many of its ramifications was summarily replaced with an individual enterprise order. National borders were opened to international trade and commerce, markets and prices were set free from bureaucratic restraints and restrictions, government learned to live within its means, that is, balance its budgets, the national currency was reformed, and many public enterprises were returned to private ownership. Even in such fields as education and old age insurance, government beat a hasty retreat and made way to the private property order.

And yet, all these remarkable achievements, admired by the friends of individual enterprise everywhere, are seriously flawed. They were attained by order of a military junta and are safeguarded by armed power and might, that is, by an authoritarian state, which is denying basic human rights to thousands of its citizens and repressing important political rights to all. To most observers, Chile stands condemned as an outcast in the family of nations, a pariah country run by generals and colonels who lord over their subjects. In the world press and the international news media, Chile is a primary target of severe censorship and bitter condemnation.

The friends of the market order are bewildered and perplexed by the Chilean situation. If they hail the

Dr. Sennholz heads the Department of Economics at Grove City College in Pennsylvania. He's a noted writer and lecturer on economic, political and monetary affairs.

restoration of the enterprise system and the restitution of many property rights, they face the biting criticism of being "anti-democratic" and supportive of a regime imposed by brute force. They are chastised for their ideological bias that allegedly surrenders basic human rights in order to achieve a particular economic order. But if they choose to disapprove of the Chilean system they find themselves in the uncomfortable company of communists and socialists everywhere, and in agreement with radical critics and commentators.

Allende Deposed

Communists and socialists the world over spurn and despise the military regime because it overthrew the Marxist-dominated government of President Allende. On September 11, 1973, the armed forces arrested some 6000 known Marxist activists in the country, including several hundred foreigners. All resistance by partisans of the *Unidad Popular* coalition of communist and socialist parties was crushed. Allende died in the national palace, refusing to surrender.

Salvador Allende had been the first freely elected Marxist president in the Western hemisphere. As candidate of the *Unidad Popular* he had won over two opponents with 36.3% of the vote in the September 1970 elections. In the March 1973 congressional elections, the UP had won 44% of the vote. But Allende never won majority control over the legislature, which kept the Marxist executive branch at odds with a congress dominated by the opposition parties. Nevertheless, he proceeded to socialize Chile. He expropriated the U.S.-owned copper companies and ordered wage increases of up to 40%. He imposed stringent price controls and ordered production to be doubled. He inflated the currency at accelerating rates. In 1973 inflation reached almost 1000% and the wholesale price index increased 1,147%.[1] When the government exhausted its financial reserves it defaulted on international obligations and sought aid and support from the Soviet Union and other communist countries.

As students of economics would expect, economic chaos soon descended on Chile. Strikes and demonstrations were crippling the country, and food shortages brought mass exodus from the cities. Farmers stopped producing for fear of either legal nationalization of their products or illegal seizure by roaming hungry workers. Businesses were failing by the thousands, unemployment was soaring, and living condi-

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[1]Juan Carlos Mendez G., *Chilean Socioeconomic Overview,* Santiago, 1980, p. 15; also *Chilean Economic Policy,* edited by Juan Carlos Mendez G., Santiago, 1979.

tions were deteriorating everywhere. In short, the division of labor, which is an essential condition of human existence, was disintegrating rapidly, giving way to economic chaos and civil strife.

Economic Reconstruction

After the 1973 coup the junta headed by General Augusto Pinochet Ugarte hastened to make peace with Chilean businessmen and foreign investors. The nationalization of American copper companies was declared irreversible, but the compensation claims of Cerro Corporation, Anaconda Company and Kennecott Copper Corporation were settled amicably. A new foreign investment law was designed to lure foreign investors by guaranteeing remittance of profits and safeguarding their property. The government also began to return private companies, seized by the previous regime, to their owners. In September 1975 Chile conducted a currency reform introducing a new monetary unit, the peso, equal to 1000 old escudos.

Gradually the government budget was balanced and the rate of inflation reduced. In 1974, prices rose 375.9%, in the following year 340.7%, then 174.3%, 63.5%, 30.3%, 38.9%, 27.5%, and an estimated 10% in 1981. The central bank's stock of money, which stood at some 200 billion escudos at the time of the coup, rose to 836.7 billion in December 1974, to 3,279 billion escudos (or 3.279 billion new pesos) in 1975, 9.6 billion pesos in 1976, 18.3 billion pesos in 1977, 30.5 billion pesos in 1978, 47.4 billion pesos in 1979, and 50.3 billion in 1980.[2]

At its best, such statistical evidence is rather dubious and inconclusive. When offered by government it is especially suspect of crude political manipulation and interpretation. Nevertheless, it may be concluded without much contradiction that the Pinochet junta indulged in rampant inflation throughout most of the 1970s. It reported its first balanced budget in 1979.

When labor unions all over the Western world threatened to block shipments to and from Chile the junta hastened to make peace with the labor union movement. It enacted the 1979 labor code which restored the right to form labor unions. But the code also established the right to work without labor union affiliation, and made union dues voluntary. It allowed collective bargaining although negotiations were restricted to individual plant and company level. Labor agreements were made legally binding and had to be made for at least two years. Strikes were permitted after a secret ballot, but only for 60 days after which workers would be assumed to

[2] *Encyclopaedia Britannica,* Books of the Year, 1974–1981.

have quit their jobs. The new code immediately led to a number of ugly strikes by unions protesting against the "union-busting" provisions in the code.

Welfare State à la Junta

The friends of the individual enterprise order who may rejoice about the return of some property to the legal owners and the restoration of some goods markets must not overlook other junta policies that were designed to restore and strengthen the welfare state. Soon after the September 1973 coup the regime set out to make the tax system "more efficient and equitable." It proceeded to extract a larger share of tax revenue from the "wealthier sectors." It repealed a great number of so-called "development" laws that were said to discriminate in favor of capital. It eliminated the tax exemption on undistributed corporate profits, thereby including them in the taxable income base. While it was raising the minimum levels of tax exempt incomes it collected ever higher shares from larger incomes. While it lowered its real estate taxes on many property units it raised them significantly on more valuable properties. While it lowered most tariff rates to 10%, it raised them on capital goods by eliminating their previous exemption from customs duties. It imposed a general system of monthly tax indexation which made it possible to extract more revenue from business more quickly. It added a Value Added Tax which made collections from business more efficient and easy to manage. It embarked upon an intensive campaign to crush tax evasion by businessmen. Altogether, it worked feverishly "to enhance the equity of the tax system" by redistributing the tax burden from the poor to the more affluent, from workers to businessmen and capitalists.

The Burden Increases

It is significant that the fiscal burden of the junta state has risen markedly since the 1973 coup. In 1977 the gross national product of Chile was estimated at 313 billion pesos. Government revenue amounted to 120 billion pesos, or 38.5% of GNP, which probably came to some 45% of net national income. That is, the military regime of General Pinochet is consuming some 45% of all goods and services legally produced in Chile. In 1972, the last full year of the Allende Administration, the government reported expenditures of some 40.689 billion escudos of a gross national product of 228.64 billion, or 17.8% gross and 21–22% net.

Even official junta statistics reveal that economic activity after the junta tax reform in 1974 contracted severely. In 1975 GNP declined by 12.9% and output per capita by

14.4%. The latter remained below the 1972 per capita product until 1980.[3]

Transfer expenditures have changed little since the Allende Administration. However, the source of revenue probably changed significantly. While Allende supplemented his tax revenue with generous helpings from the printing presses (40.9% of 1972 spending), the generals were laboring successfully to rely increasingly on taxation. Allende was seizing income and wealth from the middle classes, the primary victims of inflation, while in 1978 Pinochet was extracting ever more revenue from businessmen and capitalists.

Social Spending[4]
(Millions of U.S. 1976 Dollars)

	Allende (1972)	Pinochet (1978)
Health	242.36	172.75
Social Asst.	41.14	179.20
Housing	156.20	67.58
Welfare	372.75	341.56
Education	502.98	456.12
Regional Dev.	17.91	51.34
Total	1,333.34	1,268.55

Bitter Fruits

It was no surprise to the impartial observer that in 1981 the Chilean economy ran into new trouble, the worst in its eight years of "restoration." Thousands of enterprises went bankrupt, mines and factories were closed and farms sold at public auctions. Many banks and financial institutions are insolvent; the government had to save eight in November. Unemployment is soaring and is expected to exceed 20% in 1982. According to Cardinal Raul Silva Henriquez, head of Chile's Roman Catholic Church: "I could be wrong, but never in my long life have I seen such a disastrous economic condition."

Government economists blame the disaster on the world recession with its slump in commodity prices, including Chilean export prices for copper, timber, fresh fruits, and so on. But critics point out that the monetarist policies of the economic team called "the Chicago boys" (because many studied at the University of Chicago under Nobel Laureate Milton Friedman) contributed to the disaster. The monetarists insist in affixing their national currencies to the U.S. dollar which, in their belief, affords international monetary stability and order. They fixed the peso-dollar exchange rate at 39 to 1 in 1979 and then clung to it although Chilean prices subsequently rose 60% while U.S. prices rose less than half that rate.

In time the peso became greatly overvalued, which did double damage. It made Chilean products more expensive abroad, while it made imports cheaper. The overvalued peso

[3]Juan Carlos Mendez G., *ibid.*, pp. 40, 41.
[4]*Ibid.*, p. 71.

brought devastation to Chilean exporters. Hundreds of small mines and smelters were forced to close, throwing thousands of miners out of work. But at the same time Chilean consumers went on an import binge, buying foreign cars, home appliances and television sets.

The binge was financed primarily by foreign credits extended to Chilean banks and consumer-finance companies. Chile's foreign debt, which for years had been the concern of foreign lenders, being the second highest per capita in the world after that of Israel, increased by $4 billion in 1981, to $15 billion. Under President Allende Chile had gone bankrupt with a debt of just $3 billion.

Many Chilean banks are in grave difficulty today. The deepening recession is frightening foreign bankers, causing them to go slow with new credits. They are beginning to have second thoughts about Chilean lending practices and on the future of the junta order itself. Struggling to survive the liquidity pressures the Chilean banks have raised their interest rates on 30-day loans to 4.6% a month, which is hastening the demise of many industrial and commercial enterprises.

For a while there was a feeling of hope and optimism, which came with the restoration of some features of the market order and its easy access to the world credit markets. Moreover, the peso pegging to the dollar à la monetarist recipe permitted the Chilean people to live far beyond their means. But, as always, overconsumption can only be temporary; it must come to an end as soon as the limits of credit are reached. It is obvious that Chile has reached its limit and therefore faces the strenuous task of consolidation and repayment. Chilean levels of living must fall not only by the rate of previous overconsumption, but also by the amounts of necessary repayment. The deterioration in living conditions now clearly visible throughout Chile is putting new strains on the credibility and popularity of the junta regime.

Transgressions Against Human Rights

To most observers of the Chilean dilemma such economic deliberations have much lesser import than the consideration and observation of basic human rights. American liberals who may even be tempted to applaud the restoration of the Chilean welfare state and the redistribution of income through progressive taxation, are objecting strenuously to the junta denial of human rights and political rights. To them, property rights must always give way to the political rights of democratic majorities. If a popular majority acting through a democratic election process desires to seize income and wealth from entrepreneurs and capitalists, or wishes to control prices and wages by political force, no property right must stand in their way. The political rights to seize and confiscate private property must be supreme. The junta's return of some business property seized by the Allende Administration obviously violates their democratic maxim.

Property rights actually are basic human rights. They are derived from the God-given right to life that must be sustained by man's labor and effort. To deny the right to the fruits of one's labor and effort is to deny his right to life. To create a political right to seize or confiscate private property not only negates this basic right to sustain life through labor and effort but also creates an insoluble conflict. When political rights are pitted against property rights, social conflicts arise that cannot be solved by majority vote.

On the contrary, a society bent on seizing and confiscating the property of its minorities must brace for a bitter economic, social and political struggle not only with its minorities but also among the beneficiaries themselves. Ugly political battles are likely to erupt about access to the public trough at which the beneficiaries hope to partake of the transfer. The magnitude of the transfer tends to determine the severity of the battle. When economic transfer by political might finally assumes ultimate desperate significance to the victims as well as the beneficiaries, the political battle tends to erupt into bloody confrontations. When society disintegrates into fighting mobs, the time has come for Caesar as the bringer of peace.

Political Dictatorship

Thinkers and writers who would deny property rights or create political rights over private property, are the ultimate heralds and harbingers of dictatorship. Most nations of the world are led by dictators of one color or another because they worship political might that negates property rights. To them, political freedom means the right to seize and plunder, to inflict harm on each other by majority vote. It does not matter whether they are guided by hatred, envy, greed, resentment, or merely by popular transfer ideologies; they all are heading toward the final battle in the streets where the biggest guns determine the outcome.

Human tragedy reaches its climax in civil strife. All the political transgressions committed in years of peace are mere trifles compared with the evils stalking the streets in revolts and revolutions. Their outcome does not materially change the transfer system but merely readjusts the order at the public trough. For as long as political rights negate property rights and the transfer ideology leads men to prey on each other, the conflict will rage on in one form or another.

The military coup of September 1973 was the first experienced by Chile in 49 years, which in South America was a long record of military neutrality in political affairs. Chile was going from crisis to crisis, with chaos in the streets, daily demonstrations, strikes, and bloody riots. There was hunger, deprivation and desperation in the homes and illegal seizures and confiscations of property. For many people these events were raising the question of survival in Chile. Under such conditions a few individuals may turn their backs on society so bent on self-destruction, and emigrate to safer shores. But most people do not have this opportunity for lack of mobility, flexibility, knowledge, or the necessary means. Moreover, even if they would want to leave their country, they are not welcome abroad. In desperation they may call on the armed forces to restore order and social cooperation. When the military finally strikes, the people usually welcome and hail it as the restorer and guardian of peace.

For the generals the coup may be a patriotic duty which they reluctantly assume in order to save the country. The multitudes may applaud their courage and devotion to duty, and admire their example of leadership, which in time may actually corrupt them and finally destroy them. After all, they are not intellectual leaders who through patient teaching and preaching can change the hearts and minds of the people so that they discard their economic and social conflict notions and embrace the philosophy of individual freedom and social harmony. The generals themselves usually cling to the very ideas that are tearing society apart. They, too, favor economic redistribution by political force. But they want it in an orderly fashion without the fighting in the streets. The Chilean junta immediately reconstructed, with minor variations, the Allende transfer-conflict system.

Changing of the Guard

A junta regime usually comes to a violent end when it loses the support of public opinion. When economic conditions deteriorate again for any reason, or when public sentiment strenuously disapproves of the benefit order at the public trough, a violent reaction is likely. It may come from another general or colonel who senses the junta loss of popularity and, when successful, promises to be carefully guided by the popular will. Some juntas may even resist the temptation and corruption of power and relinquish it as soon as they sense a loss of public support. They may return the instruments of political power to the democratic transfer state and then wait patiently for the coming chaos when they will be needed again. By their timely withdrawal they manage to safeguard the public esteem for the armed forces as the ultimate guardian of law and order.

The seizure of power by the military always entails the risk of violence and bloodshed. The risk is minimal when the administration in power has lost all respect and support by the disillusioned public. But it is serious as long as some elements of public opinion continue to give the administration their loyal support. Many communists and socialists held to their Presidente to the bitter end. Thousands of them were incarcerated for several years, hundreds lost their lives, many were later expelled from the country. Political parties were dissolved, the news media placed under censorship, the public subjected to rigid curfew.

In every case of civil rebellion the victor is quick to point at the sum total of social benefits created by his rebellion. When communists or socialists prevail they may speak of a liberation of the proletariat from capitalist exploitation. When defenders of the private property order prevail they may point at the restoration of private property and free markets. Both invariably propose to weigh their open violations of human rights against the economic and social rights which their violent actions are presumed to have gained. Both regularly conclude that their actions were justified by the sum total of benefits to society.

There surely is such a scale in the realm of political rights that negate individual rights, especially property rights. But, by its very nature, it is an arena of perpetual social conflict that ultimately brings forth the strong man. A society that routinely weighs political rights against property rights and finds them wanting ultimately will weigh the loss of human lives in revolution and rebellion against the sum total of collective benefits.

There is no such scale in morality which is religion with its face toward man. No sum total of social utility and benefit whatever can outweigh the death of one human being or any suffering inflicted on him. No man or assembly of men can secure well-being or happiness by violence against a single individual. Violence breeds violence and is an offense against God even when committed in the name of majorities.

A Shadowy Future

The ideological forces of social and economic conflict that led to the 1973 disintegration of Chilean society continue to be alive and active at home and abroad. Under their spell the junta hastened to restore the conflict system that forcibly redistributes income and wealth from the more productive members of society to its favorite beneficiaries. In fact, the junta's fiscal policies were designed to impose ever larger burdens on the business community, which for most of the seven years of junta regime has lingered in stagnation or recession. Wages and salaries throughout most of the decade have been lower than before. Some 20% of the working people now are walking the streets in idleness and despair. Foreign credits have been squandered and must now be repaid. And there is not a single voice of dissent that is explaining the road toward a brighter future.

Surely, the political dissidents who escaped or were expelled are vocal enemies of the junta. Many Christian Democrats now are making common cause with the parties of Allende's former Marxist coalition. The Communist Party and the Socialist Party in exile are calling upon the people of Chile to continue their armed struggle against the junta. They have nowhere to go, they are told, but the *Unidad Popular*.

All along, the "Chicago Boys" in the inner councils of government are keeping in touch with the world by writing glowing reports and projections about growing GNP's and rising incomes from work and pensions. But the results of their efforts are surely disappointing. It seems that they are rejecting or ignoring the fruitful lessons learned in Chicago, but are applying diligently the errors of monetarist thought.

General Pinochet and his men are probably evaluating the situation correctly: there has been little or no progress in economic and social thought since 1973. The only dissenting voice they hear is abroad, that of the *Unidad Popular*. They still loathe it and will not bear it. Therefore, they have been clinging to the reins of power as long as possible. And in lieu of promoting meaningful changes in social ideology and political morality, which alone would change the course of the future, they have busied themselves—as well as many jurists and lawyers—with reshaping the form of government by rewriting the constitution. In 1980, on the seventh anniversary of the military coup that overthrew the Allende government, they submitted a new constitution to a national plebiscite. Of the votes cast, 67.5% approved of the constitution, which strengthened the presidential powers, created an eight-year nonrenewable term for the president, and restored the bicameral Congress composed of a Senate and a Chamber of Deputies. General Pinochet was elected the first president.

But no matter what we may think of the Pinochet junta we must not forget that the generals always have been, and continue to be, viscerally opposed to the *Unidad Popular* anti-

U.S., pro-Soviet attitude. They are looking upon Chile as a Christian nation and a loyal member of Western society, a willing friend and ally of the U.S. They are resenting American criticism of their barracks rule and denial of human rights. After all, their intentions were so noble, restoring law and order and returning their country to the Western camp.

Continuing Threats

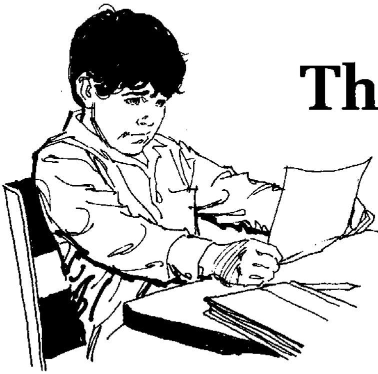
Dark clouds are hanging over the future of Chile. Ideologies of economic and social conflict are tearing at the roots of society, straining social cooperation and the division of labor. The doctrines of conflict are permeating every aspect of social life. Similar conflicts springing from identical causes are visible also in neighboring countries, which is aggravating the uncertainties of life in Chile.

Old wounds are festering and may break open at any time. Territorial disputes with both Bolivia and Peru frequently raise border tensions and threaten to erupt into open hostility. Bolivia wants access to the Pacific Ocean which it lost to Chile in the War of the Pacific in 1883. Peru demands the return of its provinces lost in the same war. Chile's powerful neighbor, Argentina, is claiming territorial rights to the islands of Picton, Lennox and Nueva, south of the Beagle Channel. They all are awaiting their opportunity for moving on Chile, which often sends the Chilean government scrambling for more planes and tanks from the U.S. and other countries. Chilean weakness through social disintegration may someday offer this opportunity.

Ideas and beliefs are the invisible powers that govern man's actions. Ideas of economic, social, and national conflict have made their way in silence and swept around the globe. The Chilean situation does not differ materially from that of other countries.

There is an alternative other than *Unidad Popular* and its armed struggle against the junta. There is the road to individual freedom, which step by step retrieves the freedom of each and every individual to pursue his own good, in his own way, as long as he does not deprive others of theirs. On that road, no political party or pressure group seeks to enrich its members at the expense of others. There is no transfer program, in fact, no government that seizes income and wealth from some people in order to benefit itself and others. There is no public trough at which political right and might determine not only who shall feast at the trough but also who shall labor to keep it ever well-filled and bountiful. There is harmony and peace on the road to freedom.

Steven N. Spetz



The Day Welfare Hit the Classroom

I HAVE OFTEN HEARD it expressed that the classroom should be a small window upon life and prepare students for the world they will soon enter as adults. I accept this idea, and introduced a magnificent scheme of marking that would alert students to economic factors they should appreciate. When I gave back a major assignment, the students noted some peculiar entries on their papers.

"Sir, what does it mean, minus six marks for the Student Pension Plan?"

"Well, Bob, the Student Pension Plan is one that I invented similar to a government pension plan. You put aside some of your marks each week into a fund which will be available should you decide to retire toward the end of the school year."

"Do I get them back?"

"Yes, but in the meantime inflation will have eroded the marks terribly, so you will probably get back only a small part of what you set aside. Yes, Mary?"

"Sir, what does it mean, minus four marks for Unemployed Student Insurance?"

"Ah, good question. Suppose you are absent or for some reason fail to hand in your assignment? Then, you are authorized to draw marks from the Unemployed Student Insurance Fund to make sure you don't suffer a drop in marks."

"But what happens to my marks if

Mr. Spetz teaches Economics at Bayridge Secondary School in Kingston, Ontario. This article, prepared some years ago for a teacher's magazine in Canada, merits further distribution.

I do all my assignments—do I get my marks back?"

"Certainly not. The marks are needed by the less fortunate."

"Sir . . . Fred got a 55% on his assignment and he didn't even do it!"

"Yes, I know. You see how the Unemployed Insurance works? Fred didn't do anything, but we can't let him fail, so I authorized him to draw 55 marks from the Insurance Fund."

"But the reason he didn't do it was he went to the hockey game. He said to ---- with your assignment and . . ."

"It doesn't matter. Each of us owes a duty to our neighbors to see that they encounter no hardships. It's their birthright."

"Even if they don't do anything?"

"Perhaps he was unable to do it."

"Sir, what would happen if we all didn't do the assignment? I mean, suppose we all just asked for 55 marks, what would happen?"

"Tsk, tsk, Tom. I assume that each of you wants to work, that you seek work and savor it. I know none of you would deliberately turn down the opportunity to work."

"Sir, what does it mean, minus 5 marks for Student Health Plan?"

"That is in case you are ill for a prolonged period of time. The Plan will pay you 60 marks a week while you are convalescing."

"Why didn't you deduct any marks from Hilda for the Student Health Plan?"

"She comes from a low-income family. Can't expect her to pay anything, can you?"

"Sir, you took fifteen marks from me for Student Income Tax, but you only took four from Ralph."

"Well, you are in a higher bracket than Ralph. You had a mark of 86% while Ralph only had a 57%. You should pay more than he."

"Why?"

"Just because it always works that way."

"Sir, I had a mark of 58%. After you deducted Student Income Tax, Student Health Plan, Student Pension Plan, and Unemployed Student Insurance I ended up with only 39%. I passed the assignment but all your deductions made me fail. I would have been better off if I hadn't done it at all like Fred. He didn't do anything but got a higher mark than I did."

"Yes, unfortunately there are a few cases where it does work out like that. Some people are financially better off not working than working."

"You mean it's better to refuse to work rather than work and get a low passing mark?"

"Yes, but again I want to emphasize that I know each of you would not want to take advantage of such an idea. The thrill of the job alone should drive you onward even though you end up with fewer marks. Besides, you wouldn't feel morally right knowing you were drawing marks from your fellow students when you were perfectly capable of getting them yourself."

"Sir, do people really live like this?"

"Certainly, it's part of the great social scheme of life."

As the bell rang, I knew I had succeeded beyond my utmost dreams. The students were actively talking about incorporating so they could defer taxes, bringing in large numbers of immigrant students to do their assignments at a low pay scale while they collected from the Unemployed Student Fund year around, applying for government assistance to pay their Student Health Plan premiums because they came from low-income families, and had started a Strike Fund to keep their marks up while they were busy picketing the school for higher marks, a four-day week, and a student drinking lounge.

As I watched them happily thinking of ways to obtain extra marks from the Unemployed Student Insurance Fund by enrolling in the plan under more than one name, I recalled the words from the musical, *My Fair Lady:* "By George, she's got it!"

Market Pricing

IDEAS ON LIBERTY

IN a market economy of private ownership, the most desirable use for the land (and other means of production) can be, and is, quickly decided by the highest bidder. If the beet grower outbids the office builder, the land is used for beets. If he has miscalculated and can't at least cover his total costs by the sale of his product to willing buyers who have freedom of choice, he goes broke—and some other person who is searching for profit-making opportunities replaces him and produces whatever product *he* thinks the consumers will buy. Thus the consumers, by their buying or abstention from buying, will make sure that the land is used for a purpose that pleases them.

But under total socialism, there is no price and no market for any capital good, including land. No person is free to produce what he thinks the consumers would prefer. Thus all land, all natural resources, all building materials, and all capital of any description must be arbitrarily assigned to whatever purpose happens to please the planner. Literally, there is no other alternative in a command economy.

DEAN RUSSELL, "Play Store Economics"

Clarence B. Carson

THE RELICS OF INTERVENTION:

2. Progressivism

SOME of the major relics of government intervention are still with us today as a result of the Progressive movement of the early twentieth century. The Progressives promoted and brought about intervention in three distinct ways. (1) They made the fateful link between the idea of progress and positive government action. (2) They adapted socialistic reform to the American framework as gradual and mounting government intervention. (3) They succeeded in getting some of their reforms enacted into law either as particular programs or constitutional amendments.

The Progressive movement began to make its political impact in the first years of the twentieth century and had largely spent itself by 1920. Some would date the beginning of that impact from 1901, when Theodore Roosevelt became President after the assassination of McKinley.[1] The end of its thrust as a national movement can be dated from two events which occurred in 1920: the election of Warren Harding as President vowing to oversee a "Return to Normalcy," and the adoption of the 19th Amendment, which was the last of the Progressive amendments to the Constitution.

The peak of the movement was reached in 1912 when Woodrow Wilson, an avowed progressive, was elected President as a Democrat, when Theodore Roosevelt came in second to him as the nominee of the Progressive Party, and when William Howard Taft, whom Roosevelt had chosen to succeed him in 1908 because of his progressive tendencies, came in third as the Republican candidate. Most of the legislative triumphs which can be attributed to the Progressive movement came during the years 1913–1916.

Dr. Carson has written and taught extensively, specializing in American intellectual history. He is the author of several books and a frequent contributor to *The Freeman* and other scholarly journals.

Neither the public in general nor very many intellectuals in particular associated the idea of progress with government intervention in the economy before the twentieth century. On the contrary, the prevailing ideas in the nineteenth century opposed government intervention as retrogressive and reactionary. Political and economic progress were to be attained by restraining government and freeing the energies of peoples. The Progressives, then, effected a major change in thought by giving currency to the notion that progress could be made by forceful government action.

The Idea of Progress

How important this change was for the thrust of intervention becomes clear only when we recall the lodestone-like attractiveness of the idea of progress over the past several centuries. Since the seventeenth century, European thinkers had become increasingly enamored of the idea. Indeed, the belief that progress was taking place goes back further than that. Men of the Renaissance believed that they were progressing far beyond their Medieval forebears. But their progress they attributed mainly to the recovery of the learning of the Ancients.

Seventeenth-century scientific discoveries, however, began to point in a different direction. Thinkers were now discovering laws and relationships not only unknown to thinkers of ancient Greece and Rome but also some of which ran counter to their assumptions, such as that the sun moves around the earth and that freely falling bodies accelerate at a uniform rate regardless of weight. However much their thinking might be buttressed by the earlier work of Greek and Roman thinkers, the Moderns were now going well beyond them. They were making progress. (That there were still champions of ancient learning as late as the eighteenth century to contend with the proponents of modern progress is at least suggested by Jonathan Swift's satire, *The Battle of the Books,* published in 1710.)

The idea of progress gained increasing sway in the course of the eighteenth century, especially among intellectuals. The idea of an orderly universe which was greatly bolstered by the findings of Kepler, Galileo, and Newton, among others, was now being extended into the social, political, and economic realms. Everywhere men studied they found signs of underlying laws, laws subsisting, as they said, in the nature of things. The belief took hold that by gaining knowledge of this natural order great progress could be made by men by bringing their behavior into conformity with it. There were many indications, too, that something like this was actually taking place.

In the nineteenth century, belief in the idea of progress was well on its way to becoming an article of faith. Cities began holding great fairs and expositions at which displays of the latest marvelous achievements from around the world could be made. Even so, a major change was occurring in the ideological underpinnings of the idea of progress.

Evolutionary Theories Gain in Social Impact

Evolutionary theories, particularly the biological theories of Darwin, were being substituted for or being used to support older ideas of progress. Herbert Spencer made the social interpretation of evolution that had the greatest immediate impact. But progress, on this view, was the result of the working out of natural laws for the development of society. Governments could not intervene so as to alter the course of development. As William Graham Sumner, Spencer's American disciple, described the situation, the Western world had moved into an industrial stage. It was a stage which, he believed, was bringing great progress. The notion of intervening in it so as to change its course was absurd. "We have to make up our minds to it," he said, "adjust ourselves to it, and sit down and live with it."[2]

My main point, however, is that by the early twentieth century Americans generally had come to believe in progress. It had become, or was becoming, a word to conjure with and was ready to join that other word, "freedom," which all politicians who would succeed must avow as the aim of their programs.

It was especially important for those who would use the power of government to make social improvements to identify their programs with progress. After all, the only feasible justification for making their innovations was that they would lead to improvement or progress. Yet their path was doubly blocked in the late nineteenth century. In the first place, the case against intervention had been made by the Spencerians, who had made the earliest and most plausible application of the Darwinian theories. In the second place, much of socialist thought, which was the main source both of the critique of contemporary society and of the vision of a better one, was equally set against government intervention. Karl Marx, for example, was so convinced of the futility of ameliorative measures achieved by government intervention that he believed socialism could only be reached by violent revolution.

The work of overriding these theoretical obstacles to reform by way of government intervention had been largely accomplished before the Progressive movement was well underway. It almost certainly had to be. While a goodly number of thinkers contributed to the undertaking, Lester Frank Ward, an obscure sociologist, made one of the most direct assaults on the Spencerian position. (American thinkers could, and did, usually ignore the Marxian argument against ameliorative reform.)

Ward granted that in times past social change as well as biological changes had taken place without being consciously directed. But, he proclaimed, a new stage in evolution had now been reached as a result of thousands of years of movement in its direction. The new stage was the "advent with man of the thinking, knowing, foreseeing, calculating, designing, inventing and constructing faculty, which is wanting in lower creatures. . . ." This development repealed "the law of nature and enacted in its stead the psychologic law, or law of mind."[3]

By the Mind of Man

The vision that Ward held forth was one in which man could use the creative powers of his mind to take over the direction of social development. By so doing, he could bring nature and natural law to heel, or, as Ward put it:

> . . . When nature comes to be regarded as passive and man as active . . . , when human action is recognised as the most important of all forms of action, and when the power of the human intellect over vital, psychic and social phenomena is practically conceded, then, and then only, can man justly claim to have risen out of the animal and fully to have entered the human stage of development.[4]

In short, the path to progress now lay through man's taking over and directing the course of social development.

It should be pointed out, however, that neither Lester Frank Ward nor anyone else has proved that government intervention in general can produce progress, nor even that particular interventions will necessarily do so. Indeed, the intellectuals—Ward, Richard Ely, E. A. Ross, John Dewey, Walter Rauschenbusch, Thorstein Veblen, Herbert Croly, Oliver Wendell Holmes, Jr., Louis Brandeis, and others—were generally strong on assertion and weak on proof. By and large, they were enthusiasts, caught up in the vision of making all things new, eager to innovate, aware, perhaps, that most men do not so much require proof as vigor in assertion, and bent toward joining their word visions of the future to political power. In any case, they prepared the way for linking the idea of progress to government intervention, not because they had proved the connection by evidence and reason, but by laying their claim on the basis of assertions about what could be accomplished. The politicians did the rest.

Even though the linkage was made by little more than intellectual sleight of hand and political bombast, it was nonetheless a political master stroke. Long after the Progressive movement had been relegated to the pages of history reformers continued to give impetus to their measures by claiming they were progressive and by denouncing those who opposed them as reactionaries desirous of returning to the unsavory past. Today, the linkage is a relic, a relic of intervention.

Actually, the linking of the idea of progress to government intervention was one of the ways that socialistic reform was adapted to the American framework. It was, however, such an important element of that effort, and so distinctive, that it has been accorded separate discussion. What needs discussing about the adaptation is how the Progressives smoothed the way and prepared Americans for the reforms and interventions.

Americanized Reform

Most of the basic reform ideas were promulgated by the Populists in the 1890s. However, they advanced them as immediate demands and made it appear that if they were adopted a virtual revolution would be accomplished. Their arguments were cast in class language; their denunciations of wealth, banking, and gold were clearly demagogic; their proposals were rough hewn and heavy handed. Their monetary panaceas were at considerable remove from programs the generality of Americans were likely to find acceptable.

By contrast, Progressivism was much more attuned to the American political motif. Demagoguery there might be, but it was toned down to a level that made it little different from the approach of most politicians. The class struggle was muted; wealth and property were not attacked directly; the utopianism of populism was kept out of sight, and reform and gradual change were the only tickets presented.

However much Populist ideas might be drawn from intellectuals, they had about them the aura of Kansas farms and Chicago factories. Progressivism, on the other hand, brought to the fore the reformer dressed in his Sunday best, so to speak, ready to take up his place in the American mainstream. While Richard Hofstadter held that Populism merged into Progressivism in the early twentieth century, he described the differences between them this way: "Populism had been overwhelmingly rural and provincial. The ferment of the Progressive era was urban, middle-class, and nationwide. Above all, Progressivism differed from Populism in the fact that the middle classes of the cities not only joined the trend toward protest but took over its leadership."[5]

Both Theodore Roosevelt and Woodrow Wilson, the most prominent political leaders of a progressive bent, illustrate the point well. They were of older American stock, respectable, and had their political careers in the established political parties. Roosevelt was a Republican, until his temporary break in 1912, and Wilson was a Democrat throughout, as befitted a man who was born in Virginia and who grew up in the South. They were both college men, trained at old prestigious universities, Roosevelt at Harvard and Wilson at Princeton. Both, too, went to law school, Roosevelt at Columbia and Wilson at the University of Virginia, though neither was attracted to the practice of law. They were both historians, of sorts, though Roosevelt had no extensive formal training in the discipline in contrast with Wilson, who obtained a Ph.D. at Johns Hopkins. In short, they were nurtured in the most prominent of American institutions and were successful members of the prevailing American society.

To put it another way, they were ideally suited by background and training to help make reform respectable in America, and they did. Both were attracted to reform initially in opposition to what they took to be the corruption of American ideals and political principles.

Roosevelt had been only a few weeks in his first political position as a member of the New York legislature when he moved to have a well known judge impeached. The judge had made favorable rulings for some financiers and, although the impeachment move failed, Roosevelt did manage to make known his belief that the legislature was being corrupted by what he called the "wealthy criminal class."

One of the first acts Wilson managed to get through the New Jersey legislature after he was elected governor in 1910 was a Corrupt Practices Act. He also managed to get direct primaries instituted, a measure touted as "returning the government to the poeple." Such reform did have the appearance, at least, of being an effort to restore American ideals rather than to make radical changes.

"National Need" Comes First

But both Roosevelt and Wilson, and Progressives in general, were something much more than simply reformers bent on rooting out corruption. They had hold of the vision of using the power of government to change the direction of the development of America. What Roosevelt sought, according to Richard Hofstadter, was "A strong centralized State, extended government interference in economic life, freedom of politics from concern for special interests. . . ."[6]

As Roosevelt himself stated it in his call for a New Nationalism: "The American people are right in demanding that New Nationalism, without which we cannot hope to deal with new problems. The New Nationalism puts the national need before sectional or personal advantage. . . . This New Nationalism regards the executive power as the steward of the public welfare. It demands of the judiciary that it shall be interested primarily in human welfare rather than in property, just as it demands that the representative body shall represent all the people rather than any one class or section of the people."[7]

Wilson said, "I believe that the time has come when the government of this country, both state and national, have to set the stage . . . for the doing of justice to men in every relationship of life. . . . Without the watchful interference, the resolute interference, of the government, there can be no fair play between individuals and such powerful institutions as the trusts. Freedom to-day is something more than being let alone. The program of a government of freedom must in these days be positive, not negative merely."[8]

Since both men wanted to use government for large and extensive purposes the attack on corruption had for its specific purpose the building of public confidence in government. Only if the public had confidence in the uprightness of government in general would it be likely to support such a great increase in reliance upon it.

Moving Gradually

Progressives were reformers, meliorists—"improvers"—not revolutionaries. They proposed to work within the existing framework, even to change the framework, and sometimes posed as conservatives, seeking to preserve the inherited order by making changes. If they be considered as socialists, and a case could be made for it, they were gradualists, moving gradually toward a distant goal of socialism. The extent to which particular Progressives had such a distant goal in view is largely undetermined. The evidence exists mostly in bits and pieces. For example, Wilson was reported to have made these remarks to a confidant, while ruminating about the changes that would occur after World War I:

> The world is going to change radically, and I am satisfied that governments will have to do many things which are now left to individuals and corporations. I am satisfied for instance that the government will have to take over all the great natural resources . . . all the water power, all the coal mines, all the oil fields, etc. They will have to be government owned.[9]

He went on to deny that he was a socialist, but his words speak for themselves.

Be that as it may, the Progressives served the function of acclimating Americans to socialism by the gradual process. Moreover, the gradual method had already been set forth when Wilson and Roosevelt were advancing their programs. The English Fabians had described how it was to be done at great length in the 1890s. Some American intellectuals were not slow, either, to explain how it could be done within the American framework.

Perhaps, the most thorough effort along these lines was made by Herbert Croly in *The Promise of American Life,* a book published in 1909. Croly's work is important in this context, too, for Roosevelt read and was influenced by it.[10] The book is largely a reprise of American history written to show that certain seeds of a promise had been here in the beginning in the ideas of Jefferson and Hamilton, but they had never been brought to fruition because Jefferson had been individualistic and Hamilton had focused on the development of business. Croly's program has been summarized by one historian this way: It would establish "a tremendously powerful national state that would regulate corporations, unions, small businesses, and agriculture in the 'national interest.' "[11]

Croly admitted that in very important respects his programs might well be characterized as socialistic.[12] Most important, however, was his consistent gradualism. This is well illustrated by his description of how government might gradually get control of the railroads. He explained it this way:

> In the existing condition of economic development and of public opinion, the man who believes in the ultimate necessity of government ownership of railroad and road-beds and terminals must be content to wait and to watch. The most that he can do for the present is to use any opening which the course of railroad development affords, for the assertion of his ideas; and if he is right, he will gradually be able to work out, in relation to the economic situation of the railroads, some practical method of realizing the ultimate purpose.[13]

This gradualist approach has been taken by reformist politicians not only for regulation of the railroads but also for just about everything else. It is a premier relic of intervention from the Progressives.

Trusts and Monopolies

The *bête noire* of the Progressives was what they most often called "the trusts," but which they also described as "monopolies." By so doing, they promoted a confusion as to the meaning of these words which became a part of the American lexicon. The businesses they castigated as "trusts" were not in fact trusts. The trust device had been employed at one time by Standard Oil to control companies not owned. However, the Sherman Anti-Trust Act of 1890 prohibited the business use of the device, and it was abandoned. True, the holding company was eventually developed to perform a similar function, but whatever else might be said about it, it was not a "trust."

As to "monopoly," the word had been used in the past most commonly to refer to a legally established exclusive right of sale of some good or service. The new use, which somewhat antedated the Progressives, conveyed some such notion as a company becoming the "only" or "major" seller of some good or service. In fact, the word lost all precision, and its vagueness down to this day has served mainly to make all enforcement of anti-trust legislation arbitrary and punitive.

What the Progressives apparently meant, so far as they meant anything specific, when they castigated "trusts" and "monopolies," were large nationwide businesses and especially those that had resulted from combinations of these. At any rate, everywhere they looked they saw either potential or actual "trusts" and "monopolies." If there was not already a "trust" under every bed there soon would be, to hear them tell it. There was an "oil trust," a "sugar trust," a "steel trust," a "tobacco trust," probably a "telephone and telegraph trust," and so on.

Above all, by 1913 there was something on the order of a "money trust," according to the Pujo Committee report. Two great confederations of Wall Street financial organizations, those of J. P. Morgan and of Rockefeller, occupied a dominant position in finance, so this report concluded. By interlocking directorates they controlled huge banks, major insurance companies, large railroads and other industries, and investment firms. Prior to 1907, the houses of Morgan and Rockefeller had competed with one another, but after the panic of that year they worked with one another.[14] Talk of a money monopoly was already rampant before the committee made its report.

Different Directions of Reform

Progressives were agreed that business combinations, concentrations of wealth, and Eastern financial institutions posed a serious and mounting threat to Americans and that the Federal government should do something about it, but they differed on important points as to what should be done. Roosevelt and Wilson divided sharply in the campaign of 1912, and the different directions they set forth have remained in the reform impulse ever since and often resulted in inconsistent lines of political action.

Roosevelt had gained fame during his presidency as a "trustbuster." By 1910, or earlier, he had changed directions in his thinking about this. He had concluded that combination and growth in business was a natural development, that it was often the most efficient way to produce and distribute goods, and that it was both futile and harmful to set out to break them up. Instead, he favored vigorous government regulation of business, in effect, government control of it. He favored government empowerment of labor unions and their regulation as well. Generally, Roosevelt favored the establishment of commissions, such as the Interstate Commerce Commission, to accomplish the regulation.[15]

By contrast, Woodrow Wilson was much more intent upon breaking what he conceived to be the power of the "trusts." His analysis convinced him that the "trusts" were not a natural growth so much as a product of government nurture. The traditional arguments of Democrats against the protective tariffs could be rung in to support this view. He pointed out, too, that the corporation derives its powers "wholly . . . from legislation."[16] He proposed to remove government supports, where appropriate, the use of government power to break them up, in many instances, and to prevent by law the development of industrial giants.

The legislation of the Progressive years bore earmarks of both these strains of thought. Before discussing that, however, it may be well to emphasize that both Roosevelt and Wilson believed in a strong and innovative presidency. In his earliest studies, Wilson had described the potentialities of presidential power, and Roosevelt demonstrated how it could become actuality by his energetic involvement in all sorts of things. They initiated and developed the idea of presidential candidates developing full-fledged programs, giving them a name, and campaigning on the basis of them—what I have elsewhere characterized as "Four-Year Plans."[17] Roosevelt weighed in with the first program under the rubric of a Square Deal. For the campaign in 1912 he came up with the New Nationalism. Wilson followed suit by dubbing his program the New Freedom. Since that time, such program names have been devices used mostly by Democrats.

Regulatory Measures

In the main, the reform legislation of the Roosevelt-Taft years (1901–1913) falls into the regulatory pattern. Much of it had to do with increasing the power and sway of the Interstate Commerce Commission. (The Commission was established in the 1880s, but it was granted little power, and the courts tended to restrain it even further.) In 1903, the Elkins Act provided statutory penalties for railroad officials who gave rebates and defined and prohibited discrimination between railroads. The Hepburn Act of 1906 empowered the ICC to set maximum rail rates and prescribe uniform accounting procedures. It expanded the jurisdiction of the ICC and gave to its decisions binding authority subject to court review. The Mann-Elkins Act of 1910 extended the authority of the ICC to telephone and telegraph facilities and further expanded its powers. The whole scheme of railroad regulation was finally rounded out by the Transportation Act of 1920, which gave the ICC the most comprehensive control over the railroads that had ever been devised for privately owned companies.

Progressive legislation moved into other areas during these years, too. In 1903, a Department of Commerce and Labor was established. It had within it a Bureau of Corporations which was empowered to investigate corporate behavior, a first step toward control. An Expedition Act was passed in the same year, giving the Attorney General authority to place anti-trust suits at the head of court dockets. A Pure Food and Drug Act was passed in 1906 which put the Federal government in the business of regulating these. On the same day, a Meat Inspection Act was passed. The Aldrich-Vreeland Act of 1908 turned out to be a forerunner of the Federal Reserve, since it authorized the issuance of currency on the basis of commercial paper and government bonds. The act also established a National Monetary Commission, whose eventual report pointed hesitantly toward the setting up of a central banking system. In the same year, a National Conservation Commission was established for the purpose of cataloging the natural resources within the United States. The Mann Act of 1910 put the Federal government into the business of regulating morals by prohibiting the transportation of females across state lines for immoral purposes. And, a Postal Savings bank was established in the same year, bringing into being a system sought by the Populists first in 1892.

Constitutional Amendment

Four amendments to the Constitution can be attributed to the Progressive impulse. Two were passed by Congress and sent to the states for consideration during Taft's presidency. The 16th Amendment, whose ratification was completed in 1913, made taxes on incomes legal and has been used as the basis for the graduated income tax on individuals and corporations, though there is no specific grant of power to do so contained in it, or elsewhere in the Constitution. At any rate, the stage was now set for a direct assault by government upon the accumulation of wealth.

The 17th Amendment was a more indirect slap at wealth. It provided for the direct election of Senators. The charge had been repeatedly made that the Senate was a rich man's club, and claims were made that since Senators were elected by state legislatures wealth could easily be used to influence elections. The much more important impact of the amendment, however, was to reduce the extent to which Senators represented states.

The 18th and 19th Amendments were passed and ratified during Wilson's administration. The 18th—the Prohibition Amendment—was in several respects more revealing of the heart of the Progressive impulse than any other. It was an attempt to use the power of government to alter human behavior, perhaps, even human nature. Drinking had long been reckoned a major evil among reformers. Most Populists had loathed alcohol with as much fervor as the gold standard. The amendment, too, was an attack on business and trade, since the manufacture and sale of alcohol is a business. The Volstead Act, passed to enforce prohibition in 1920, looked more like the New Tyranny than the New Freedom, but it was Wilsonian in spirit nonetheless. It was an attempt to stop the liquor traffic, once and for all, root and branch. The Roosevelt approach won out in the end. Prohibition failed; the amendment was repealed; but the industry remains heavily regulated and highly taxed. That would have been Roosevelt's way. The 19th Amendment simply extended the franchise to women.

Wilson moved quickly, with the help of a compliant Congress, to enact major parts of his New Freedom program. Probably, the single most important act was the one setting up the Federal Reserve system. It was passed in December, 1913. Although the act was supposed to break up the alleged money monopoly and decentralize monetary sources, it actually set up a central banking system under the auspices of the government. While state chartered banks did not have to become a part of the system, most eventually did, and national banks had to become members. Its establishment turned out to have been a gradualist move to give the national government full control of the money supply.

Curbing "Unfair" Trade

Two acts passed in 1914 appear to have been more along the Rooseveltian lines of regulating business than the course Wilson claimed to be set on. The Federal Trade Commission was established to prevent what were called "unfair trade practices." It had similar investigative powers to those given to the Bureau of Corporations, which was now eliminated, and it was authorized to issue cease and desist orders. "Among the practices which the commission subsequently singled out were trade boycotts, mislabeling and adulteration of commodities, combinations for maintaining resale prices, and false claims to patents."[18] The Clayton Anti-Trust Act singled out and prohibited a number of practices, such as interlocking directorates, which were supposed to lead to monopoly. Ostensibly, it exempted from its provisions worker organizations. The tendency of this act was to discourage business cooperation and to encourage the organization of labor. It was certainly class legislation.

These acts, and supportive ones not discussed, demonstrate the determination of the Progressives to establish government control over the economy. There is a widespread misconception that intervention on any scale got underway with the New Deal. That is by no means the case. Progressives had not only worked out the intellectual justification and set forth the methods but also made headway in altering the Constitution and passing legislation. Most of this was done, too, without even the excuse of any emergency, economic or otherwise. The United States generally enjoyed unparalleled prosperity from the beginning of the century to World War I. The relics of intervention are from further back than is commonly supposed. Even so, the New Deal did make a more concerted effort toward a government managed economy than the Progressives ever managed (except, possibly, during World War I), and it is appropriate now to turn to that story.

Next: *The New Deal Bent to Inflation.*

—FOOTNOTES—

[1]See, for example, Daniel Aaron, *Men of Good Hope* (New York: Oxford University Press, 1951), p. 245.

[2]William G. Sumner, "The Absurd Effort to Make the World Over," in *American Thought: Civil War to World War I*, Perry Miller, ed. (New York: Rinehart, 1954), p. 81.

[3]Quoted in Henry S. Commager, *The American Mind* (New Haven: Yale University Press, 1954), p. 206.

[4]Lester F. Ward, "Mind as a Social Factor," in *American Ideas*, Gerald N. Grob and Robert Beck, eds. (New York: Free Press of Glencoe, 1963), 129.

[5]Richard Hofstadter, *The Age of Reform* (New York: Alfred A. Knopf, 1955), p. 131.

[6]Richard Hofstadter, *The American Tradition* (New York: Vintage Books, 1954), p. 232.

[7]Theodore Roosevelt, *The New Nationalism*, William E. Leuchtenburg, ed. (Englewood Cliffs, N. J.: Prentice-Hall, 1961), p. 36.

[8]Woodrow Wilson, *The New Freedom*, William E. Leuchtenburg, ed. (Englewood Cliffs, N. J.: Prentice-Hall, 1961), pp. 130, 164.

[9]Quoted in Hofstadter, *The American Political Tradition*, p. 278.

[10]See Charles Forcey, *The Crossroads of Liberalism* (New York: Oxford University Press, 1961), p. 5.

[11]Eric F. Goldman, *Rendezvous with Destiny* (New York: Vintage Books, 1956, rev. ed.), p. 156.

[12]See Herbert Croly, *The Promise of American Life* (New York: Capricorn Books, 1964), p. 209.

[13]*Ibid.*, p. 203.

[14]See Arthur S. Link, *American Epoch* (New York: Alfred A. Knopf, 1955), pp. 51–52.

[15]See Roosevelt, *op. cit.*, pp. 86–96.

[16]Wilson, *op. cit.*, p. 85.

[17]See *The Flight from Reality* (Irvington, N. Y.: The Foundation for Economic Education, 1969), ch. 22.

[18]Richard B. Morris, ed., *Encyclopedia of American History* (New York: Harper & Bros., 1953), p. 275.

California, Inc.

California, Inc., by Joel Kotkin and Paul Grabowicz (Rawson, Wade Publishers, Inc., 630 Third Ave., New York, N.Y. 10017, 312 pp., $13.95), is written by two authors who have had leftist literary connections, but, curiously enough, it ends up as quite a paean to the entrepreneurial spirit. The book is dedicated to the late Carey McWilliams, who knew his California but was never, in his career as a journalist, interested in capitalist solutions.

Kotkin and Grabowicz seem to be unaware of some of their own contradictions, which involve them in condemning Ronald Reagan for favoring businessmen during his term as governor and then, in a subsequent chapter, praising Governor Jerry Brown for going Reagan one better in putting entrepreneurs in his kitchen cabinet. The authors evidently continue to hold an ancient antipathy to Ronald Reagan for his "coziness with the blacklisters" in the days of the Hollywood Communist scandals. But when Jerry Brown switches gears to take over the California tax revolt of Howard Jarvis, thus jettisoning the "radical dreamers of the Tom Hayden camp," Kotkin and Grabowicz are quite complacent about it.

Brown, they say, "may yet emerge as the spokesman of an ascendant 'new class,' rich and powerful enough to sustain a long-term serious bid for national office." He has "finally stumbled on the secret of California's 'manifest destiny.' "

Whether Jerry Brown can maintain any consistency over the years still remains to be proved. But the "new class," as Kotkin and Grabowicz see it, is here to stay in California.

Men of Action

The Golden State was always hospitable to new technologies. Kotkin and Grabowicz spend very little time on California's famed kooks. They prefer to concentrate on the "doers," such as the men who brought water from the mountains to make deserts bloom. There was William Mulholland, the outspoken chief engineer of Los Angeles who raised the money in 1913 to build the aqueduct that has made modern Los Angeles possible. There were the oil men, John Paul Getty and Henry Salvatori. There were—and are—the great engineering firms of Fluor and Bechtel, who now build all over the world. And there was Henry Kaiser, who formed the "six companies" that created the sixty-stories-high Hoover Dam, which was completed two years ahead of schedule in 1936.

The son of Italian immigrants, Amadeo Giannini, ran his California bank with the "homespun guile learned in the produce trade," making loans to working-class people who would not have qualified for money back East. With knowledgeable branch banks all over the state, Giannini had the information at his finger tips to enable him to shift funds to match the seasonal needs of different crops and different farmers. When he retired he let his bank be controlled by an Easterner. He was quickly disillusioned by the Easterner's antipathy to innovative methods. To save the bank from collapse Giannini had to return from an overseas convalescence to take charge again. By 1945 the Giannini Bank of America had become the nation's largest bank.

Hollywood to Silicon Valley

Kotkin and Grabowicz take the movie men, William Selig, Sam Goldwyn and Adolph Zukor, for what they were, great entrepreneurs who understood the world's "desperate need for fantasy." Howard Hughes, who had gone West to make his name as a film maker, was a believer in the sales value of fantasy, too. But he was also interested in airplanes. His Hughes Aircraft Company, originally started as a lark, was ready for World War II. By the late Nineteen Forties Hughes, Northrup, Douglas, Lockheed and North American Aviation were all reaping the benefits of military contracts, as Hughes had predicted.

Litton Industries was the creation of "Tex" Thornton, a Hughes man who was one of the first to see the future in terms of data processing, guidance systems, digital computers and other advanced electronic devices. The California universities, notably Stanford, have fed industry in novel ways; Stanford engineering students, working out of their garages, have created billion-dollar companies. And "Silicon Valley," that stretch of coast south of San Francisco near Palo Alto, has become a synonym for what is colloquially known as high-tech. The silicon chip, which can store thousands of memory bits within the space of a dime, has made the modern low-cost computer age possible.

Japanese Influence

All of which brings Kotkin and Grabowicz to the Japanese, who are so good at taking over American innovations and improving on them. California does not see the Japanese as any great menace. As the ultimate assembly point for imports from Asia, California's location on the "Pacific rim" has helped produce more than a million jobs. California looks forward to becoming the financial center of "the Asian community." California agribusinessmen have built fortunes through serving as Japan's leading supplier of fruits and its second-largest source of cotton.

Governor Jerry Brown's advisers have counseled him to take the lead in making California a "Pacific rim" power, quite as if the state were a nation all by itself. Andy Safir, the director of the California Office of Economic Policy, puts the Brown Administration view in perspective. "There is a tendency," he says, "to look to imports for our industrial goods that used to come from the East Coast . . . now we look to Japan . . . for us the Japanese are a close market . . . you have in Japan an economy that can respond to specialized demands of a place like California while you have no such ability in the East."

The admiration for Japan has led to the adoption of Japanese-style management techniques by large numbers of California corporations. In the high-tech firms of Silicon Valley, tennis courts, swimming pools and running paths are supplied to employees, quite in the Japanese style. At the new San Francisco high-rise headquarters of the Shaklee Corporation one whole floor has been reserved as a sports and recreation center, all encircled by an indoor jogging path. "The purpose of the future revolution in the West," says Action Instrument's founder Jim Pinto, "is to eliminate the difference between workers, managers, and the owners by making all the same. If you are part of the place, you can do everything you can to increase efficiency and productivity. In many ways Action Instruments is very Japanese."

Despite their personal antipathy to Ronald Reagan and their partiality to Jerry Brown, Kotkin and Grabowicz see "Reaganism" as a continuing wave of the future. The California style, they say, is taking over the whole United States. High-tech enterprise will continue to keep the California spirit of entrepreneurship going strong. The odd thing is that Kotkin was born in West Germany and Grabowicz in Springfield, Massachusetts. But they are Californians now.