

Free to Try

The Foundation for Economic Education, Inc.
Irvington-on-Hudson, New York

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The Foundation for Economic Education (FEE) is a "home" for the friends of freedom everywhere. Its spirit is uplifting, reassuring, contagious: FEE has inspired the creation of numerous similar organizations at home and abroad.

FEE is the oldest conservative research organization dedicated to the preservation of individual freedom and the private-property order. It was established in 1946 by Leonard E. Read, and guided by its adviser, the eminent Austrian economist, Ludwig von Mises. Both served FEE until their deaths in 1983 and 1973, respectively.

Throughout the years the mission of FEE has remained unchanged: to study the moral and intellectual foundation of a free society and share its knowledge with individuals everywhere. It avoids getting embroiled in heated political controversies raging in Washington, D.C. Located in Irvington-on-Hudson, New York, FEE has remained a purely educational organization.

Since 1956, FEE has published *The Freeman*, an award-winning monthly journal with a long and noble lineage. Under the profound editorship of Paul Poirot it rose to great heights, always fighting for the timeless principles of the free society.

The *Freeman Classics* series of books reflects these heights, consisting of topical collections of great essays and articles published throughout the years. *Free to Try* is the fourteenth volume in the series. Also available: *The Morality of Capitalism, Private Property and Political Control, Prices and Price Controls, Public Education and Indoctrination, Politicized Medicine, Man and Nature, Taxation and Confiscation, Bankers and Regulators, American Unionism: Fallacies and Follies, The Spirit of Freedom, Inflation is Theft, The Lustre of Gold, and Leviathan at War.*

—Hans F. Sennholz

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Introduction

There is something thrilling and exalting in the thought of the future. It elevates human nature and makes man happier and better. The present does not satisfy; man reaches out to the future with its intimation of eternity and immortality.

Man does not have a knowledge of things to come. And yet, his blindness to the future does not deter him from preparing for it. Standing firm in the world of daily tasks, he is making preparations in all his aspirations, be they religious, cultural, social, or economic.

In the sphere of business all future-oriented activity is often called "speculation." The businessman who is building a plant or store speculates on future business conditions that will hopefully permit him to retrieve his investment. The merchant who places a purchase order for future delivery speculates on future demand for his merchandise. Even the young physician who chooses to settle in a certain community to build his practice speculates on the economic future of his community and the demand for his services. They all lack the knowledge of things to come, but are hopeful that future changes and developments will reward their present decisions. And they all are taking various measures of risk that flows from the uncertainty of the future.

And yet, all such future-oriented activity has come under a dark cloud of suspicion. It is more popular to live in the present for instant gratification of wants and desires. Public policy promises benefits and services now—even at the expense of the future. He who steadfastly keeps his eyes on the future faces censure and condemnation as a "speculator." In a strange twist of terminology the "now-generation" questions his motivation and denounces him as a "self-centered," "greedy" monster seeking profits from changes. Countless laws and regulations aim to seize his rewards and restrain him from searching for the future.

The conflict is as old as man himself. It arose on his first day on earth when he became aware of tomorrow. Was he to allocate his labors to the urgent needs of the moment or to the demands of tomorrow? The answer to this question provides an important explanation of wealth and poverty. Present-oriented societies linger in perpetual poverty always living from hand to mouth, while future-oriented so-

cieties soon prosper and multiply. It also gives rise to great differences in individual income and wealth, which in turn breed envy and covetousness and bring forth countless schemes and policies toward a new redistribution. It makes the successful entrepreneur a favorite target of envy to present-oriented individuals who fail to comprehend entrepreneurial and speculative activity. Preoccupied with the present, and chronically poor and always unprepared, they tend to suspect all those individuals who differ in outlook and life-style.

Speculation also upsets those politicians and officials who would like to guide and direct society. They are eager to direct the destiny of all, which they call "central planning." When some individuals shape their own plans and act independently of the central planners, it is "selfish speculation," "unplanned," "atomistic," "harmful," and "chaotic." When central planning fails dismally and inflicts great harm on countless victims, the blame is laid invariably on "speculators." When the stock market crashes and economic depression seizes the country, the speculators caused it. When the U.S. dollar falls in purchasing power and sinks to lower levels in world money markets, the speculators sold it. When central planning creates an energy crisis, the political planners denounce the speculators and impose more stringent controls on individual initiative. In fact, the speculator is depicted as the personification of all human vices and failings.

Such diatribes merely reveal the great schism that separates the two conceivable systems of economic and social organization: the private property order with its individual freedoms, and the command system with its political coercion in many aspects of social life. Man always must choose between these two modes of organization. For long periods of time he chose the command system under such labels as feudalism, mercantilism, fascism, socialism, or communism. But occasionally Western man chose to be free and independent, unconfined by political limitations and controls. The history of the United States provides a splendid example of such an order.

The free order is also a future-oriented order inasmuch as it permits its members to save and invest for a better future. It liberates man from ancient restraints and limitations that shackle his initiative and creative energy. In a free society the future takes the deepest root, and is most discernible, in the plans and aspirations of the great entrepreneurs and geniuses of enterprise. Through their actions and provisions for the future they greatly affect the daily lives of their fellowmen. Their names and exploits are familiar to most Americans. John D. Rockefeller, Andrew Carnegie, J. P. Morgan, and Henry Ford were dramatic leaders, bold and original, with visions of change and a

better future. Under their leadership and that of many other exceptional men the U.S. had become the most productive country on earth by 1893, and American wage rates and standards of living soared to the highest levels in human history shortly before World War I.

And yet, these men have become important symbols of an economic order that stands condemned in the eyes of many of our contemporaries. Textbook writers utilize them to illustrate personal greed and lust for power that allegedly characterizes the period of "unbridled capitalism." Contemporary literature censures them for the poverty and misery of their workers from whom the great fortunes allegedly were taken.

We need not dwell here on the great achievements of those exceptional men who affected the economic lives of so many Americans. Nor need we analyze the motive powers that drove those men to such performance. Their motives probably did not differ from those of most other men in other ages and places. But we need to be mindful that their very appearance presupposed a climate of individual freedom that is so rare in human history. Surely, they were "unbridled" with political edicts and controls, confiscatory taxation and regulation, and many other manifestations of the command order. They were left free to try and experiment, to save and invest for a greater future. No matter what we may think of them as individuals, we must admire the society that set them free and let them pass unencumbered by the strictures of envy and the demands of the moment.

Present-day Americans would never tolerate the exceptional man who creates new industries on the ruins of old production. There can be no Henry Ford in the present climate of our political economy. Under the influence of ancient ideologies modern man is suspicious of individual freedom that gives rise to economic inequality. He uses his political apparatus of coercion to maintain and restore some measure of equality. His tax collectors seek to extract the lion's share of "unearned" individual income and wealth. And his numerous officials in a host of regulatory agencies seek to restore equality and provide equal opportunity through stringent supervision and control.

Under the influence of old suspicions and prejudices modern man prefers to rely on political action rather than on voluntary cooperation. In the command order every individual is a wheel in a giant political machine and every sphere of his social life is politicized. And even where modern man has retained some democratic institutions, politics plays an important role in his life. Parliaments, which were originally set up to limit the profligacy of the rulers, are incurring huge expenditures on behalf of the electorate. To be the favorite of an envious

multitude, a politician must be on their level. He must desire what they desire, yield to their prejudices and substitute them for principles. Instead of enlightening their errors, he must adopt them. As a political leader he merely furnishes the sophistry that will defend and propagate those errors.

When he must choose between the needs of the moment and the demands of tomorrow, modern man opts for instant gratification of his wants and desires. He wants social benefits and services *now* through political redistribution and transfer. He preys on the richer members of his society, and when such revenues no longer satisfy him, he embarks upon massive deficit spending. That is, he consumes the savings of his more provident members. And finally, when their means no longer suffice to meet his insatiable demands for present benefits, he may consume his economic substance. In economic parlance, he may consume his productive capital, which previous generations created and left for him, and thus diminish the apparatus of production at the expense of future generations.

The future is purchased today. We have a number of choices. But all sales are final.

—HANS F. SENNHOLZ

I. FROM RAGS TO RICHES

A Triumph for Bootstraps Capitalism

by Clint Bolick

Ego Brown never fancied himself a crusader. His ambition is more that of a classic entrepreneur. His dream, as Mr. Brown describes it, is to "spread the shine" with shoeshine stands on street corners throughout Washington, D.C., and eventually in other cities as well.

The story of Ego Brown in many ways exemplifies the great American tradition of bootstraps capitalism: the methodical climb up the economic ladder by means of creativity, talent, and hard work. Indeed, Ego Brown's little enterprise took on added luster by providing employment opportunities to the homeless—a classic case of an entrepreneur doing good by doing well.

But along the way, Mr. Brown encountered an unexpected obstacle—a District of Columbia law that forbade him from pursuing his chosen business. This law and thousands of others like it form an oppressive barrier that prevents entrepreneurs like Ego Brown from earning their share of the American Dream.

The resulting battle for the right to earn a living free from excessive governmental interference cast Brown in the unlikely role of champion in the cause of economic liberty. His pathbreaking triumph is a beacon to others outside the economic mainstream that opportunity still exists in America.

An Entrepreneur in Action

Ego Brown launched his career after he quit his job as a voucher examiner for the Navy seven years ago. "I used to look outside and think about how good it would be to work for myself," he recalls. He cast about for the right opportunity to do just that. Mr. Brown quickly discovered a lucrative potential market in the thousands of scuffed shoes pounding the sidewalks of downtown Washington. "It's an image city," he says. "People care about their appearance and they wear nice clothes, but they forget about their feet."

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He set out to remedy this anomaly by providing the “finishing touch”—a quality shoeshine. Drawing upon the talent he developed as a youngster shining shoes for pocket money, Mr. Brown went to work. He started out in a barber shop near Howard University, but soon hungered for his own business. In 1985, he obtained a vending license from the District of Columbia, invested in a portable two-seat shoeshine stand, and set up shop at the corner of 19th and M Streets, N.W. Attired in his trademark tuxedo, Brown quickly attracted a large clientele for his distinctive “Ego Shine.”

Mr. Brown dismisses the notion that shoeshining is degrading to blacks. “I’m out to change that stereotype,” he says. “I’m a shoeshine *artist*. I provide a valuable service, and I do it with a touch of class.”

The success of his first stand encouraged Brown to expand his business. That’s when the idea of employing homeless people occurred to him. He recalls that “when I used to see these people on the streets, I’d dig into my pockets and give them money. Then one day I realized I wasn’t helping them. They didn’t need a handout. What they needed was an opportunity; a chance to lift themselves by their own bootstraps.”

Thereafter, Ego Brown enlisted workers from the ranks of the homeless. He provided his homeless recruits a shower, clean clothes, a shoeshine kit and training—and most important, a renewed sense of dignity. Brown estimates he employed as many as 20 homeless men, both black and white, at shoeshine stands in downtown Washington. His efforts were so successful, in fact, that a District of Columbia social worker regularly referred enterprising homeless people for the “second chance at life” Ego Brown offered.

But during the summer of 1985, these efforts came to an abrupt end as District of Columbia police shut down Mr. Brown’s business. They cited a 1905 law providing that “No permit shall issue for boot-black stands on public space.” Regulated vendors peddling goods and services ranging from hot dogs to photo opportunities with cardboard celebrities were allowed to operate, but shoeshine stands were prohibited.

Mr. Brown appealed to his elected representatives for help, to no avail. Although Mayor Marion Barry was calling for massive private sector assistance to cure the homeless problem, he ignored Brown’s plight, apparently preferring to have homeless people sleeping on the streets rather than earning their livelihood on those streets.

Thwarted by this anachronistic law, Brown struggled to stay in business by shining shoes in private establishments. But by late 1988,

he was a step away from the welfare rolls, his dream dimmed to a faint glimmer.

Sordid Origins

The District's shoeshine stand prohibition was a relic of the Jim Crow era. Governments during that time frequently placed severe constraints on economic activities pursued by blacks. Though ostensibly race-neutral, these laws were designed to prevent blacks from gaining economic self-sufficiency.

The shoeshine ban was such a law, adopted in a political environment permeated by racial bigotry. A 1906 District of Columbia Health Service report reflected the government's prevailing attitude when it spoke of blacks as "a race just entering what is termed civilized life."

The same District Board of Commissioners that adopted the boot-black ban took a number of other steps designed to subjugate blacks. W. Calvin Chase, editor of *The Bee*, Washington's black daily newspaper during this period, assailed the District government for erecting a public whipping post and enacting stringent licensing requirements for the building trades. Chase called the whipping post "a pet scheme to deter the white wife-beaters by whipping the negroes. The moment a white man is thrashed, the law will go out of business." Of the builder licensing requirements, Chase asked "[W]hat becomes of the minor builders, who are fully competent to construct a house, but not able to pass an examination?" (*The Bee*, January 7, 1905)

The shoeshine ban fit neatly into this pattern. According to the 1900 census, the public streets of Washington provided a means of living to 15 percent of the city's employed black male population as "bootblacks," "hucksters," and "peddlers." By prohibiting bootblacks on the street—hence confining them to hotels and barber shops as employees rather than independent entrepreneurs—the government eliminated an important outlet for economic self-sufficiency.

Today, oppressive economic regulations such as occupational licensing laws and government-conferred business monopolies proliferate at the state and local levels. These laws often far exceed legitimate public health and safety concerns. Like their Jim Crow antecedents, these laws are race-neutral but impose their harshest burdens on people outside the economic mainstream—primarily minorities and the poor.

From the Street to the Courtroom

For more than 50 years, the courts have consistently declined to protect entrepreneurs from arbitrary or excessive economic regulation. Moreover, establishment civil rights groups have ignored such barriers to opportunity, preferring to focus on social engineering schemes like quotas, business set-asides, and welfare.

As a result, in May 1988 the pro-free enterprise Landmark Legal Foundation launched its Washington-based Center for Civil Rights, which initiated a long-range economic liberty litigation program. The Center hopes to restore the basic civil right of individuals to pursue a trade or profession—a civil right that provided substantial impetus for many of the major civil rights laws, including the Fourteenth Amendment and the Civil Rights Act of 1964. The Center promptly filed its first economic liberty lawsuit against Mayor Barry and the District of Columbia on behalf of Ego Brown and two homeless men who worked for him.

In light of a half century of adverse legal precedent, the Center faced an uphill battle. The District cited scores of decisions in which the courts refused to strike down economic regulations, no matter how onerous. But the Center argued that the shoeshine ban went too far, violating the Fourteenth Amendment's equal protection, due process, and privileges or immunities clauses. Allowing the District to extinguish opportunities in this quintessentially entry-level business, the Center charged, would destroy economic liberty.

Ego Brown's lawyers suffered a setback in October 1988, when Federal District Court Judge George H. Revercomb denied an injunction on procedural grounds. But Judge Revercomb expressed strong sympathy for the merits of the case, declaring that individuals have a Constitutional right "to follow a chosen profession free from *unreasonable* governmental interference," adding that "the federal courts' role in protecting American citizens from unreasonable economic regulation has been one of the hallmarks of American liberty, prosperity, and progress." Heartened by Judge Revercomb's language, the Center pressed forward. Finally, on March 22, 1989, Judge John H. Pratt declared the shoeshine ban unconstitutional and permanently enjoined its enforcement. "We would have to 'strain our imagination,'" Judge Pratt declared, "to justify prohibiting bootblacks from the use of public space while permitting access to virtually every other type of vendor." The District is free to adopt reasonable regulations, he ruled, but may not altogether prohibit shoeshine stands.

An Entrepreneur Vindicated

Ego Brown's victory in the courts may signal a crucial turning point in the battle to protect economic liberty. The Center plans to use the *Brown v. Barry* decision as a building block for other assaults on excessive economic regulation, and already has filed a challenge to the Houston Anti-Jitney Act of 1924 on behalf of entrepreneur Alfredo Santos.

For Mr. Brown, the ruling means vindication and a chance to pursue his dream. His enthusiasm waned during the four years following the forced demise of his business. Brown remarked a week before the court decision, "I lose sleep because I can't understand why." But following his triumph, Ego Brown displayed the resilience that is the hallmark of a successful entrepreneur. "I plan to get back on the streets and prove—to myself more than anybody else—that my idea, my dream can become a reality." Asked if he feared competition from other shoeshine entrepreneurs, Brown replied to the contrary. "It would stroke my ego to see someone else out there with me," he said. "I would think I had something to do with that, that I inspired someone to go into business. I beckon competition."

And compete he will. Even before spring reached full bloom in the nation's capital, Ego Brown was back on the streets of Washington, pursuing his dream. His stand was booming, and homeless people were learning the trade. Well-wishers were streaming by yelling, "Way to go, Ego!"

For countless others like him, however, arbitrary barriers remain. For a nation whose moral claim is staked in its doctrinal commitment to opportunity, such barriers are a matter of shame. Challenging such barriers—securing for all individuals the ability to control their own destinies—is part of the unfinished business in the quest for civil rights.

But Ego Brown's successful struggle provides hope to would-be entrepreneurs that one day our nation will honor that basic opportunity that is every American's birthright—every American's *civil* right.

Davíd: From Beggar to Entrepreneur—In a Day

by Bruce Alan Johnson

The difference between education and intelligence is this: intelligence will make you a good living.

—Charles F. Kettering

The backstreets of Lima, Peru, are cobblestoned alleys of poverty and squalor. Yet, as G. K. Chesterton remarked, it is the task of the artist always to see beauty behind the masks of even the most depressing human suffering. To be sure, amid these narrow, winding lanes there are countless colonial balconies overhanging the cobblestones, many of them dating back to the early nineteenth century and all of them reflecting the grace of a departed era.

While walking in these backstreets one Saturday afternoon this winter, I heard a young boy's voice call out to me, in half-educated Spanish, "Señor, you got a hundred *soles* [about 22 cents] for a starving boy?"

I paused. Third-World cities are crowded with hungry children, many of them orphans, as families migrate to the cities in hopes of finding the employment that simply isn't available. When I turned around and saw him, I faced a boy of about ten or eleven years, with black hair and a torn T-shirt. He walked toward me, and his eyes fairly flashed with intelligence and the wariness that only the "street-wise" seem to acquire—a special toughness that is their very defense against the hustlers, the petty thieves, and the unprincipled.

"You're chubbier than I am!" I answered him, smiling.

"Yeah, well, it works on *most* tourists," he said lamentedly.

"Ah, but I'm not a tourist!" I thought I had him.

"I know. There's something about you. . . ." The street wisdom again? "Well, thanks anyway. *Hasta luego.*"

"I was just looking for a tamale and some good Peruvian coffee," I said in a loud voice as he turned away from me. "You know any good places?"

His eyes smiled back, and he approached me briskly. "*Amigo!* I

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know the best tamales in all of Lima!" I believed him. And he was right.

At a tiny, rundown tamale stand only a few kilometers from the crystalline glamor of the Sheraton, we stood and ate hot tamales wrapped in cornhusks. And drank coffee. I had seen suffering children all over the world, for years. I always had given them money, but what was it about this boy that told me there was something extra—perhaps something even redeeming? At this point, it was only a vague feeling.

"Señor," he said suddenly to me, "you like Peruvian wine?" Peru makes one of the best rosé wines in the world.

"You're too young to like wine," I said gruffly. At least I thought I had said it gruffly. But his eyes twinkled:

"Ah, señor, can one ever be too young to love the nectar of the gods?" Then I knew what had captured me: not just his obvious intelligence, but his passion and love for life. Despite the horrors of daily living on the streets—and off his wits—and despite the taunts of other children striving like him to eke out a bare subsistence, this boy had risen above them by seeing beauty where they saw terror, and by seeing hope where they saw only despair. I was hooked.

"¿Como se llama Usted?" I asked him, for it had just occurred to me that we didn't even know each other's names. I continued to address him in the polite rather than the familiar form used normally when talking with children. This he clearly was not accustomed to, and he responded enthusiastically. You've recognized my dignity, he seemed to be saying in return.

"David!" he answered with gusto. "¿Y Usted?" David. The slayer of Goliath. He who rose to greatness out of his love for his own people. I tried to shake off what was clearly only a romantic image of a small street orphan in the modern-day backstreets of a developing city.

"Bruce!" I answered back. But I knew he was not going to be able to pronounce it without considerable difficulty. I was taken aback when he modified it so quickly to suit his Spanish and his own sense of propriety:

"Ah, Señor Brúce!" he said with satisfaction, pronouncing the Scottish name BROO-say. I was quite used to this variation by adults, but had never heard a child adopt the name so readily. I was pleased.

He was licking the cornhusk wrappers of his tamale, and I took the hint to order him another. He beamed.

"David," I began, "What do you want to do? How do you want to live?" He obviously was not in school but, I was to learn later, he had taught himself to read phonetically, and was the proud owner of

two bedraggled copies of Miguel de Unamuno's novels, as well as an even more dog-eared paperback Spanish-English dictionary.

He stared straight into my eyes as he answered with resolution I had never heard in any child. "I want to have my own shoeshine business."

"Really?"

"Really!" A fierce determination underscored his answer—not arrogance, just the plain determination of someone who knew what he wanted and knew *somehow* that he would get it. How could anyone fail to be moved by this little boy's confidence and precocity?

Shoeshining is an occupation of thousands of young boys throughout the developing countries of Latin America, Africa, and the Middle East. Most of them use cheap polish and no skill in their craft, but it struck me at once that here might be an exception.

"David, going into business entails capital, and I know you know the meaning of that word. Have you any money at all?"

He reached into the side pocket of his tattered and filthy jeans, and withdrew a small bundle of 500-soles banknotes. Altogether, he had the equivalent of nine dollars. "Where did you get this?" It was a good deal of money for a small boy in Peru to have.

"I saved it from *turistas*." I believed him. Tourists—especially American tourists—typically have hearts of gold, and beggar children know this only too well. The next question was easy.

"David, I believe you. And I believe that you're serious about wanting your own business. I'll tell you what." His big eyes were fixed on mine, unmoving. "I'll be your venture capitalist, and I'll explain what that means. It means that I'm willing to provide the rest of the money you need for your venture, but only if you're willing to share part of your earnings with me: If I'm going to invest in you, I deserve a return on my investment. Fair?"

I had expected him by this time to look puzzled. I should have known better.

"But capitalism is evil—it's what makes us starve!" he spit back. It really wasn't surprising. Throughout the Third World, this time-worn cliché is being bandied about by sociologists and academics at an alarming rate. Now I was confronted by an inordinately sensitive and capable little boy who did not have the tools with which to refute something that I suspected he knew, inside, was false.

"David, in the years before your new President, did you live better or worse than you do now?"

"Things were not good before President Belaúnde," he replied. "My friends have told me bad things."

"Exactly. And that was because your friends were not allowed to practice what they wanted to do, and they were not allowed to keep what they had earned by their own hands. Right now in Perú, anyone in the country can make a living any way he sees fit, just so long as he doesn't break the law." He nodded. "David, I just paid this lady for some tamales and some coffee. Now, she's a capitalist because she's in business for herself. But when I paid her, who benefited?"

He paused a minute. "Well, I guess *both* of you did!" He knew he was right. His eyes showed me that he was beginning to catch on to an idea he had only felt before.

"Exactly! Now, what if she had wanted 1,000 soles for a tamale, rather than only 25?"

"Hey, amigo, you would have been a real *gringo turista* if you had paid that price!" He was genuinely excited, and it was contagious; two other customers at the tamale stand were watching us now, smiling.

"Yes, I would have been just that. But more likely, I would have refused to buy them from her, right?" He nodded again, enthusiastically.

"In a business transaction, the price of anything is determined not by what *you* want to charge, but by what the customer is willing to pay. In other words, the market reflects fairness, just so long as no one is allowed to get away with fraud."

"Well, amigo, there's a lot of jerks in this town, and they rip off everyone. . . ." I interrupted him.

"There's a fine line, David, between fraud and just foolhardy buying habits. If you get me to pay you, say, 100,000 soles in advance for a car, and then deliver me an old horse, *that's* fraud. But if I willingly walk up and buy your horse, after looking it over, even though I might know that neither the horse nor the price are such a good deal, then I'm just plain stupid. In other words, it's *my* responsibility to look after myself, not yours and not President Belaúnde's."

"Okay. *Bueno*. So how much am I going to charge?" Smart kid, but moving in the fast lane before he's learned to drive, I thought to myself, amused.

"What's the going price for a shoeshine in Lima?" I asked.

"I guess 275 soles," he answered quickly. About 65 cents.

"And do you think you'll be as good as the other boys in Lima? Remember, they're your competitors."

"I'm *better!*" he shouted. "I'm better than all of them!" He believed that, and so did I, because enthusiasm is the father of excellence.

"Now *that's* the spirit! Okay. So why don't you do this: offer a better service, and try charging just a few soles more for it. If you're

really that good, people will pay for the difference, quite happily."

"Really?"

I ruffed his hair. "Really!"

I put my arm on his shoulder and pulled him back into the lane. "So let's go and get your equipment," I said. It was like suggesting a glass of water to a parched desert hiker.

As I had expected, young David had picked out his equipment weeks before, in hopes that he might somehow be able to buy it soon. In a small, dingy, general-goods store, we found a shoeshine box, well used. We then went around the corner to a shoe repair shop to find the polish, brushes, and rags he needed. Altogether, the total came to about \$18.00. (Shoe polish is imported from North America, and goes for a very steep price, after customs duties are added.) So David was in debt for \$9.00.

Now it was my turn to be eager. Where had he decided to set up shop?

"At the Plaza San Martín!" He responded.

"What? Along with twenty other shoeshine boys?" It was time for a little marketing lesson.

"Yeah, but I'm *better*, remember?"

"And those twenty competitors already have their steady customers. So how are you going to break into a market that's already filled?" I tried to be firm without sounding disappointed in him.

"*Está bien*. But where can I go, where there's lots of people?" He was sincere in his concern. Plaza San Martín was one of the central hub areas of Lima.

"The Sheraton Hotel, David." I handed the shoe box over to him. "That's where there are busloads of *turistas* with big hearts and lots of dusty, dirty shoes!"

He was grinning broadly now. "Ay, *gringos!*" I wasn't sure I liked his enthusiasm this time.

On our way to the Sheraton, we discussed the fact that there were already a few boys shining shoes near the front door of the hotel. "But there aren't *twenty* of them, are there?"

We talked about fairness, and about competing without harming the other boys. Their skills should be the only standard by which they will win business. Besides, I urged him, sometimes there will be more *turistas* outside than he could handle, so sharing the business was in the best interest of everyone. He accepted this, but grudgingly.

Moments after arriving at the Sheraton he popped the question that I had completely overlooked. "Hey, Señor Brúce—how much do you get from me? Half?"

I paused to study this young entrepreneur with the stained jeans. "One percent," I answered. He stared back.

"How much is that?" I had forgotten that his education was sparse.

"That means I get one *sole* out of every hundred you collect," I answered.

He beamed. "You *are* a *gringo*, amigo!"

Five minutes later, I had talked an unsuspecting British tourist into stepping outside for the best shoeshine of his life. "Oh, really now," he had objected, "I don't at all take to these little urchins rubbing cordovan polish all over my slacks, you know, what?"

Yes, I knew. But, a few minutes later, he acquiesced, probably out of intrigue for this strange Yank who was so taken with the little enterprise.

We approached David with some trepidation. After ascertaining that the hesitant British gentleman spoke only tourist Spanish ("How much is that in *real* money, *por favor?*") I looked sternly at my young charge.

"David, if you use the wrong color or get one smitch of polish on this man's slacks, I'll chase you all the way over the Andes into Ecuador!" He knew I meant it, but he was amused nonetheless.

His brown eyes said, "Okay, boss!" My own eyes said, "Maybe I'd better go up to my room until this is all over and done with."

David went to work with a ferocity and steadiness that was intoxicating. I decided I didn't need to disappear, after all. Even the British gentleman was taken aback by the skill that this little boy was displaying—snapping his polish cloth about with the same panache as Jascha Heifetz wielded a bow. Moments later, it looked as if David had created a new pair of shoes. I was visibly relieved. So, I could tell, was his first customer.

"That is a smashing job, young man!" said the man.

David looked at me, puzzled. "¡Fantastico!" I flashed back. He grinned proudly.

"How much do I owe you?" David, of course, knew the words "how much," probably in more languages than Berlitz. He looked at me. I turned both palms up, to signify that it was his decision completely. I only hoped that he had done a minute's thinking about what we had discussed that afternoon. He had.

"*Trescientos soles, por favor, Señor!*" I smiled. Three hundred soles—three and a half cents above the competition, for a job worth much more.

The British tourist dug into his pocket and withdrew a 500-soles

note. "This is for an outstanding job!" he said, handing it to an overwhelmed David. "And I've got a few others in my group who I'll send out to you later this afternoon. Cheers!"

Cheers, indeed! Here before me stood a young man with tears in his eyes, staring hard at the first money he had ever *earned* in his life. I knew the feeling, and you know it, too.

I winked at him, and turned on my heel to go back into the Sheraton—this time to stay.

I returned to my room on the sixteenth floor, and began to write reports associated with my own employment. But from time to time I peered over the balcony of my room, only to see young David slaying the Goliath of competition he never feared, and only once did I see him without a customer. I laughed as I watched him develop a style that never failed to hook a passerby: He would bow stiffly to them, and say in an unhalting voice, "Señor, I am zee BEST!"

A few hours later, after sunset, my phone rang. It was the concierge in the lobby. They had, he said, caught a little street urchin trying to sneak up the elevators to my room, but before they threw him out they felt they should call me, because he kept threatening them that I would "chase them over the Andes" if indeed they threw him out.

"Señor," I said as formally as I could, accenting every syllable, and carefully trilling every "r," "That young street urchin is my business partner. Send him up at once!" I couldn't see David's face, of course, but I could picture him drawing himself up to his full four-foot height, dusting off his shoe box, and marching smugly to the elevators.

When I opened my door, he held out his hands. They were piled high with 100-soles coins, atop a stack of 500-soles notes. I was astonished.

"I don't know how much is yours, Señor Brúce, but I must pay you," he said quite seriously. We counted the money. He had earned enough to pay back my \$9.00 investment, and to pay me my return of 1 percent, which itself amounted to 12 soles, or 2.7 cents. He was left, at the end of his first day, with the equivalent of \$2.70. But he knew that from here on he was going to make a good deal of money, now that his initial debt had been paid off in full.

As he turned to leave, he extended his small, polish-covered hand. "Señor," he said softly, "Someday I will have enough money to come see you in America!"

I gripped his hand firmly. "David, that's a wonderful thing to say. But there's plenty of time for that. You've got a lot to give to *Perú!*"

A few moments of silence passed before he looked up at me. "I will give it," he said, and I released his hand.

He stopped and turned back on his way down the hall. I thrust out my hand, with my thumb pointed firmly upwards. “¡Arriba!” I shouted down the hall. Upwards!

“¡Arriba!” he shouted back, arching his free arm into the air. Then we both laughed, for dangling precariously from his blackened thumb was a polish cloth.

Entrepreneurs and Their Gifts

by Jane S. Shaw

The Terrapin Station is a new restaurant in the basement of an old hotel in Bozeman, Montana. At the end of a dingy hallway you suddenly come upon a place that's spiffy and charming, where the tables glitter, as the wine glasses—gaily filled with colorful napkins—reflect the light of kerosene lamps.

What makes this place exciting and heart-rending at the same time is that the proprietors are doing something outlandishly extravagant and probably foolhardy. They are providing a gourmet seafood restaurant for the middle of southern Montana.

You may not know much about Montana, but it's nearly a thousand miles from an ocean and hundreds of miles from almost anything else. Bozeman is a town of 25,000 people. Most of them don't have a craving for seafood, since Montanans grow up on hamburger or beefsteak. And the proprietors aren't selling mere seafood—they are selling exotic preparations such as blackened red snapper and bluefin tuna!

But that's the way it is with entrepreneurs. They take unpromising locales and rough raw materials and try to fashion them in accord with an idea glowing in their minds—a new offering that will appeal to the customers that they believe (against all odds) are there. That's why author George Gilder calls entrepreneurs "givers," people who give first and receive rewards later—and they are rewarded only if people voluntarily pay for what they've been offered. Frequently, few people choose to pay and the business doesn't last very long.

Sometimes, of course, enterprises succeed. Times change, new people move into town, tastes develop. Maybe this time it will work.

Thanks to an ever-renewing crop of such entrepreneurs, little Bozeman has riches beyond anything one could rationally expect—a store devoted exclusively to doll furniture, a nursery that supplies African violets only, two upscale kitchen boutiques, three high-toned wine shops, and a bookstore that carries the *New York Times Book Review* and books by Anne Tyler and Barbara Pym.

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The trouble is, a lot of shops don't last very long. At any one time, the Bozeman you see is a snapshot that will never be the same again. In the past two years, I've seen restaurants, exercise clubs, food stores, clothing shops, and furniture outlets come and go.

Shops rarely go bankrupt. According to Dun and Bradstreet, all of Montana had fewer than 200 bankruptcies in 1985. But businesses change hands frequently and for little cash. A flower shop, I hear, sold for \$3,700 several years ago—about what it had cost a few years before. Statistics show that at any one time about one in seven of all the businesses in our county is less than a year old or has changed hands within the year. New optimists take the place of old ones, renting out empty storefronts as others close their doors. I used to worry when I saw a "going out of business" sign, anticipating a great loss, but now I know that some other expansive soul will replace the one who lost his shirt.

An economist recently observed that we get more goods and services in Bozeman than we deserve. What he meant is that—as a result of all these eager entrepreneurs—we don't pay the full cost of the goods and services we buy. Instead, the providers pay in the form of lost profits and lost fortunes. We, the consumers, are the beneficiaries.

I haven't been able to determine whether the turnover in Bozeman is greater than in other places or just more visible. While Montana's bankruptcy rate is lower than that of the majority of states, bankruptcies are a relatively rare phenomenon everywhere, and bankruptcy figures don't begin to reflect the change of ownership that is so noticeable here.

If the turnover is greater here, it is because people like it here. The romance of the West and the freedom of the outdoors attract people. There isn't much in the way of employment, so people bring their own—using up their grub-stake from back East to start shops, restaurants, and businesses. They run them until their patience or their money runs out.

A business can't operate over the long run unless it makes a profit. But Bozeman's experience suggests that an endless succession of businesses can operate without profits—as long as there are romantic optimists to take up where the disillusioned leave off.

Gilder says that entrepreneurs "orient their lives to the service of others." They may not mean to do it at such great expense to themselves, but as I sip chardonnay at Terrapin Station and contemplate the blackened red snapper, I am grateful.

The Economics of Errant Entrepreneurs

by Israel M. Kirzner

A recent stimulating *Freeman* article by Jane S. Shaw (April, 1987) provocatively drew attention to some of the benefits derived by society from entrepreneurial daring and imagination—even when it turns out that these are expressed in ventures that lose money and eventually fall by the wayside. Ms. Shaw cites a spiffy and charming new restaurant in Bozeman, Montana, serving gourmet seafood. She judged the venture to be “outlandishly extravagant and probably foolhardy,” and suspects that the opportunity she enjoys of contemplating blackened red snapper in a pleasurable setting may turn out to be expensive for the restaurateurs, but is grateful for the opportunity nonetheless. Ms. Shaw recognizes that no business can operate over the long run without making a profit. But, she concludes, “Bozeman’s experience suggests that an endless succession of businesses can operate without profits—as long as there are romantic optimists to take up where the disillusioned leave off.” Ms. Shaw sees this as an illustration of George Gilder’s conception of entrepreneurs as “givers,” as economic agents who “orient their lives to the service of others.”

Ms. Shaw’s piece got me thinking. Most discussions of entrepreneurial energy, daring, and vision see *profitable* entrepreneurial activity as largely responsible for capitalist success. Ms. Shaw is pointing out that *unprofitable* entrepreneurship offers social benefits, too. Should we, then, celebrate capitalism not only because it stimulates profitable entrepreneurship, but because it stimulates unprofitable entrepreneurship as well? Should we indeed view entrepreneurs who lose money as unselfish benefactors of market societies? Does the “social” perspective suggest that young people should be encouraged to become independent entrepreneurs—even where we judge them likely to lose money—on the grounds that even erroneous entrepreneurs are socially beneficial?

A little thought will convince us, and I believe that Ms. Shaw would thoroughly agree, *not* to arrive at affirmative answers to these questions on the basis of Ms. Shaw’s observations. There may be nu-

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merous benefits to society that derive from entrepreneurial error—but such benefits are likely to be far out-weighted, in the judgment of most observers, by the *harm* caused by entrepreneurial errors. I shall later argue, in fact, that there is only *one* benefit to society arising out of unprofitable entrepreneurship that deserves to be treated as a fundamental advantage. All other benefits, while we may indeed be grateful for them, are likely to be enjoyed at the expense of more serious disadvantages both to others and to ourselves.

A profitable entrepreneurial venture benefits society in a way central to the logic of capitalist success. If an entrepreneur hires productive services for one million dollars and produces consumer goods that are bought for two million dollars, this means that services that might otherwise have produced goods judged to be worth not much more than one million have, in fact, produced goods that are much more valuable to market participants, as measured by money offered. An unprofitable venture, on the other hand, has *harmed* society insofar as it is likely to mean that it has used valuable, scarce social resources to produce goods worth *less* than other goods that could have been alternatively produced.

As Ms. Shaw has pointed out to us, however, it should not be thought that *no one* in society has benefited from a losing entrepreneurial venture. Clearly those who voluntarily sold to and those who voluntarily bought from losing entrepreneurs, did well for themselves as do *all* participants in voluntary exchange transactions. Moreover, Ms. Shaw seems to suggest, not only does one who dines in an excellent, but money-losing, restaurant, gain from the venture, others do too. That is, we gather, because the parade of ever-changing opportunities offered by imaginative entrepreneurs undeterred by the losses of others, is itself a fascinating sight to watch, even if many of them, being unprofitable, are likely to disappear after a brief moment in the sun. Despite all these benefits derived from unprofitable entrepreneurial ventures, we must recognize that few thoughtful observers are likely to judge that, all in all, the members of society should be grateful for this outpouring of entrepreneurial errors. The truth is that each and every entrepreneurial error represents a tragic waste of resources. For every beneficiary of such error, there are likely to be many whose lives, in consequence of this error, are poorer and less fulfilled than was in fact necessary. These victims of entrepreneurial error may never know that they are being harmed by these errors. In fact no one may ever know what alternative products these unprofitable ventures have precluded. As Henry Hazlitt taught us, the true costs of waste are always unseen—yet are nonetheless real and poignant.

The case for capitalism, for free entrepreneurial entry, does not and should not rest upon the possible residual benefits that some may derive from unprofitable entrepreneurial ventures. The great economic virtue of capitalism lies in its ability to stimulate vigorous and imaginative entrepreneurs who create *profitable* enterprises. In this way resources come to be deployed usefully for purposes whose urgency or feasibility had hitherto been overlooked. The virtues of capitalism rest not on any supposed altruism evinced by entrepreneurs who lose money while catering to the tastes of a too-narrow group of consumers, but on the daring and judgment of entrepreneurs who see socially valuable opportunities before others do.

In fact, the one really valuable feature of unprofitable entrepreneurial endeavor lies in its crucially important role in stimulating *profitable* entrepreneurship. Only in a society where entrepreneurs are free to make errors, can we expect an outpouring of entrepreneurship to lift its economy to new, hitherto unglimped, heights of prosperity. Only where potential entrepreneurs are free to follow the lure of profits as they see them, will there be the unleashing of entrepreneurial vision, daring, and judgment that creates profits in fact—and in so doing, creates new, more valuable ways of utilizing resources.

To be sure, errant entrepreneurs suffer losses, and it is precisely because entrepreneurs with poor judgment are likely to think twice before jumping into dangerous waters, that such erroneous leaps are likely, to some extent, to be discouraged. Moreover, as Ludwig von Mises pointed out, it is likely to be those entrepreneurs who in the past have exhibited sound market judgment, who will have accumulated the capital funds that are now able to be channeled into new entrepreneurial ventures. Hence, the central social gain from losing entrepreneurial ventures is derived not by individuals unusual enough to enjoy the output of these overoptimistic ventures, but by all members of society insofar as they stand to gain from *superior* entrepreneurial judgment—a quality standard enforced by the severe discipline imposed on errant entrepreneurs, and stimulated by the freedom of market participants to follow their dreams and hunches as they, and they alone, see fit.

This freedom will, to be sure, always attract a stream of entrepreneurial fools and romantic optimists. But the incredible successes of capitalism do not depend on such follies; they depend on the stimulus the system provides to farsighted, clear-visioned entrepreneurs who are, at all times, competing away resources from foolish ventures towards more judicious, more accurate, dreams and aspirations.

Women and the Market

by Sam Staley

The U.S. economy is faced with one of the most difficult challenges of the century. A dramatic shift in the labor market has occurred during the 1960s, 1970s, and 1980s which significantly affects the direction and composition of the hi-tech, hi-touch economy of the information society. The huge influx of working women over the past two decades has created enormous economic and political pressures, pushing the issue of discrimination to the forefront of political and economic debate once again.

As a group, women are unquestionably discriminated against in the market place. Women often have fewer skills, are more inexperienced, and more likely to leave the labor market than are men. Further, men often preclude their advancement, whether consciously or unconsciously.

Faced with these impediments, what are the most effective means for women to achieve economic success? While many have chosen political solutions, legislated approaches to the problems of discrimination have failed. Laws rarely change fundamental attitudes and prejudices. At the same time, however, a growing number of women are trying a much more effective approach: entrepreneurship.

In a market economy, economic development can only occur through initiative, innovation, and, above all, risk-taking. Contrary to popular belief, the market has a long and successful history of taking people of all ethnic and racial groups from "rags to riches."

The market, however, works in a subtle way that few people fully comprehend. A market economy is driven by entrepreneurship which thrives on providing a socially desirable product efficiently and effectively. It is only through the utilization of means compatible with the market that any person or group can succeed.

Women now make up 44 percent of the work force. The number of women re-entering the work force soon after childbirth rose to 57 percent in 1985. This feminization of the work force has dramatically

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altered the scope and dynamics of the economy, and, contrary to popular belief, the economy is responding accordingly. Business increasingly realizes that it must cater to the needs of women if it is to remain competitive, and herein lies the real opportunity for economic progress.

"One of the most interesting things I see happening in the late 20th century is that the corporation is changing because women are starting to participate in it," observes economist Jennifer Roback. "Women's greater participation benefits small companies at the expense of big ones. Big companies are not willing to be flexible about child care and maternity leave and home emergencies. Small businesses can handle things like that, and, in particular, your own business can handle it."¹

Twenty-four percent of all the businesses operating in the United States are owned by women, accounting for \$98.3 billion in receipts in 1982. While these businesses are still concentrated in low income service companies (over half earned less than \$5,000 per year), their representation is increasing. The 1986 White House Conference on Small Business in Washington, D.C., serves as one indicator: participation by women doubled from 1980 to 35 percent of all delegates.

More important, however, is the service orientation of these businesses. Service-oriented businesses, which are becoming increasingly important in the innovative information society, offer unique opportunities for many women. First, they often are labor intensive, requiring little capital but many hours of work to succeed. Second, they can be started on a small scale and built over time, utilizing skills that can be developed in the process. Third, they often do not require, immediately, the complete commitment of the entrepreneur. These businesses can be started relatively easily and have extraordinary possibilities for growth.

Ironically, these types of businesses have often fueled the development of other minority groups facing severe discrimination. Asian-Americans, for instance, started out in labor-intensive industries such as laundries and restaurants. Indeed, the experiences of other groups lacking suitable job skills, experience, and capital indicate that the process of entrepreneurial development applies to many sectors of the population.

The Legacy of the Market: Ethnic Enterprise

Traditionally, economic success for minority and disadvantaged groups has come through business not politics. Jews, Asians, blacks,

and Hispanics have all succeeded in the American economy through employment in small businesses or entrepreneurship, whether in storefront shops or professional careers. No group has been successful in using the political system to affect significantly their relative income. In fact, "some of the most dramatic rises from poverty to affluence in the United States have been among groups who did not attempt to use the political route to economic advancement"2

Table 1 provides statistics about various ethnic groups and their relative family incomes. Notably, the groups with the highest family incomes have faced severe discrimination based on their ethnicity and race. However, racism has not prevented the Jews, Japanese, or Chinese from becoming economically successful in the United States. Furthermore, these groups have not been favored by government intervention.

Table 1: Family Income by Ethnic Group

Ethnic Group	Relative Income (percent of national average)
Jewish	172
Japanese	132
Polish	115
Chinese	112
Italian	112
German	107
Irish	102
Filipino	99
West Indian	94
Mexican	76
Puerto Rican	63
Black	62
American Indian	60

Source: Sowell, p. 8.

The key element of economic success for these ethnic groups has been their relative concentration in business and enterprise. Indeed, aside from the well-known position of Jews in business, the Chinese and Japanese have a long history of entrepreneurship stemming from their immigrant background in the United States. "[T]he social histories of Americans of Chinese and Japanese descent," writes sociologist Ivan H. Light, "offer empirical illustration of the manner in which

poverty, discrimination, and ethnic visibility stimulated business proprietorship among some disadvantaged immigrants."³ For example, almost 12 percent of Koreans are self-employed, while 7.9 percent of all Japanese and 7.6 percent of all Chinese are self-employed. These percentages are well above the national average of 6.8 percent.⁴ Despite extreme discrimination against Asian-Americans in the past, they remain one of the most upwardly mobile income groups in the United States.

The recent experience of Korean immigrants most dramatically illustrates this phenomenon. Ethnic and immigrant businesses provide an essential alternative to the general labor market. Self-employment helped Korean immigrants overcome tremendous disadvantages in the work place and attain more secure work at higher incomes, accelerating the pace of social mobility. Immigrants face many of the same disadvantages as native born minorities (including women), and, in many cases, the discrimination is more severe: "Immigrant doctors, pharmacists, engineers, or attorneys may pump gasoline in service stations, but they are looking for escape from this level of employment. Hence, their labor force disadvantages (poor English, unrecognized professional degrees, under- and unemployment) confer on educated immigrants a motive to open their own businesses." Further, these groups maintain a propensity toward self-employment through successive generations.⁷

For minorities, especially immigrants, the market has allowed them to take advantage of their undervalued human capital. Instead of attempting to overcome institutional barriers to social mobility, many minority groups have chosen the entrepreneurial route to success. Asian-Americans in particular have much higher rates of self-employment than other groups.⁸

Women and Economic Change

The market provides a remarkable opportunity for women as well. When people shop for services in the Yellow Pages, or buy a product on the supermarket shelves, they do not check the ethnic background or sex of the producer.⁹ Sexual discrimination, like racism, cannot be legislated away.¹⁰ By participating in the market, and taking advantage of the renewed trend toward small companies and entrepreneurship, women will make more headway against discrimination than at any other time in their history.

The problem, however, is much more complex than getting more women into business. Corporations, with their hierarchy of power-

brinksmanship, allow men to exercise their prejudices to the detriment of women. While some have made progress in hiring women, large corporations often institutionalize impediments to progress. Furthermore, men may not realize that they are discriminating. In a recent *Woman's Day* survey 81 percent of the women polled felt that men underestimate them in the work place.¹¹ Since men often dominate decision-making in larger corporations, women are often fighting the perceptions of their male supervisors.

Yet, with the current trend toward an economy driven by smaller corporations, the prospects for women are looking better. The 1980s is hailed as the decade of entrepreneurship, and companies such as Federal Express and Apple Computer successfully challenge corporate giants. Deregulation has sparked entrepreneurship in many sectors of the economy, and this trend has clear implications for the role of women.

Jennifer Roback notes that "We are starting to observe a strengthening of the smaller firm as opposed to the larger firm *because* the small firm can accommodate the other needs that women have in their lives."¹² Women are beginning to dominate the labor supply, and newer and smaller firms have the managerial flexibility to more effectively utilize female workers. As Table 2 illustrates, women are currently concentrated in flexible, service-oriented firms. Many, such as personal services, allow for future growth, building from the ground floor up.

Table 2: Ranking of Women-Owned Businesses

Personal services	419,113
Real estate agencies	225,551
Health services	128,389
Restaurants	66,811
Special trade contractors	47,219
Food stores	37,635
Apparel and accessory stores	29,130
Wholesale trade, non-durable	22,231
Total Women-Owned Businesses:	2,884,450

Source: 1982 U.S. Economic Census¹³

Despite their large numbers, however, women are still relative newcomers to the economy. In the past, significant economic progress has not occurred for a generation or two. While this may seem slow,

no other system has permitted faster change or growth for any particular group. In fact, the free market is often derided for the pace of economic and cultural change inherent in it as a social system.

Implications

The influx of women, like immigrants in the late nineteenth century, has created an imbalance of resources in human capital. This condition, however, merely sets the creative and innovative forces of the market in motion. As long as it is free to change, the economy will adjust. In effect, the market economy is driven by a "causal loop" between resources and human wants.¹⁴ The evolution of the market society has created institutions which distribute natural resources (including people, human capital) so that the most valued wants of society are met.

In achieving this, the market has developed an amazingly diverse, decentralized economic system unparalleled in the modern world. "This diversity in the forms of economic life is important not for its own sake but because it is an earmark of successful adaptation and full utilization of the resources available. The thematic terms are thus *autonomy, experience, and diversity.*"¹⁵

Women, like various minority groups, may find that their talents, skills, and needs are best met outside the corporate world and in the realm of small business. By moving into entrepreneurial enterprises, they are more likely to expand their own opportunities and open up the road to economic progress. The ultimate result of this challenge is a more competitive and more productive society.

Rather than attempting to find political solutions, then, women should be moving into the market through their own business ventures. Instead of regulating policies and practices of existing businesses, women should be setting the standards for future generations by providing more efficient and effective alternatives in the market. Instead of mandating the approval of men in existing corporations, they should be maximizing their effectiveness by providing a better product cheaper within an economic climate suitable to their needs and wants.

Thus, the needs of women in the market may be better served by deregulating the economy—by allowing people to provide capital to new and "risky" businesses without the burdensome rules of the Securities and Exchange Commission or potential regulation of the Federal Trade Commission. The key to the success of women and minorities is access: protecting the ability of all people to enter the market and

provide products that consumers desire without paternalistic and counterproductive restraints perpetuated by the state.

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 4. Ivan H. Light, "Immigrant Entrepreneurs in America: Koreans in Los Angeles," in *Clamor at the Gates* (San Francisco: Institute for Contemporary Studies, 1985), p. 170.
 5. Light, 1985, pp. 172-178.
 6. Light, 1985, p. 175.
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 8. See Table 1 in Light, 1985, p. 170, for a breakdown of statistics on self-employment of ethnic groups.
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 11. Reported in Dayton, Ohio, *Journal Herald*, June 26, 1986, p. 25.
 12. *Cato Policy Report*, p. 9.
 13. Reported in the Dayton, Ohio, *Journal Herald*, August 7, 1986, p. 30.
 14. Nathan Rosenberg and L.E. Birdzell, Jr., *How the West Grew Rich: The Economic Transformation of the Industrial World* (New York: Basic Books, Inc., 1986), p. 33.
 15. Rosenberg and Birdzell, p. 33.

Home-Based Work: New Opportunities for Women?

by Joanne H. Pratt

The activities of women in the labor market reveal two contradictory trends. On the one hand, women are better educated and have more job skills and training than ever before. On the other hand, a substantial number of women are leaving executive suites and returning home to have children and care for their families.

Is there a way for women to resolve the conflict between the career goals for which they have been trained and the family goals that many want to pursue? For many women, the answer is home-based work. Surveys show that:

- As many as 23 million people are using their homes as a place of work.
- Among businesses that are run exclusively out of the home, more than 70 percent are run by women.

Women are taking advantage of a number of important economic and technological trends. Advances in computer technology mean that millions of workers can "telecommute" from their homes. The growth of the service economy is opening the doors for millions of small businesses. Most are being launched from the home.

- Of the 8.2 million sole proprietorships in the United States in 1980, 63 percent were located in someone's home.
- While the number of new sole proprietorships is increasing at a rate of 3.7 percent per year, those started by women are increasing at a rate of 6.9 percent per year. Despite the enormous economic and social benefits created by home-based work, those who work from their homes face a maze of legal uncertainty arising from Federal, state and local regulations.

Ms. Pratt has published extensively on home-based work. This article appeared in the May 1988 issue of *The Freeman*.

Local Laws. About 90 percent of all U.S. cities place restrictions on home-based work. These include requirements that no outside employee may work in the home; only one family member may work in the business; only one business may be operated from each home; only one room of a house may be used for business purposes; a separate entrance must be maintained for business customers, and no business inventory may be stored in a garage. Among the many and sometimes bizarre regulations:

- In Blaine, Minnesota, a home-based tutor in math, English or a foreign language may not tutor more than one student at a time.
- In Long Beach, California, ministers, priests, and rabbis may not give religious instruction in the home.
- In Dallas, Texas, home-based businesses may not be listed in the yellow pages of the telephone directory.
- In Danville, Illinois, no one may sell goods in a home other than by filling an order previously placed by telephone.
- In Southern Pines, North Carolina, there is a total ban on retail sales in the home and no inventory may be displayed in the home.
- In Downey, California, a garage may not be used for home-based work.
- In Rockford, Illinois, there can be no more than one home occupation in any single residence.
- In Chicago, there is virtually a total ban on home-based work, including a ban on connecting a home computer to an office computer.

State Laws. Many states ban entire categories of products from home production. These include cigars, artificial flowers, articles of food and drink, toys, dolls, bandages, purses, feathers, children's clothing, and cosmetics. When home production is allowed, it is often restricted to a small part of the labor market:

- In Hawaii and Illinois, the only people allowed to work in the home are people who are unable to leave the home.
- In Massachusetts, no one under contract with an employer or business outside the home may produce goods in their home.

Federal Laws. After a protracted court battle, the U.S. Department of Labor has managed to liberalize restrictions on home knitting. However, federal law still bans home production (for sale) of women's garments, embroidery, handkerchiefs, jewelry, buckles, mittens, and gloves.

Many of these regulations needlessly interfere with valuable economic activity and have no apparent valid social purpose. They threaten to stifle one of the most important and growing sectors of our economy, and to place obstacles in the way of the economic and social goals of an ever-increasing number of women.

Computers and Capitalism

by John Jefferson Davis

It is an increasingly obvious fact of contemporary American life that the computer is having a pervasive influence on the way we work and live. What is not so obvious is that the computer is beginning to challenge some of the most widely held assumptions about the nature of our economic system. Specifically, the invention of the microprocessor has helped to make obsolete some of the most common objections which the free market system has faced during the last several generations.

"Capitalism leads to excessive market concentration." This criticism is at least as old as Marx himself. Capitalism, it is said, inevitably leads to monopolistic concentrations in each industry which ruthlessly suppress the competition and which leave the consumer at the mercy of a few powerful producers.

A corollary of this criticism is that capitalism leads to social inequality as well: not only is production concentrated in fewer and fewer hands, but wealth itself, the fruit of production, is concentrated in fewer and fewer hands as well. "The rich get richer, and the poor get children." An increasingly stratified society, with the poor at the mercy of the wealthy ruling classes, with little hope of upward social mobility—such is the popular image of the results of the free market.

It should be noted, of course, that the criticism of excessive concentration of the means of production boomerangs against the socialist critic. In a socialist system the state has a monopoly of the means of production, and society in effect becomes one large company store, with all the potential for abuse and inefficiency which that entails. A thoroughgoing socialistic system is in fact the prime example of monopolistic concentration in economic life. The Communist Party of the Soviet Union exerts far more power in economic life than Exxon or Gulf Oil could ever exert in the petroleum and energy industries. Exxon cannot send its competition to prison; the Communist Party can.

The facts of recent American experience do not support the "exces-

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sive market concentration" criticism. Especially in the rapidly growing fields of computers, data processing, and electronics, new firms are challenging the dominance of older firms such as IBM. New fortunes are being made almost on a daily basis, and a whole new generation of bright and energetic young entrepreneurs has appeared on the international scene to vindicate the wisdom and productivity of the classical free market.

The Computer-Based Economy

In the new "Information Age" economy created by the computer, creativity can be richly rewarded, age is no barrier to success, and entry into the marketplace has never been easier. In the new world of the computer-based economy, "breaking in" does not necessarily require vast amounts of steel and concrete and capital, but rather new ideas, a willingness to take risks, and imaginative insights into new applications of the burgeoning computer technology. A new insight, a knowledge of programming, and access to a computer terminal are all that is needed to launch a new software enterprise.

James Nitchals is now 21 years of age, runs his own computer software company, and expects to make his first million dollars before he is 25. Rob Fulop is only 25, but is already making more than \$100,000 a year, drives an expensive BMW and owns his own town house near San Francisco. Nitchals and Fulop are examples of a successful new breed of young video and computer game designers that are leading the way in a new industry that already generates more than \$1.2 billion in revenues annually.¹

Steven Jobs, a college dropout, and his friend Stephen Wozniak started Apple Computer Incorporated in a garage with an initial investment of \$1,300. Sales surged from \$2.7 million in 1977 to \$200 million in 1980. In 1981, Apple controlled 23 percent of the \$2.2 billion world market in personal computers.²

The wealthiest man in New England is not a "Boston Brahmin," but 62-year-old An Wang, who emigrated to the United States after World War II from Shanghai with personal assets on the order of \$100. Wang went on to found Wang Laboratories, producing computers and other high-tech devices, and today Wang's holdings are valued at \$200 million. His wife Lorraine's holdings are on the order of \$120 million, and his children hold \$300 million in stock.³

As journalist Alexander Taylor has noted, "Up to now, it seemed as if opportunities for making great fortunes like those of the Rockefellers and Carnegies had been cut off. It is heartening that peo-

ple are taking chances and sometimes succeeding beyond their wildest dreams."⁴

The success stories of Jobs, Wozniak, Wang, and many others demonstrate that the doors of the free market are wide open today for those who have the energy, the initiative, and the imagination to walk through them. The new world being brought into existence by the computer chip is dispelling the myth of the closed economic society and the "monopolistic market concentrations" which shut out all competition.

The same principles of ready access to rapidly changing markets and the need for constant creativity and innovation hold true in the international arena. American computer firms cannot assume that today's successes and today's profits assure an easy time in the economic battles of tomorrow. The Japanese now export more than \$1 billion worth of semiconductor devices. In the strategic market for 64K Random Access Memory chips, the heart of the modern microcomputer, the Japanese have captured the lead even in the United States.⁵ "Excessive market concentrations" are neither inevitable nor permanent in the dynamic and rapidly changing world of computer technology.

Enemy of the Environment?

A second frequently raised criticism is that "capitalism destroys the environment." Images of greedy corporate moguls turning the wilderness into vast strip mines, asphalt parking lots, shopping centers, and fast food chains come to mind. While there are certainly legitimate concerns for the safe disposal of toxic wastes and other environmental hazards, the general environmental picture presented in the mass media has tended to be one-sided.

As Professor Julian Simon of the University of Illinois has pointed out in a detailed article in *Science*, between the years 1920 and 1974 the total acreage in the United States devoted to wildlife preserves and to state and national parks increased from 8 to 73 million acres. It is still the case that all the land in the United States used for urban areas and roads amounts to less than three percent of the total surface area of the country. Lake Erie, which was pronounced ecologically dead some years ago by Barry Commoner, has improved significantly, and the fish catch is actually increasing.⁶

More fundamentally, the thesis that "capitalism destroys the environment" overlooks the fact that the computer is leading the way from an economy based on heavy industry and manufacturing to one in-

creasingly based on the creation, processing, and distribution of information. We are now in fact already living in the "Information Age." Today more than 60 percent of the American labor force works with information as programmers, teachers, clerks, secretaries, accountants, managers, brokers, insurance people, attorneys, bankers, and technicians. Only about 13 percent of the labor force is actually engaged in manufacturing operations. Almost 90 percent of the 20 million new jobs created during the 1970s were in the areas of information, knowledge, and service jobs.⁷

In the new Information Age created by the computer, the creation of new wealth is not exclusively or even primarily dependent on digging physical resources from the ground—with the environmental problems which may be entailed—but rather, depends on intangibles: new ideas, new processes, and new ways of organizing people and providing services. A new computer software program for businesses or a new video game can create an enormous amount of new wealth and human employment without destroying the environment. Human creativity has taken ordinary sand, a physical resource for which there is virtually an inexhaustible supply, and by turning it into a silicon chip, has created an almost boundless cornucopia of income, employment, and opportunities for human development.

Videotex and Fiber Optics

The relatively new videotex market, which provides online information to computer terminals in businesses, government, and private homes, already represents a \$250 million a year business. Industry analysts expect that the videotex industry, together with its associated hardware and software components, will be approaching a \$7 billion dollar market by 1987—a projected annual compound growth rate in excess of 93 percent.⁸

The transmission of data between computer-controlled systems is being revolutionized by new developments in fiber optics technology. New glass fibers now being developed in the laboratory are only one-tenth the diameter of a human hair, and yet are so efficient in the transmission of information in bursts of light that the full contents of 16 Bibles could be transmitted across the country in a single second. Already some 37,000 miles of the new fibers have replaced copper wires in the telephone system, and by the end of the decade, the U.S. market in fiber optics technology is expected to reach \$1.2 billion.⁹

Videotex and fiber optics technology—powerful new generators

of wealth that hardly existed a decade ago—are only two examples among many in the new computer age which make the older environmentalist criticisms of the free market system largely obsolete. No longer must society face the apparent dilemma of new jobs versus clean air: with careful planning and creativity, society can enjoy both.

During the age of industrial capitalism, the forces of the market tended to concentrate resources and manpower in the large urban areas. The need for such concentration no longer exists in the new computer based economy.

In the small town of Peterborough, New Hampshire, there are no traffic jams and many of the town's 5,000 residents are on a first-name basis. This tiny town in the southwestern part of the state, some 80 miles from Boston, is the hub of some rapidly growing publishing and mail order businesses. More than 20 periodicals and countless books, catalogs, and newsletters are being published within a ten-mile radius of this small New Hampshire town. Titles such as *Byte*, *Microcomputing*, and *Robotics Age* herald the new information-based economy which has come to town.¹⁰

When ideas rather than physical resources have become the coin of the realm, there is no need to crowd all successful enterprises into already overcrowded urban areas, and the environmental advantages can be considerable. When the "commodity" being produced is information, deliveries can be made easily and rapidly over a telephone line, and the producer can be located almost anywhere.

Third World Oppression?

Yet another charge leveled against the free market system is that capitalism inevitably oppresses the poor peoples of Third World nations. According to Third World revolutionary Franta Fanon, "The question which is looming on the horizon is the need for a redistribution of wealth. Humanity must reply to this question, or be shaken to pieces by it."¹¹

Criticisms such as Fanon's are not really new, but derive from the thesis of Lenin that capitalistic economies are inherently oppressive and imperialistic, ever seeking to expand markets, seeking cheap raw materials from the poor nations and then selling finished goods to those same poor countries at exorbitant prices. As has been the case with the great social mythologies of history, there has been just enough of an element of truth in the Lenin thesis to make it persuasive in the minds of countless millions of people in the twentieth century.

Recent experience, however, indicates that Lenin was never entirely correct, and that his analysis is rapidly becoming out of touch with reality in today's international high-tech economy.

It is no longer the case that developing nations are condemned forever to be merely the suppliers of raw materials for the factories and heavy industries of the West. Hard work, initiative, and technical know-how are enabling many of these once impoverished nations to leapfrog ahead in the world economy.

Singapore, with hardly any natural resources, and a land area hardly larger than Memphis, Tennessee, has won 25 percent of the global backlog of orders for oil rigs, second only to the United States. South Korea is now the world's largest producer of black and white television sets. These new high-tech giants of Asia are now offering stiff competition to Japan in the international market.¹²

Atari has decided to move a significant portion of its computer assembly operations offshore to Taiwan, in order to take advantage of favorable tax structures and the energetic and more economical Taiwanese labor force. Rather than being "oppressed," the Taiwanese have found themselves to be the beneficiaries of economic dynamics in the computer age where societies that are labor and knowledge intensive can compete very effectively with the older industrial societies.

Enemy of the Family?

Perhaps one of the most serious charges to be laid at the feet of the free market system is that the capitalistic system is inherently destructive of such critical human values as marriage, strong family ties, and community stability. Is it really the case that capitalism has sacrificed some of civilization's most treasured values at the altar of greed and economic gain? The relentless search for profits, the promotion of a mercenary frame of mind, the weakening of ties with the soil, the family, and the town, the constant corporate moves and the transient style of life: such is the litany of accusations made against the free market system.

These charges are to be taken seriously, and historical honesty requires that they not be dismissed out of hand. It is indeed the case that fathers under the age of 40 in America move on an average of every three years.¹³ The American family is experiencing tremendous stress, and it is undeniable that economic factors have contributed to the crisis.

Any economic system or theory which neglects the role of the

family runs the risk of killing the goose which is helping to lay the golden eggs. As George Gilder has pointed out, the creation of wealth arises out of a matrix of values and character traits which are learned in healthy families. "If work effort is the first principle of overcoming poverty, marriage is the prime source of upwardly mobile work ... work, family, and faith ... are the pillars of a free economy and a prosperous society."¹⁴

One of the most encouraging dimensions of the computer revolution is that it has great potential for reducing this tension between home and work. In his best-selling book, *The Third Wave*, Alvin Toffler has even ventured to predict the advent of the "home-centered society" in which an increasing number of Americans will be operating out of their homes as the centers of their business, educational, and personal lives. Instead of being forced to move to a different town in order to change jobs, many will be able to simply "plug into a different computer." The "Home Centered Society" of the Information Age will mean less forced mobility, fewer transient relationships, and greater participation in community life.¹⁵

William H. Bowman of Belmont, Massachusetts is a good example of the new breed of cottage-industry entrepreneurs. Bowman and his friend David Seuss formed Spinnaker Software Corporation in May of 1982. Bowman, whose firm markets learning games written for microcomputers by freelancing programmers, expects to earn \$3 million in revenues in 1983, and as much as \$50 million within five years. The "testing laboratory" for the computer games has been Bowman's Belmont home, where his six children and their friends play the new games for hours on end.¹⁶

The computer revolution has brought earning and play and family and work together in an entirely new way virtually unparalleled in the experience of mankind. This is not to say, of course, that the Information Age is without its own hazards, but the new economic realities of the computer revolution make some of the most common criticisms of the free market obsolete and open up exciting new vistas for human creativity and the well-being of mankind as a whole.

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Lessons From an Entrepreneur

by David N. Laband

The praise recently showered upon the late Sam Walton suggests that now is an opportune time to question the consistency with which Americans treat successful businessmen and to reaffirm the *universal* applicability of capitalism's Invisible Hand as a "mechanism" to promote consumer welfare.

On March 17, 1992, Sam Walton received the Presidential Medal of Freedom, the nation's highest civilian honor, from President Bush. Upon Walton's death, the President remembered him as "an American original who embodied the entrepreneurial spirit and epitomized the American dream." Mr. Walton was not lionized by President Bush merely because of his entrepreneurial spirit; millions of Americans have entrepreneurial spirit. What made Sam Walton unique was his spectacular success as an entrepreneurial capitalist. Mr. Walton and his four children have become fabulously wealthy from their creation of over 1,735 Wal-Mart stores and 212 Sam's Wholesale Club warehouses throughout America. They ranked numbers 3-7 on the most recent *Forbes* list of wealthiest Americans.

Sam Walton was an enormously successful free-market capitalist. An appropriate eulogy for him would include thanks for an economic system that rewards individuals who cater to consumers' wishes. The millions of Americans who have patronized his stores and contributed thereby to his immense wealth would do well to consider the meaning of Sam Walton's success story in terms of international trade.

Our admiration for Sam Walton goes far beyond mere awe of his fortune. Indeed, his great wealth reflects something far more significant. The cavils of anti-free-market fanatics notwithstanding, American consumers *voluntarily* made Sam Walton rich. The same individuals who seek to raise taxes on the rich because of their enviable position in the current income distribution probably buy merchandise at both Wal-Mart and Sam's. They, like many other rational consumers, flock to Wal-Mart stores because of the low prices, the service, and the quality. In short, Sam Walton figuratively built a better mousetrap

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than his competitors, and with their many billions of dollar-votes American consumers demonstrated that they preferred his product. Those who continued to patronize *other* department stores and shops benefited too, as these stores were forced to lower their prices and improve their product lines and services to remain competitive. The personal wealth amassed by the Walton family pales in comparison to the cumulative benefits Sam Walton generated for virtually all American consumers.

However, in the process of making Sam Walton rich, American consumers impoverished many of Mr. Walton's competitors. Every dollar spent at Wal-Mart was a figurative dollar and a quarter not spent for similar merchandise at Sears, K-Mart, J. C. Penney, or any of the other large chain department stores. Perhaps more importantly, it was a dollar and fifty cents not spent at local, small businesses. Some owners of small businesses, unable to take advantage of Wal-Mart's huge economies of scale, sought to prevent Wal-Marts from being built in their local communities. The everyday low-price strategy employed by Wal-Mart would put them out of business, they argued. They were (and continue to be) half-correct. It is true that Wal-Mart's competitors lost business. However, let's get the cause and the effect straight: Wal-Mart never put anybody out of business, *American consumers* did.

Businesses that lose their competitive edge to a more efficient rival have three options. They can: (1) change their product/service mix to reflect more accurately what they do best, (2) exit the market, or (3) petition consumers and/or the state for protection against "unfair competition." The first two responses enhance consumer welfare. To the extent consumers *voluntarily* purchase more expensive, lower-quality goods produced by domestic manufacturers, no self-respecting economist would argue with their choices: *de gustibus non est disputandum*. However, the instant the state regulates to protect domestic firms from "unfair competition," the result is higher prices, reduced choice, and lower quality and service for American consumers.

Shooting the Messenger

Every effort by small businessmen to forestall the building of a Wal-Mart is an attempt to shoot the messenger rather than pay heed to the message. Local economies do not go to pot when Wal-Marts are built. Quite the opposite: Sam Walton once said, "There was a lot more business in those towns than people ever thought."

Without question, each Wal-Mart and Sam's store alters the struc-

ture of local unemployment. The sons and daughters of local businessmen and women no longer follow in their parents' proprietary footsteps. Now they, as well as many other local workers, go to work for Uncle Sam (Walton). Thus, the overall rate of local employment is generally not adversely affected. While we may feel sorry for the personal losses suffered by the owners of these no-longer competitive small firms, the aggregate benefits reaped by (all-too-often forgotten) consumers, including those same small businessmen, outweigh their losses.

The pleas to local zoning boards and planning commissions for protection from "unfair competition" by small businesses faced with the prospect of having to compete with a new Wal-Mart store sound identical to the rhetoric employed by mouthpieces for the Big Three automobile companies, the textile and steel industries, sugar producers, and every other domestic industry seeking to restrict foreign sales of these products in America. To kick Japanese and other foreign producers out of American markets is to deny the benefits of Sam Walton-esque competition.

The negative impact of one business on another in the process of ordinary competition (price, service, quality, product line) is known among academic economists as a "technological externality." Technological externalities are the fingers of Adam Smith's Invisible Hand that guide producers to supply what consumers want, when they want it, at prices equal to cost of production. Any interference with these technological externalities, especially government interference, jeopardizes consumer welfare.

By invoking the rhetoric of "unfair competition," domestic firms seek deliberately to mislead consumers into thinking that protection of competitors is the same thing as protection of competition. Nothing could be further from the truth. Protection of the existing firms in an industry against more efficient competitors, be they American or foreign, insulates those firms from the forces of competition. American consumers are the worse for it: they pay higher prices for shoddy products than would be available in a more competitive environment.

Japan-bashing is equivalent to Sam Walton-bashing. The principles of competition are universal, whether the competitors are domestic or foreign. The fact that sellers are foreign does not diminish the potential gains to American consumers from competition between sellers. If we're going to lionize Sam Walton, consistency demands that we lionize *every* successful producer in the global economy.

Economic Prediction and Entrepreneurial Success

by Dennis L. Peterson

While traveling in my car recently, I was intrigued by an illustration given on an audio cassette presentation to which I was listening. It set me to reflecting on the power of the human spirit in a free environment and the futility of government attempts to regulate and predict that spirit.

The speaker was Thomas J. Peters, author of the best-selling *In Search of Excellence*. In the process of discussing his thesis, Peters described a man who defied all the negative predictions and forecasts of the "experts" and created an \$1.3 billion company. According to the "experts," what he did was impossible, and he did it in an area that would qualify for the "Least Likely to Succeed" award.

In every single year since 1930, the "experts" predicted that consumers had had it with chicken. There was just no more demand for it on the market. Despite gloomy prediction for so many years, Frank Perdue "made it" with chicken! And he did it in the economically "depressed" Delmarva Peninsula. From that unlikely spot, he has successfully expanded into the largest urban areas of the eastern United States, including New York, Boston, Baltimore, Washington, D.C., and Philadelphia. His lowest share of any of these market areas is 50 percent.

On the reverse side of the tape I had just heard author and lecturer Earl Nightingale recount another story of the economic success that comes from a free human spirit. He told how a milkman named Stew Leonard was seemingly forced out of business when a major highway construction project ran through his small dairy.

Rather than surrender to this intrusion by government "progress," Leonard borrowed some money and built another store. Since then, he has expanded it 25 times. Today it is—the largest dairy specialty store in the world. It covers 8.5 acres, is patronized by more than 100,000 customers each week, and sells in excess of 10 million quarts of milk a year. This is to say nothing of the "1 million pints of cream,

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1 million cartons of yogurt, 100 tons of cottage-cheese, 3 million quarts of orange juice, more than 500,000 pounds of butter, 520 tons of salad . . . 1,040 tons of hamburger meat and 1,820 tons of poultry products—oh, and 1.56 million ice-cream cones!”

The accomplishments of Frank Perdue and Stew Leonard could not be predicted by government economists. Their successes are due to the imagination, creativity, and purposeful actions of free individuals in the free enterprise marketplace. They were spurred to these entrepreneurial heights by the desire to make a profit and thereby improve their lot in life. In the process, they met the needs of millions of similar individuals. None of this could have been accomplished by the mere manufacture of charts, graphs, and “guesstimates” by government’s “experts.”

Charts and Statistics

One of the fallacies promulgated and perpetuated in many high school and college economics courses today is the idea that economics is charts, graphs, statistics, and predictions. Economics, when taught in such a manner, is perceived as a very complex and mysterious realm into which only the “experts” dare venture. All the rest of us, then, are expected to act and react according to the predictions, presuppositions, and economic philosophies of these “experts.”

“The only function of economic forecasting,” Ezra Solomon stated, “is to make astrology look respectable.” Another wag declared that if all the economic experts who ever lived were stretched out head-to-toe around the earth, they would never reach an accurate conclusion.

While charts, graphs, and statistics are appropriate for the study of past economic events, activities, or trends, they have little to do with predicting the quantitative actions of individuals in a free market. The impression that “figures give you all the answers is wrong,” Earl Nightingale concluded. “Figures don’t give you the answers. Figures merely give you the questions.”

No less an authority than Ludwig von Mises showed the futility of government planning and prediction in the economy. “The most that can be attained with regard to reality is probability,” he stated. “The fundamental economic problem,” he continued, “consists in the neglect of the fact that there are no constant relations between what are called economic dimensions.”

Statistics can also be distorted to fit the views and purposes of whoever is using them. As one of my college economics professors once said, “Figures don’t lie, but sometimes liars do the figures!”

There are those who will argue, however, that whereas it may be true that government forecasting and planning were not necessary in the early stages of our nation's economic development, today's rapidly-changing and highly technical industrial society makes it essential. Joseph P. Kennedy firmly believed this. "An organized functioning society," he contended, "requires a planned economy. The more complex the society, the greater the demand for planning."

Once government officials adopt this fallacy as public policy, there is no end to the extremes of regulation and experimentation that government will undertake. It is this interference in the free market, more than any other single factor, which brings about inflation, unemployment, scarcity, and depression. And, ironically, these problems then lead to increased demands for government intervention.

John Chamberlain addressed so succinctly the problem created by such government interference in the market: "Where government tries to substitute itself for the economic motor, there is the inevitable confusion between the starter, the accelerator, and the brake."

"Fellows with Schemes"

Reduced to its simplest, government interference through planning is the attempt by a few to tell the rest what is best for them, as though the individual is too ignorant to determine his own self-interests. Humorist Will Rogers might have had this in mind when he commented, "World ain't going to be saved by nobody's scheme. It's fellows with schemes that got us into this mess."

Socialistic planners think in terms of a nebulous nonentity called "society." They think "society" produces goods and services. They think "society" consumes the goods and services "society" produces.

In reality, only individuals produce and consume. There is no economic action of the masses but only of individuals. Government actions in a free economy, therefore, must be based on this foundation principle. This precludes all government planning and interference in the economy beyond the requirements of defense and general safety.

After thinking about the phenomenal successes of Frank Perdue and Stew Leonard, I wondered where we would be today had these entrepreneurs and others like them permitted government predictions to cloud their visions. Literally millions of consumers would have had needs unmet. Billions of dollars in economic activity would have been redirected into other channels. Many profitable jobs would never have come into existence. The experts' predictions would have been

“proven” by self-fulfilling prophecy. The myth of economics as the realm of the experts would have been further perpetuated.

But these and other believers in the free market refused to be kept down by the gloom and doom forecasts of the planners. They knew that if they worked hard to meet the needs of consumers, produced quality products, and served their customers courteously, they would have a fantastically profitable market at their fingertips. They put their knowledge and imaginations to work and, with faith in the free market system, made their dreams realities.

The attempts of such individuals—both their successes and their failures—are what the free market is all about. And it will continue to survive and thrive in spite of government interference. It operates best, however, when it is permitted total freedom.

Mr. McAllister's List

by Donald G. Smith

Ward McAllister, a nineteenth-century social climber, coined the term "The Four Hundred" to determine who was, and who was not, among the social elite. The term had great relevance for him because it determined the other 399 people who could be comfortably accommodated in Mrs. William Astor's ballroom. Those who were invited were *in* and those who were not invited were *out*, and McAllister did the spade work for Mrs. Astor in making this determination.

McAllister seemed to assume that this situation would last forever; that the "right" people would breed more of their kind and that his beloved Four Hundred would continue through eternity. He was wrong, however, because he totally misread the forces that were shaping a great nation. His venture into American aristocracy failed because in our society any elite grouping is necessarily a fleeting, temporal thing. Whatever kind of an upper class exists at a given moment is based upon accomplishment.

By the 1890s, when McAllister compiled his list, the movers and shakers of a new era were already taking form. Sebastian Kresge risked it all by opening his first store in 1897. A Polish orphan, later to Americanize his name to Samuel Goldwyn, would pass through Ellis Island without a penny in his pocket.

A Four Hundred of the 1950s, 1970s, or of today would include almost none of the surnames on McAllister's list. There were no Sarnoffs waltzing in that ballroom because the family hadn't yet immigrated from Russia. Nor was there anyone from Glenn Martin's family tree. Young Martin would start his first aircraft company in 1915, his "plant" being an abandoned church in Santa Ana, California. Walter Chrysler at the time was working as an apprentice at the American Locomotive Company, and Henry Ford was a backyard tinkerer in Detroit. There were no Trumps or Krocs on the guest list; nor were there any Gianninis, Sikorskys, or Gettys.

Two young men named William Hewlett and David Packard would make a name for themselves in American industry, but not

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before they had pooled their assets of \$538 and started a company in Packard's garage. Celebrated architect I. M. Pei arrived in this country in 1935 and, as the expression goes, made something of himself. His ancestors, of course, weren't on the Astor guest list because they were otherwise occupied with finding something to eat in southern China. McAllister, as might be expected, had never heard any of these names. These people would come along later, make an indelible mark on this country, and take a place on whatever list a collector of big names happened to be compiling.

The crux of all this is in the very nature of capitalism. If there is a social elite, it is an elite of accomplishment. Those who move to the forefront do so by what they have done and hold their power only as long as they are producing. In American society one doesn't coast on a family name for very long. *Old* money is measured in decades, not in centuries.

Those who say that one has to belong to a certain social class to make a mark have no comprehension of the capitalistic system and less of history. Our "in people" are invariably those who have done something. These are the people who are the most wanted by talk-show hosts and are considered catch-of-the-day for any social-climbing party giver.

McAllister's guest list is a time capsule that clearly identifies the people who shaped an era. Included in *The Four Hundred* were the accomplishers of the late nineteenth century: the industrialists, the artists, the builders, the people who made decisions and got things done. Most of them were self-made, and the old money in the room would have looked like new coinage on the other side of the Atlantic. Indeed, the Astors themselves could look back only a century to when John Jacob arrived penniless from Germany with ideas of making it big in the New World. His American Fur Company was founded in 1808, and his descendants had become the oldest of the old money long before the century had played itself out.

No, there is no American aristocracy, and one doesn't have to be born to the purple to make it big in America. Tomorrow's *Four Hundred* is now in the larval stage, waiting to break out into the sunlight. Right now they are children living in crowded apartments in Brooklyn, trailer parks in New Mexico, or strawberry fields in California; or maybe their parents are looking for ways to get to America. They will somehow elbow their way to the top and will spend their time on center stage. These people will be the new social elite and will bring a brand-new set of names to the roster of big and important individuals.

This is the way the system works. We will always have a Four Hundred of sorts, but no one gets a free ride, and there are no names carved in stone. As they say in Hollywood, you are only as good as your last picture.

II. FRUITS OF FREEDOM

Liberty and the Entrepreneur

by Perry E. Gresham

When firms are failing and people are out of work, there is clamor for government action to reduce foreign competition and to subsidize faltering industries. An unfortunate inclination to run to government obscures the real hope for solution to these problems. What is really needed is enough liberty for entrepreneurs to do their work.

Francis Amasa Walker, economics professor at Yale and later President of M.I.T., met the "iron law" theories of Malthus, Ricardo, and Mill head on. He demonstrated with stunning clarity that new opportunities do not derive from dipping into some imagined "wage fund" or from exploiting the workers. Walker identified the entrepreneur as the significant factor in economic development—especially in times such as his or ours.

David Birch and his M.I.T. colleagues startled America by their study of nearly six million firms reported in Dun and Bradstreet. They concluded that small companies, each with fewer than one hundred employees, created 82 percent of the new jobs in the United States economy during the period 1969–76. These small companies are the realized insights, dreams, and formulated plans of action on the part of entrepreneurs.

The Complex Motives of the Entrepreneur

The entrepreneur in America can be truly classified a rare bird. He differs from the conventionally defined businessman in many ways. The entrepreneur's motives are not merely to avoid loss, turn a modest profit if possible, defend the organization, maintain a position, and win approval for exemplary conduct. The entrepreneur is possessed above all with drive, insight, and ingenuity.

Adam Smith assumed the economic motive to be "a drive to better one's own condition." Ludwig von Mises refined this viewpoint as "an attempt to substitute a more satisfactory state of affairs for a less

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satisfactory one." The entrepreneur, however, has more complex motives.

The will to power is a basic factor in human psychology, and many economic motives derive from this will—the entrepreneurial drive included. Possessions often bring power and position. George Gilder, however, reminds us that individual economic motives need not be altogether selfish. Henry Ford not only sought profit, but hoped to provide transportation at low cost for the people of America. John and George Hartford, who created the Great A&P Tea Company, sought to better their condition, but also to supply the American people with better food for less money. The old service club slogan, "He profits most who serves the best," is true. Emulation, nevertheless, is a prime factor for each entrepreneurial venture. When other people are making substantial profits, the entrepreneur wishes to do the same thing.

Risk Factors

The speculative aspect of entrepreneurship has been emphasized by Ludwig von Mises in his great book *Human Action*. Israel Kirzner, in his timely book *Competition and Entrepreneurship*, acknowledges the speculative character of business innovation, but points out that the wise entrepreneur is alert to the fact that "opportunity for profit does exist." He goes on to say, "All human action is speculative; my emphasis on the element of alertness and action has been intended to point out that, far from being numbed by the inescapable uncertainty of our world, men act upon their judgments of what opportunities have been left unexploited by others."

One of the neglected philosophical aspects of economics has been the acknowledgment and understanding of the principle which the philosopher, Charles Sanders Peirce, called *Tychism*. The very smallest particles of the universe exhibit a random performance which can be actuarially described for purposes of rough prediction, but cannot be assumed to exhibit the kind of absolute causation that made many of the laws of science and, to a lesser extent, the social sciences seem capable of flawless prediction. The economic determinism of Karl Marx must go the way of all absolute determinism. The word "Tychism" derives from Tyche, the goddess of chance. The Latin name for this fair mythological maiden is "Fortuna." She is, indeed, the goddess of the entrepreneur.

Some people have native capacity to take risks. As Gilder points out in his *The Spirit of Enterprise*, "whether sorting potatoes or writing

software, they are movers and shakers, doers and givers, brimming with visions of creation and opportunity. They are optimists who see in every patch of sand a potential garden, in every man a potential worker, in every problem a possible profit." These are people who take the plunge to create new enterprises, build new businesses, revitalize old ones. They struggle, flounder, work day and night, sometimes succeed and often fail; but they are resilient and they keep coming on.

The Compleat Entrepreneur

I shall not attempt to describe the compleat entrepreneur as Izaak Walton made glamorous "the compleat angler." I shall, however, outline a few characteristics of the numerous entrepreneurs who are building America out of the ruin of some of our traditional beleaguered and subsidized industries.

Kirzner correctly identifies alertness to new opportunity as the principal factor in entrepreneurship. The person who fails to see an opportunity is disqualified. A wise old African observed, "Anybody can see a seed in an apple; the wise person can see an apple in a seed."

Only optimists transform the economy. The optimism must be disciplined, and cannot give way to gloom. The turn of mind which settles for Murphy's Law is doomed. To build upon my earlier figure of speech, the pessimist is a person who can see a bellyache in an apple blossom!

Boundless energy is a great aid to an entrepreneur. Very few people succeed in life without sizable reservoirs of energy. The pioneer who starts a new business may very well wind up working at it all hours of the night. Entrepreneurs make money the old-fashioned way: "they earn it!" Lack of fiscal discipline encouraged by government and somewhat by huge corporations is the enemy of business innovation and successful development. The young Turks who have learned their habits from bureaucracies, whether public or private, may argue the maxim, "You've got to spend money to make money." My experience is that most who urge this action are more adept at the spending than the making. The entrepreneur who starts in his basement then mortgages his house and works on a shoestring is much more likely to succeed than is the person who takes out a huge loan and attempts to live up to his presumed status as a businessman.

The entrepreneur, moreover, must be able to face failure and be resourceful enough to learn from it. Some of the most successful companies in America are the result of early entrepreneurial failures. The

imaginative and creative business person learns by failure, as well as by success.

A talented entrepreneur must have a better-than-average sense of timing. When Shakespeare wrote "There is a tide in the affairs of men, which, taken at the flood, leads on to fortune," he provided the maxim for the modern American entrepreneur. My friend Richard Cramer exemplifies the possible accomplishment of a genius entrepreneur who acts at the right time and in the right place. I quote a paragraph from his letter:

I left IVAC Corporation in May 1972 and founded IMED Corporation in September of 1972. I brought with me from IVAC, engineers and marketing people who had been with me all the way back to my start in 1962. IMED proceeded to continue to develop products in the IV control area and developed the first truly volumetric IV pump, which allowed, in turn, the development and use of a wide range of IV solutions, and the expanded use of IV therapy in patient care. IMED grew very rapidly and very profitably by concentrating on these nurse-related instruments, that positively affected the stabilization and recovery of patients. In 1982, I sold IMED to Warner Lambert company for \$465 million cash. This, incidentally, was the largest sale of a private industrial corporation in United States history.

The cybernetic revolution is of considerable benefit to the aspiring entrepreneur. The ease with which relatively inexpensive computers can aid in the prediction of outcomes is of great importance to the daring innovator. Ford and Carnegie had to do it the hard way.

The Social Economic Climate

Our present business climate has negative aspects for entrepreneurship. The inevitable competition may be fierce; business and union monopolies have erected formidable barriers to progress, but the brave and the daring succeed!

The greatest enemy of the entrepreneur is government intervention. The do-good motives which prompt politicians to pass laws and erect bureaucracies not only restrain the pioneer, but mobilize formidable obstacles in the form of unnecessary regulation and discrimina-

tory taxation. The daring, innovating entrepreneur is well-equipped for the struggle, but the government holds a frightening advantage: it has a monopoly on violent force!

No one, however, can thwart the insight, initiative, imagination, drive, and determination of a true entrepreneur. While economists are describing the impossibility of the project, and the government is regulating against the success of the enterprise, and the unions and associations are mobilized to thwart progress, the truly intrepid are winning fortunes and providing employment for unnumbered multitudes.

If Men Were Free to Try

by John C. Sparks

Private ownership, private initiative, the hope of reward, and the expectation of achievement have always been primarily responsible for the advancement of mankind. Continued progress—be it spiritual, mental, or material—rests squarely upon a better understanding of the idea of individual freedom of choice and action, with personal responsibility for one's own decisions.

For the purpose of illustrating this idea, let us suppose you had lived in 1900 and somehow were confronted with the problem of seeking a solution to any one of the following problems:

1. To build and maintain roads adequate for use of conveyances, their operators, and passengers.
2. To increase the average span of life by 30 years.
3. To convey instantly the sound of a voice speaking at one place to any other point or any number of points around the world.
4. To convey instantly the visual replica of an action, such as a presidential inauguration, to men and women in their living rooms all over America.
5. To develop a medical preventive against death from pneumonia.
6. To transport physically a person from Los Angeles to New York in less than four hours.
7. To build a horseless carriage of the qualities and capabilities described in the latest advertising folder of any automobile manufacturer.

Without much doubt you would have selected the first problem as the one easiest of solution. In fact, the other problems would have seemed fantastic and quite likely would have been rejected as the figments of someone's wild imagination.

Now, let us see which of these problems has been solved to date.

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Has the easiest problem been solved? No. Have the seemingly fantastic problems been solved? Yes, and we hardly give them a second thought.

It is not accidental that solutions have been found wherever the atmosphere of freedom and private ownership has prevailed wherein men could try out their ideas and succeed or fail on their own worthiness. Nor is it accidental that the coercive force of government—when hooked up to a creative field such as transportation—has been slow, plodding, and unimaginative in maintaining and replacing its facilities.

Does it not seem odd that a privately-owned automobile company found it expedient to sponsor a national contest with tremendous prizes and to conduct its own search in order to correct the faults of the publicly-owned and inadequate highway system? The highway dilemma has become more and more acute until someone other than the public owner has sought an answer. If the points of ownership had been reversed in 1900—that is, motorcar development in the hands of the government, and highways left to private individuals—we would have likely participated in a contest sponsored by the privately-owned highway companies to suggest how to improve the government's horseless carriage so that it would keep pace with the fine and more-than-adequate highways.

How could roads be built and operated privately? I do not know. This is a subject to which none of us directs his creative attention. We never do think creatively on any activity preempted by government. It is not until an activity has been freed from monopoly that creative thought comes into play.

But go back to 1900. Could any of us then have told how to solve the six problems to which solutions have been found? Suppose, for instance, that someone could at that time have described the looks and performance of the latest model automobile. Could any of us have told him how to make it? No, no more than we can describe how privately to build and operate highways today.

What accounts, then, for the present automobile and other "fantastic" accomplishments? Government did not pre-empt these activities! Instead, these have been left to the area of free, uninhibited, creative thinking. Millions of manhours of technically skilled, inventive thought have been at work. And the end is not yet. Nor will there be an end as long as the inhibitory influence of government is confined to its proper functions of protecting equally the life, liberty, and property of all citizens; as long as men are free to try their ideas in a competitive and voluntary market.

Entrepreneurship

by Ludwig von Mises

What induces an entrepreneur to embark upon definite projects is neither high prices nor low prices as such, but a discrepancy between the costs of production, inclusive of interest on the capital required and the anticipated prices of the products.

The real entrepreneur is a *speculator*, a man eager to utilize his opinion about the future structure of the market for business operations promising profits. This specific anticipative understanding of the conditions of the uncertain future defies any rules and systematization. It can be neither taught nor learned.

Those who confuse entrepreneurship and management close their eyes to the economic problem. In labor disputes the parties are not management and labor, but entrepreneurship (or capital) and the salaried or wage-receiving employees. The capitalist system is not a managerial system; it is an entrepreneurial system.

It is impossible to eliminate the entrepreneur from the picture of a market economy. The various complementary factors of production cannot come together spontaneously. They need to be combined by the purposive efforts of men aiming at certain ends and motivated by the urge to improve their state of satisfaction. In eliminating the entrepreneur one eliminates the driving force of the whole market system.

Ludwig von Mises (1881–1973) was one of the great defenders of a rational economic science, and perhaps the single most creative mind at work in this field in our century. This article, an excerpt from *Human Action*, appeared in the September 1981 issue of *The Freeman*.

Small Business and Entrepreneurship

by E.C. Pasour, Jr.

Business news in the United States focuses on economic activities of giant corporations. In recent years, for example, politicians and newspaper editors have castigated the "obscene profits" of "Big Oil." A large increase in profits by Exxon, IBM, and other large corporations frequently evokes calls for divestiture. The conventional wisdom is that the American economic system is dominated by large corporations because big business firms are so productive that small firms cannot compete. In this view, ever vigilant government regulation of these large firms is required to prevent exploitation of workers and consumers.

In addition to the concerns about "big business," there is a growing feeling that the entrepreneurial spirit has lost its vitality in the "new industrial state." The rate of increase in labor productivity has been decreasing over time, and United States business firms have become less competitive with foreign manufacturers in the production of a wide range of products including automobiles, watches, steel, and television sets. Current economic problems including financial difficulties on the part of Chrysler, International Harvester, and other large companies, the slowdown in labor productivity, and a rising level of unemployment have evoked calls for the U.S. government to underwrite a "reindustrialization" policy. More central economic planning is held to be necessary to revitalize American industry and provide jobs both for the unemployed and for new entrants into the labor force.

The purpose of this paper is to show that the preceding scenario is not an accurate description of the business environment in the United States or in other countries where entrepreneurial incentives are not stifled by inflation, taxes, economic regulations, and other factors contributing to an unfavorable business climate. Small business, already the most important source of innovative activity and new job opportunities in the United States, can play an even more important role with an easing of the restrictions on entrepreneurial

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incentives. A market economy is a dynamic discovery process generated by the competitive entrepreneurial scramble for profits.

Entrepreneurship and the Market Process

In a free enterprise economic system, expected prices and profits provide incentives for entrepreneurial activity. If market participants had perfect information, all market activity would be perfectly coordinated and there would be no profit opportunities nor role for profit-seeking entrepreneurs. In a dynamic economy, however, market conditions are constantly changing due to the invention and introduction of new products, changes in production technology, changes in consumer preferences, and so on. Consequently, there are always profit opportunities available for alert individuals with innovative ideas.

Entrepreneurship may be aptly defined as an alertness to profit opportunities which have not been grasped and acted upon by others. It should be stressed that the potential for (and expectation of) profits in the competitive market process creates powerful incentives for profit-seeking individuals to discover and make use of information before it is widely known by other people.

In a fundamental sense, entrepreneurship is the key to market creativity. Business firms are induced by the profit motive to search for a unique profitable niche. This search for profit may take a number of quite different forms. An enterprising firm, for example, may invent and produce a new product. Henry Ford, the founder of the Ford automobile company, provides a classic example of successful entrepreneurship based on this approach. However, the creation and development of a new product does not ensure financial success for the inventor. Of the thousands of inventions each year in the United States, only a handful prove to be an economic success. In order for a new product to be profitable, the producer must be able to sell the product and at a price high enough to cover the production costs (including a return to management).

Another possible road to profits is to advertise or market a product in a way that differentiates the product in the eyes of the consumer. McDonald's, for example, reaped substantial profits as a pioneer in the production and selling of "fast food" hamburgers. This profitable business organization soon spawned a host of close competitors. Regardless of the road to success, the effect of profits on competition is predictable.

Profits invite competition and ensure that rival firms will compete to erode the profit advantages of the innovating firms. The result is

that profits, whether due to the nature of the product, the conditions under which the product is sold, or to other special advantages, are invariably short-lived unless the profitable firm can obtain the aid of government to restrict or exclude competition. In all countries in the developed world, there is a long history of the use of tariffs, patents, franchises, and other government-enforced restrictions on competition. The conclusion is that monopoly advantages which persist over time are invariably due to governmental restrictions on entry by potential competitors.

Entrepreneurship and Job Creation

The preceding discussion emphasizes that entrepreneurship is not a sure and certain road to profits. In a dynamic economy where economic conditions are constantly changing, entrepreneurship is, by its very nature, a high risk activity. Economic growth in a rapidly changing economy depends upon a large group of individuals who are willing to engage in risk-taking activity. It is estimated that more than two-thirds of all new business ventures in the United States collapse within five years. Despite the high failure rate of new firms, it is small firms rather than large corporations which are primarily responsible for economic growth and technological innovation. Small firms appear to be both more flexible and more inventive.

New developments seldom emerge from the leading companies in an industry, and even if a breakthrough is made by a large well-established firm, the new item is often launched by smaller firms. The result is that the more dynamic the local economy (e.g., Houston, Texas), the greater the risk-taking and the greater the proportion of firms that fail. A recent study of job creation in the United States by a group of researchers at the M.I.T. Program on Neighborhood and Regional Change found that the most successful business areas of the country were those having the highest rate of innovation and business failure—not the lowest.

The implications of these findings for job creation are startling. Large firms in the United States are not the major source of new job opportunities. The study alluded to above found that two-thirds of the net new jobs in the United States from 1969–1976 were created by small firms having fewer than 20 employees. A closely related finding revealed that 80 percent of net new jobs were created by businesses no more than four years old. The fact that most new jobs are created by small business should not be surprising since, as suggested above, small firms have the capacity to start up and expand rapidly.

Shifting Job Requirements

There also has been a shift in the kinds of these new job opportunities. New jobs are predominantly associated with the production of services as opposed to jobs in the traditional "goods" industries—manufacturing, agriculture, construction, and mining. This shift in production from goods to services implies a shift from "brawn to brain" and an increasing dependence on education and training rather than physical capital.

Other countries are experiencing shifts in the nature of job requirements similar to those observed in the United States. Accompanying the shift toward the service sector has been a shift in the method of financing. As Nobel Laureate Milton Friedman points out, risky ventures have almost invariably been financed by small groups of individuals risking their own funds or funds of their relatives and friends. This method of financing contributes toward the increased flexibility and adaptability of small business.

The preceding discussion should not be taken to suggest that large corporations are not important in the U.S. economy. Large firms play a vital role, both as a source of jobs and in consolidating the advances pioneered by small firms. There appears, however, to be little basis for the widespread feeling that large firms have increased their competitive advantage over time due to technological developments. George Gilder in his recent best seller, *Wealth and Poverty*, finds that aside from communication satellites, there is no evidence that recent changes in technology have worked to the advantage of large firms. It is the small firms that are best able and most likely to respond to rapidly changing economic conditions.

Implications for Economic Planning

In view of the crucial place of small firms in job creation, what are the implications for the role of government in fostering economic growth? The political muscle of large firms makes it more difficult for market signals to operate. Chrysler and other large corporations in financial difficulty generate attention by the news media and bring calls for government aid. The number of jobs at stake in such cases means that the fate of these firms is likely to hinge on political considerations rather than on basic economic conditions. Propping up large scale noncompetitive firms through governmental assistance is to subsidize incompetence. A small business employing relatively small

numbers of workers is more likely to have the opportunity to succeed or fail on the basis of economic factors rather than political expediency.

Since most new jobs are created by small firms, it might appear that government should intervene directly. A policy of direct government intervention to assist small firms, however, is difficult to formulate even in theory. The success of any particular firm hinges not only on what that firm does but also on what its current and future competitors do. Thus, success hinges on technological developments as well as on business conditions.

There is no way to predict technology or future knowledge of any kind since, if this were possible, future knowledge would become present knowledge. Since the risk of failure is very high for small firms, in a policy of direct government intervention a decision would first have to be made as to *which* firms to assist. However, there is no accurate way to predict firm success, and government assistance of large numbers of unprofitable firms would be both politically unfeasible and economically unwise. Thus, direct government intervention becomes less and less feasible in an economy where small service-oriented firms are increasingly important in providing job opportunities.

In view of these problems associated with direct intervention, a more feasible alternative is for government to stress the creation of a favorable business climate—to adopt policies which are consistent with risk-taking and entrepreneurial activity. In this business climate approach, the role of government is largely passive and necessarily limited. Consequently, the suggested approach involves a definite change in government policies.

There is a consensus that high interest rates, high marginal tax rates, and government regulations have actively *discouraged* risk-taking and innovative activity in the United States. During the past decade, savings by individuals and business firms have been discouraged because gains were taxed at high marginal rates even though such gains were, in many cases, not real but due solely to inflation.

High Interest Rates Hamper Entrepreneurial Activity

Entrepreneurial activity in the United States in recent years also has been hampered by high and rapidly changing interest rates. It is always difficult for business firms to make decisions based on anticipated future conditions. The difficulty and the cost of mistaken forecasts increase when interest rates are high. There is a direct link between inflation and interest rates.

Nominal or money interest rates consist of two parts. The first part, a real interest component, is based on time preference—the extent to which people place a higher value on consumption in the near future relative to the more distant future. Although there is no way to measure the real interest rate, economists have generally assumed this rate to be around 3 percent.

The money rate of interest equals the real rate of interest plus a second part, the anticipated rate of inflation. This inflation component has been the dominant factor in the money rate of interest in recent years, and reduced inflation is a necessary condition for a reduction in interest rates. Thus, governmental monetary and fiscal policies to control inflation along with a reduction of taxes and regulations are important in establishing the economic climate necessary for increased saving, investment, and capital formation.

What are the implications of the preceding analysis for central economic planning? It is sometimes maintained that while a limited role for the state was feasible in sparsely settled nineteenth-century America, it is inevitable that government must play a larger role in economic planning in an increasingly urbanized and industrial society. However, as shown below, information problems intensify as the complexity of society increases which makes reliance on market prices *more* necessary and government planning *less* feasible.

Price Signals

Market prices are the signals which direct economic activities for consumers and producers in a market economy. When the price of oranges increases relative to other fruits, for example, consumers reduce their consumption of oranges. When the price of small cars rises relative to that of large cars, auto producers shift more resources into small car production. It is through this market process that relative prices induce individual decision-makers to respond to changes in economic conditions regardless of firm size.

The market integrates and mobilizes information automatically without any person having to gather information together in one place. The housewife in New York City, for example, may know nothing about a poor coffee crop in South America, but she adjusts her actions to it when the price of coffee rises. At the same time, price and profit signals provide incentives for the discovery of new facts which improves the adaptation of market participants to ever changing circumstances. Thus, market prices convey an immense amount of information to market participants which makes possible the utilization of

more data than is possible through any other known means of coordinating economic activity.

The factors which cause prices to change and thereby guide the behavior of decision-makers in a market economy are influences which would need to be taken into account in any conceivable system of coordinating economic activity. Moreover, no other way has been discovered for coordinating and transmitting information in the organization of production to accommodate consumer's wants which even approaches the efficiency of the market process. Thus, there is inevitably a loss of information when price signals are suppressed or overridden by minimum wages, rent controls, price ceilings, or other forms of wage and price controls.

Prices are important information signals in any market economy and information becomes more important as society becomes more complex. Consequently, the importance of market prices in coordinating economic activity increases with the complexity of society. The result is that central economic planning is *more* difficult and less feasible in a modern industrial economy characterized by rapidly changing economic conditions.

Conclusions and Implications

A generation ago, a famous economist, Joseph Schumpeter, predicted the withering away of the entrepreneur. In a view later adopted by many economic analysts, Schumpeter considered entrepreneurship to be crucial only in the early stages of capitalist development. In the "mature" phase of capitalism, economic activity was to be dominated by a combination of large corporation and government bodies leaving no scope for individual entrepreneurship. Today, many people still feel that the small inventors and fabled entrepreneurs of early capitalism are a dying breed having no role to play in the "new industrial state."

The actual situation concerning entrepreneurship and small business bears little resemblance to the scenario just depicted. Although large corporations dominate the business news, small business provides the dominant source of new job opportunities in the United States. Small firms, by their very nature, are more flexible and better able to adapt to ever-changing but unpredictable economic conditions. Under these conditions, pleas for a "reindustrialization" policy guided and aided by government are fundamentally misplaced. Rather, emphasis should be placed on improving the investment climate as a means of fostering entrepreneurship and small business activity.

Inflation, high taxes, and widespread government regulations inhibit entrepreneurial activity for firms of all sizes. Entrepreneurship is especially difficult under inflationary conditions both because the uncertainty created by inflation makes planning more difficult and because inflation causes income to be overstated for tax purposes. Consequently, the government can contribute importantly toward a favorable business climate through noninflationary monetary and fiscal policies.

Small business now plays a crucial role in the rapidly changing modern industrial society. If, as seems to be the case, there is a further shift away from the production of autos, steel, and other products in which the United States once had a comparative advantage, the solution lies not in trade barriers and protection or other attempts to insulate these industries from market forces but in developing those products in which the United States is competitive.

The United States, for example, is the leader in producing "thought-ware" (software as compared with hardware) upon which so much of new technology is based. New technologies such as the laser and microbiology are on the horizon. However, the precise direction of these developments is unknown and anyone who predicts the technological future is sure to soon appear foolish. Consequently, the importance of entrepreneurial activity in ferreting out profit opportunities will continue. Moreover, regardless of which products prove to be most profitable for U.S. business, there is little question that small business with its inherent advantages of flexibility and adaptability will be at the cutting edge of these new developments.

Consumer Sovereignty

by Bettina Bien Greaves

From time to time, insightful economists have *described* the operations of a market economy. Many have noted that no central planner is needed to tell producers what to produce, when to produce, how much to produce, and what quality to produce. Adam Smith, often called the "first economist," pointed out in 1776 that the butcher, the baker, and the brewer are guided as if by "an invisible hand." Frederic Bastiat remarked in 1845 that Parisians need not fear starving the next day, but could sleep peacefully in their beds, confident that the city would be provisioned during the night.

However, it was only with the development of the subjective, marginal utility theory of value by the Austrian school that economists *explained* why the market needed no central planner, why no one needed to direct the butcher, the baker, the brewer, or to plan the provisioning of Paris. It was Ludwig von Mises (1881–1973), leading spokesman for decades of the Austrian school, who clearly demonstrated the consumer's crucial role in production. Every one of us has personal, subjective values, the Austrian economists point out. Each of us acts in response to our respective values. When as consumers we buy, or refuse to buy, we send a message to the entrepreneurs who guide production. Entrepreneurs "are at the helm and steer the ship," Professor Mises noted. "But they are not free to shape its course. They are not supreme, they are steersmen only, bound to obey unconditionally the captain's orders. The captain is the consumer." Let's see how Captain Consumer directs production.

Recent accounts of economic conditions in the U.S.S.R. tell of serious shortages—of soap, for instance. Why? It is said there are bottlenecks in the production of paraffin needed for producing sulphanol, an ingredient used in making soap; hence the production of soap is held up. It is charged that the responsibility for soap-making is dispersed among several governmental departments, each with other more urgent responsibilities; hence soap production is neglected. But

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the real reason for the shortage of soap is the lack of opportunity for entrepreneurs to respond to the wants and wishes of consumers.

A widespread shortage of soap would never exist in a country with freedom of opportunity and respect for private property. At the first sign of demand for soap over and above available supplies, some entrepreneur, hoping for profit, would try to fill the gap, by starting a small soap-making operation of his own, or by shipping soap from where it was more abundant. The demands of consumers would guide him.

Given the lack of soap in Russian stores, why doesn't someone there start to make soap at home? Soap isn't very difficult to make and the ingredients aren't expensive. Many of our grandmothers and great-grandmothers used to make soap. Old cookbooks give recipes. It can be made from readily available raw materials: wood ashes, fat, lye, and salt.

Let's assume for a moment that an enterprising Russian housewife and her children weren't deterred by the threat of government regulation and decided to make soap on their own. Wood ashes they would have aplenty. Also fats left over from cooking. By pouring water over the ashes and letting it stand, they could leach out a form of lye. This they would then mix with the fats, add salt, and heat until a crude kind of soap began to form. Not a very fancy soap, to be sure, but a usable soap, which in view of the shortage in Russia, consumers would undoubtedly welcome.

Each Russian consumer who chose to spend money for this new soap, instead of something else such as cigarettes, would vote his personal values, transferring rubles to these enterprising soap-makers while, at the same time, sending fewer rubles to the producers of cigarettes. As consumers purchased soap in preference to cigarettes, they would be giving the venturesome soap-makers more and more rubles, providing them with a profit, and encouraging them to continue production.

Freedom to Choose

Consumer sovereignty is consumers making choices one by one, consumers buying one thing and not another, consumers transferring their money to some producers and not to others. The process isn't invisible; it isn't miraculous; it only seems miraculous in that it directs production without a central authority having to plan or give orders.

If consumers still clamored for more soap after the first batch was gone, the enterprising soap-makers would expand production, in re-

sponse to consumer sovereignty. As more and more consumers bought their soap, the soap-makers would profit. And their success would induce others to start producing soap, perhaps an improved variety, this too in response to consumer sovereignty. As sales grew, the soap-makers would have to look farther afield for supplies of wood ashes and leftover cooking fats. Consumer sovereignty would soon impact on suppliers of these raw materials too, affecting the prices they asked and could receive for raw materials, persuading them to sell to the soap-makers, and perhaps even to expand their production. In short order, as consumers assumed control, the production of soap in Russia would rise and the shortage would disappear.

Consumer sovereignty is manifested by consumer purchases and refusals to purchase. As long as customers continued to buy soap, they would keep on transferring money from other segments of the market to pay for their purchases. In the process, they would help to make those soap-producers who responded to their wishes richer. In the final analysis, it is the consumers, as Mises has written, who "make poor people rich and rich people poor. They determine precisely what should be produced, in what quality, and in what quantities."

Russian consumers lack soap and many other goods because potential entrepreneurs have little freedom to go into business, to invest, to experiment, and to try to respond to the wishes of consumers. In Russia, there is a shortage of soap because consumers aren't free to make some entrepreneurs richer by buying their products and others poorer by refusing to buy theirs. In Russia, there is a shortage of soap because the consumer is prevented from expressing his sovereignty on the market. In Russia, central planners, not consumers, are sovereign.

Peking Duck or Kentucky Fried?

by Lawrence W. Reed

Mao Tse-tung, the man whose 1949 revolution brought communism to China, once launched a nationwide "Four Pests" campaign. Part of the effort was designed to eradicate houseflies by having every Chinese meet a quota of swatting at least 10 flies a day.

Now years later, as the "Great Helmsman" rests in peace in Beijing's Tiananmen Square, China still has plenty of flies. But something that would undoubtedly disturb Mao far more, if he only knew it, is on view just across the street from his mausoleum: the smiling face of Colonel Harlan Sanders.

In November of 1987, Beijing became the site of the world's largest Kentucky Fried Chicken restaurant. The 500-seat fast-food eatery is the latest monument to the policies of Deng Xiaoping, under whose leadership post-Mao China has been moving away from three decades of radical isolation and doctrinaire Marxist control of the economy. In Beijing, at least, *glasnost* is finger-lickin' good.

Store manager Khaw Swee Kwang reports the place serves an average of 1,000 meals on weekdays and nearly double that on weekends. Two- and three-piece chicken dinners sell at prices comparable to what Americans pay here. The chain is negotiating with the government to open other outlets.

Strict quality control assures the taste is no different from that in the American outlets. The chickens are raised on farms outside the capital to Kentucky Fried Chicken's exacting specifications. Ditto the potatoes and cabbage. Only the famous "11 herbs and spices," a trade secret, are imported.

In an interview, Khaw made it plain that running such a capitalist establishment in a communist country has been profitable but not easy. The Chinese government, for instance, insists on majority ownership. Kentucky Fried Chicken's share is limited to 40 percent.

The management must eventually be predominantly Chinese. Khaw himself is from Singapore (which boasts 31 Kentucky Fried

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Chicken outlets) and will leave Beijing when his mission to train Chinese managers is completed.

Workers drawn from the local labor pool present a major challenge. The so-called "iron rice bowl," a Maoist notion that each worker should have a secure, lifetime job (an unbreakable rice bowl), has become so much a part of Chinese life that workers must be taught that merely showing up for work is not enough. They must learn a new ethic centered around the capitalist notion that "the customer is always right."

"It's always been difficult to teach them to really care, to go the extra mile in keeping customers happy," Khaw says. By prior arrangement with the government, the restaurant is permitted to fire unsatisfactory employees. The mere prospect, according to management, has been a "powerful incentive."

Employee wages are fixed by the government, which is anxious to avoid being embarrassed by a foreign capitalist enterprise's paying more than its domestic counterparts. Because high morale and better performance incentives are important to Kentucky Fried Chicken, the management has found the low-wage scale too stingy and restrictive. The problem is partly circumvented with occasional bonuses "paid" in fried chicken.

The restaurant is also experiencing another problem, the same energy hassle that afflicts all buildings in Beijing. The state-owned utility refuses to supply any heat before November 15. It's shut off on March 15 regardless of the weather. The city often endures below freezing temperatures into April.

Patrons like the restaurant not only for the food and the colorful, well-lighted surroundings, but for its American aura as well. More than a few will tell the visiting foreigner that eating there is as close as they are likely ever to come to fulfilling their dream of seeing the United States.

Somebody once said the formula for rolling back the communists calls for bombarding them with capitalist mail-order catalogs, video tapes, and fast food. If so, Colonel Sanders may be one of America's more cost-effective weapons.

Economic Growth in Taiwan: Invisible Factors Contributing to Economic Development in the Republic of China

by Shih Cheng Liu

During the past 30 years, the outstanding achievements in economic development within the Republic of China (ROC) have been recognized all over the world by leading economists and businessmen.

Here in its base area of Taiwan, the ROC launched the first of a series of four-year plans in 1952. Since then, the obvious statistics are impressive: GNP has increased by 11.2 times, with an average annual growth rate of 6.7 percent. Per capita income increased by a factor of five. These are calculated in real terms.

In actual 1980 exchange rates, absolute income per head for that year amounted to US\$2,102.

As for foreign trade, its 1980 exports and imports totaled, respectively, US\$19.8 billion and US\$19.7 billion as compared with the 1952 figures of US\$110 million and US\$180 million.

By this bare outline, we gain a clear picture of the magnitude of economic growth in Taiwan.

What really counts, of course, is the actual livelihood of the people and it is easily seen that they are pursuing the standard of living common to the industrialized nations.

Virtually no family is without a TV set, whether urban or rural. Most provide themselves with refrigerators. It is rare to see a person wearing patched clothing. Indeed, clothing is no longer merely a covering for the body, but is more often a fashionable symbol of prestige or social standing. Fans abound, and air-conditioning proliferates.

Traditional eating habits are still changing, but we can already see large increases in the consumption of milk, meat, and wheat as people desire more nutritious, higher protein diets. Compared with only the very wealthy of 30 years ago, today even moderately successful businessmen and industrialists mostly own and drive relatively new cars.

Overall, this enhancement in the standard of living could not have been dreamed of 30 years ago.

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This is especially so because of natural factors: Taiwan is an island of 36,000 square kilometers endowed with but a little coal, timber, and limestone. From this viewpoint, the potential for economic growth would seem poor. In other words, we may say that the main resources involve the population—currently something over 17 million. The conclusion, therefore, is that if Taiwan's recent achievements are a miracle, it is a human miracle.

This is why I want to explore the invisible factors.

Attitudes and Conditions

A number of economists, especially from abroad, have tried to explain this miracle. But they most often take the easy path in analysis. They focus upon the most visible factors, such as the quantity and quality of capital, of natural resources; the structure and diversification of transportation and communications; the quantity and sources of power; the number of schools; the labor supply, and so on. All of these visible things are more easily counted, constituting a strong appeal to the economic experts.

It is, however, my thesis that the facts will show invisible factors to be more important to economic progress than are the visible factors.

The visible factors are those tangibles which are not so difficult to get or to build, provided the people devote their time to following the successful examples of the developed countries.

But what I refer to as invisible factors are those attitudes and conditions that must grow within a society itself; they take time, depend upon the nation's culture and tradition, and cannot be produced in or imported from a foreign country. Hence, for an underdeveloped country, the provision of these invisible contributing factors to economic development is much more difficult than that of the visible factors.

Have we not seen undeveloped and underdeveloped countries, full of natural resources, struggling with little success to become industrialized? This is a good bit of evidence to support my view of the importance of the invisible over the visible factors of achievement.

Here, then, we come to factors, invisible cultural and psychological factors, which I believe have not been mentioned by economists in previous analyses of our economy.

Mounting Self-Respect

In the first place, we must consider the national self-consciousness that asserted itself after World War II within some previously colo-

nized countries. Those societies felt that they had fallen too far behind the developed nations, in both industrial, civilized standards and in the practical standard of living. Hence, they strongly desired opportunities for self-improvement. This was not only a reaction to the colonial policies of the past; it was also an urgent pursuit of self-expression—and of self-respect—on their own.

In consequence, a driving force developed, as it were, a single will for a whole people. A great pressure was brought upon these governments to make development a preoccupation.

Just such a case is the Republic of Korea—and the ROC's Taiwan province, too.

In response to this request, and with the support of the vast majority of the people, the ROC government began the first of its consecutive economic plans. They have been brought into effect, one by one throughout 30 years, while the people—the most important resource—have been employed economically and to efficient effect in coordination with the policies and measures established by the government.

But what at first sounds like standard political economy is not the whole story. Cultural ethics are also importantly involved. In Taiwan, people have gradually changed their ideas about personal behavior.

Ethics and Economics

There is both co-existence and contradiction in traditional Chinese attitudes toward ethics and economic behavior. Perhaps this is natural in all primarily agricultural societies. It is very similar to the coexistence of internal and external ethics as pointed out by the noted German sociologist and economist Max Weber. It is also something like the Jewish and Christian conflicts over usury, on the one hand, and rents, on the other.

Especially after 1952, gradually growing attitudinal changes became apparent among the people of Taiwan. In one aspect, ethics continued to be seen as rules of social behavior—but in the marketplace, it became more acceptable to view economic behavior as an aim to legally pursue maximum satisfaction or profit as a proper reward for the risks of entrepreneurship.

For our economic understanding, the most impressive changes are to be found in the new distinctions being made between obligations and personal rights; between charity and repayment of kindness.

Virtually all are now aware that pursuing the good life depends primarily upon one's own individual effort.

A relative or friend may desire to extend support; but if he does

so, it is a kindness, not any longer an obligation. From this develops the further idea that it is better to be able to give than to be in a position of having to receive.

These changes induced better and wider understanding of the risk/reward relationship in entrepreneurial efforts.

In another important aspect, too, we can see a drastic change from traditional attitudes toward, or judgments upon, social values. The Chinese have for long attached special importance to intellectualism. More than 2,000 years ago, Mencius said, "Some labor with their minds, and some labor with their muscles. The former rule; the latter are ruled."

Naturally, then, manual labor—however necessary—was to be despised, and scholasticism—even when uttering pedantic nonsense—was more likely to be revered.

But the Industrial Revolution has taught all of its successful followers that such compartmentalization is wastefully inefficient. And so we see that economic development—modern industrialization—makes necessary changes in various criteria of social values.

Especially amongst the younger but also amongst the sharper of the older generation in Taiwan, we see strong consideration being given to the value of independently earning one's own way in profitable enterprise.

Erasing Prejudice

From these considerations there follows a marked decrease in prejudice as all honest and legal jobs are seen to be useful to the personal goal. The manual laborer, educated and trained to think, becomes semi-skilled and then skilled. The college engineer, getting his hands familiar with the inner workings of machinery and circuits, tempers theory with practicality and becomes a more efficient designer. And as both groups come into more frequent contact, old prejudices further diminish.

All of these foregoing attitudinal changes in Taiwan have nicely conspired to bring forth extraordinary and unprecedented driving forces in both manual skills and in creativity. They are factors which are not easily quantified statistically and are, in that sense, invisible. But I would find it hard to overestimate the extent to which these valuable changes have exercised a favorable impact upon the economic development of the ROC on Taiwan.

Underlying all of this, there must be, of course, a proper infrastructure that includes a work ethic, education, law, and order.

In some underdeveloped societies, particularly in warm or tropical areas, there is an attitude toward work itself that can only be described as indolent. But the people of Taiwan, an island classified as subtropical, are influenced by an age-old Chinese ethic that is much more northerly. It strongly stresses "respectful attention" or a phrase that might be translated into "sincere, true, and faithful mentality," though it does not emphasize the Western "exactness" or "precision."

In America, the coined "workaholic" is popularly applied to managers and executives who work habitually more than 50 or so hours per week. But in Taiwan, especially since the onset of industrialization, the newly arising entrepreneurs, in conjunction with their employees, expend great effort by assuming respectful attention to their business; they watch everything carefully and dare not be negligent in their duties. Today, visiting foreigners are usually amazed at the number of managers and executives who work long after suppertime and throughout the weekend.

Better Educated and Trained

Still, all of the above would be in vain were the following generation to be no more advanced than the one before. Thus, 30 years of expanding and improving education have prepared myriads of sons and daughters not only to enter, but to improve our industries and services. On a competitive basis of high standards, application to undergraduate and graduate studies is publicly available. From these qualified young people, numerous men and women of high ability are equipped with the knowledge and skills required to run the businesses of design, production, and trading and shipping services. It must, then, be concluded that success in Taiwan's educational efforts is partly responsible for its achievements in economic development. Of course, schools and graduates can be quantified and analyzed and are, in that sense, visible. But there is an invisible aspect that I want to stress. Before being awakened to a specific sense of economic development, most Chinese people were more or less satisfied with being "constant-income earners"; meaning that they tended to run some business in a routine way, peacefully, safely—avoiding risk where possible. But this could never have resulted in the tens of thousands of firms that now exist on Taiwan.

Taking Entrepreneurial Risk

For some, it began after schooling; for many, it began during school days: but as Taiwan's embryonic development began to unfold,

thousands of youths acquired an attitude just the opposite of their father's attitude. Thousands and thousands of young people—and this does include women—began to seriously consider quitting jobs with incomes controlled by others in order to set up one-man or youthful-partnership companies. At best, of course, this is risky. But the young people have learned to do their best in forming optimum combinations of the factors of production. And, in taking these risks, they have also learned that the entrepreneur is the most important factor in national economic expansion. Recognizing the risk of failure, the potential satisfaction and profits of success are the basic, driving power that pushes the young person who sees the light of entrepreneurship.

So this is another thing that amazes the foreign visitor to the ROC on Taiwan: The very high percentage of one-man firms, of companies headed by a two- or three-man partnership, and so many of them not yet 30 years of age. They total a huge contribution to domestic production and services and, of course, to overseas marketing. The growing dollar value of their efforts is statistical and visible. What is not so visible to foreign economists is the tremendous energy that our youth bring to discovering new ways to get the job done.

I do not hesitate to say that positive attitudes, particularly amongst the young, toward entrepreneurial effort all over Taiwan are enormously beneficial to its economic achievements.

Some would avoid the issue of race; but, even avoiding it publicly, many will privately filter any analysis through their own biases. Allow me to openly declare that I believe the Chinese are among the more intelligent races of mankind.

Historical evidence places sixteenth-century China at least on the same level with other nations, both in culture and in economy; it is one of the oldest of nations, and one of the few not colonized by the Western world.

So far as I can see, the factor that caused China to fall behind the western world was the absence of an industrial revolution. Ah, yes; but, why this lack?

Barriers to Trade

Western societies and nation-states first arose around an inland sea that bordered upon the edges of three continents, permitting faster and somewhat less risky intercommunications between diverse peoples. For most of Western history, there have ever been two, and sometimes several, cultural systems in contention—which means a more frequent, if not always constant, contest of ideas.

In contrast, the vast bulk of China was and is landlocked by formidable natural barriers on three sides, with an infinitely larger, and frequently angrier, ocean on the fourth.

Too, a thousand years before Athens contested with the cultures of Asia Minor and Egypt, China was unified, and under the twin conditions of unity and relative isolation, the Chinese form of feudalism and monarchism grew stronger and more ritualistic. These are the conditions that combined forces to restrain the kind of thought, action, and experimentation that might otherwise have permitted an almost wholly agricultural society to discover or learn the secrets of industrialization.

I submit, then, that race has nothing to do with the earlier failure of industrial development in China. For added proof, observe that from the very earliest emigrants, those Chinese, individuals or families, who moved outward to South-East Asia, taking little or no capital with them, came quickly to positions of economic prominence and sometimes to great wealth among the societies in which they worked, and this is now observable all over the world. Chinese people are as capable of entrepreneurial activity as are the Scots of Adam Smith. And to this fact we may attribute much of the success in the development of Taiwan's economy.

A Favorable Climate for Industrial Development

Finally, it is a basic premise that there must be a good climate for investment, many trading opportunities, and a high probability of profit-making. These, in turn, depend upon a "rule by law and not by men." Given this, one expects a stable political environment that safeguards private property and legal economic activities, paving the way for harmonious relations between labor and management. These will make it possible to produce and trade in compliance with planned, or at least reasonably anticipated, costs and sales. These also make possible the advancement of the laborer and the upward mobility of the young as they may risk striking out on their own.

In the past 30 years, the Republic of China has impressed the world with its long-term stability. There have been no social upheavals or crippling strikes, largely because both labor and management see greater benefits for all through cooperation and concession. Many foreign investors and traders have stated that such a favorable and stable climate can hardly be found elsewhere in the developing world. Thus, this favorable image is projected and perceived internationally,

with a result that enhances domestic capital formation and both foreign investments and trade relations.

For these reasons, many more factors of production become available and move steadily into Taiwan, paying back their fair and reasonable returns through the market functions. No place is perfect; but a society that approaches economic activity with a sense of fair play brings forth an additional factor which hastens its economic development.

I began with the thesis that invisible factors have contributed greatly to the economic achievements of Taiwan.

The factors I have emphasized are not tangible. They are not well described by charts, diagrams, or statistics.

Yet they do indeed exist.

And I am certain that they are more important than the visible factors so much beloved by so many.

The biggest difficulty is: To begin!

Economic development in the Republic of China was embryonic for many years. Then, as entrepreneurial attitudes took shape under a rule of law, it began rolling like a snowball down a favorable path, constantly accumulating both substance and velocity.

And, this has been witnessed and well understood by the young.

Today, the young Chinese emerge—both men and women—stronger and better educated than their fathers.

They have no hesitation in taking full responsibility for moving forward, moving upward, moving at full speed.

Many of the results are statistically visible. But the entrepreneurial attitudes—the motivations and the inner achievements and satisfactions—these are the invisible factors of success in the ROC.

Agricultural Technology, Economic Incentives, and World Food Problems

by E.C. Pasour, Jr.

British Parson Sir Thomas Malthus predicted in 1798 that population increases over time would outstrip increases in food production causing chronic food shortages. In recent years, a neo-Malthusian doctrine has again gained popularity as widespread hunger problems, especially in Ethiopia and other African countries, command front-page headlines. It is ironic that visions of a starving Africa are obscuring a major surge in agricultural productivity throughout much of the world today. Moreover, there is a great deal of evidence that the most serious constraints on food production are not weather or natural resources but rather government policies that stifle entrepreneurial incentives. This paper presents evidence on rising farm productivity, the importance of economic incentives in agriculture, and implications for world food production and economic development.

Rising Farm Productivity¹

Increases in agricultural technology are resulting in dramatic increases in farm productivity throughout much of the world. In the United States, farmers planted the world's first hybrid wheat in 1984, which increased yields from 25 to 30 percent. Rice growers in the Gulf states planted a new rice variety, which also had yields 25 to 30 percent higher than earlier varieties. At the same time, Taiwanese farmers are feeding surplus rice to livestock. Agricultural output is also increasing rapidly in the European Economic Community (E.E.C.). Wheat yields rose 23 percent in the E.E.C. in 1984 and French harvest of field peas has jumped 50 percent in two years.

Contrary to popular impression, world agricultural production is also increasing rapidly in the developing countries. Thailand, Malaysia, Indonesia, and the Philippines have all increased their farm productivity by more than 35 percent in the last decade. The International Rice Research Institute has introduced its Third World rice variety,

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which requires much less nitrogen and pesticide protection to achieve yields comparable to those of its previous "miracle" rice varieties. Researchers in Peru are making breakthroughs in production in the huge Amazon Basin replacing trace minerals that leach rapidly because of the high rainfall. Argentine wheat has become so cheap that grain companies recently considered importing it into the United States.

Agricultural productivity in Asia has been most influenced by the Green Revolution and by a recent dramatic shift in Chinese farm policy. Green Revolution rice varieties have been the biggest single factor in lifting Asian agricultural output by more than 25 percent during the past decade. Yet, potential gains from increases in available technology can be choked by policies that stifle entrepreneurial incentives.

Technology Is Not Enough

China provides a classic example both of the effect of collectivist agricultural policies and of what can happen when these policies are changed. In 1958, Chairman Mao decreed "The Year of the Great Leap Forward." Under the "Great Leap Program," large numbers of farm workers were to be diverted to industrial employment and the remaining farm population forced into agricultural communes. The loss in agricultural output caused by these policies was catastrophic. Food supplies fell to famine levels and had not recovered by 1965. Thus, contrary to conventional wisdom, per capita food consumption actually decreased during the Mao years.

China's agricultural output has increased dramatically since the late 1970s when a decision was made to increase farm product prices, scrap the big communal farms, and lease the land back to families and small groups. The privatization moves and the retreat from communism have been accompanied by an increase in food grain output of 12 percent a year for the past seven years despite bad weather in 1980, so that China has overtaken Russia as the world's largest wheat producer.²

A recent article in *The Economist* reveals a general relationship between market incentives and agricultural production.³ In a cross-country comparison of food production, Africa dominates the list of individual countries whose agriculture has increased the least since 1970. However, the difference between the most and least productive African states is dramatic. Significantly, the study concludes that: "Those which have done best—e.g., Ivory Coast and Malawi—have encouraged private ownership of land, or given peasant farmers secu-

rity of tenure. The least productive have been those which have encouraged state and collective farms."⁴

The evidence suggests that property rights and economic incentives are fully as important in less developed as in highly developed economies. This conclusion, however, should not be taken to mean that providing economic incentives will quickly transform a poor country. There is no short-cut to economic development, with or without outside financial aid. (As shown below, financial aid often is counterproductive.)

The solution to economic development in low-income countries lies primarily within the countries themselves. The only long-run solution to food and income problems in any country is to increase through capital formation the productivity of the people involved. When government policies severely distort economic incentives and discourage capital formation, it is not surprising that productivity, including agricultural output, is low.

What Can Be Done?

There is evidence that more can be done to increase food production in poor countries. Large increases in output by peasants in India, China, and other countries show that increases in agricultural output do not require big farms, big dams, big irrigation systems or an "agricultural plan." Instead, the most important step is to provide entrepreneurial incentives. This means that poor countries need to scrap those policies that are biased against farmers such as high taxes, price controls on farm products, overvalued exchange rates that depress agricultural exports, and protectionist trade policies that increase the cost of fertilizer and farm machinery.⁵

Developing countries, for example, often have regulations banning the importation of tractors, harvesters, and other mechanically powered farm machinery. Such restrictions are based on the old but persistent myth that machines destroy jobs. This argument carried to its logical conclusion would prevent all substitution of capital for labor and permanently keep workers at a subsistence level.

Another important step, as suggested by the productivity figures presented above, is to increase the application of science in agricultural production. Per capita food production rose 16 percent in South America and 10 percent in Asia between 1972 and 1982.⁶ This improved performance is due both to improved farming technology and to stronger economic incentives to use it. Many small farmers in develop-

ing countries, given an incentive, can now benefit from higher yielding varieties and better pest control.

Africa—No Exception

But what about Africa? In recent months, the world's attention has been riveted on Africa's hunger problems. The food problem in Africa is not due to the lack of natural resources. The problem is that most of Africa has continued to practice its traditional method of cultivation as rising population pressures allow fallow land less and less time to recover its natural fertility. Overgrazing is also encouraged by communal landholding. Public policies rooted in a development model stressing the necessity of central planning and rapid industrialization stifle agricultural production (and economic development in general). Dennis Avery, senior agricultural analyst, U.S. Department of State, presents a vivid example:

The importance of policy is amply demonstrated in the neighboring countries of Kenya and Tanzania. The two nations have similar agricultural resources and histories—but in the 20 years since independence, they have followed diametrically opposite farm policies. Kenya divided big landholdings among smallholders, then backed the smallholders with price incentives, research and extension programs. Overall farm productivity increased 37 percent from 1971 to 1982. Tanzania forced its scattered family farmers to consolidate into large villages. . . . Tanzania's farm output rose only 12 percent in the 11 years from 1971 to 1982—even by the Tanzanian government's highly optimistic numbers. Only massive food aid forestalled widespread hunger in Tanzania even before the recent drought.⁷

Avery contends that even in Africa, technology is now available to double yields and drought-proof its food supplies.⁸ He cites as evidence a new, more drought-resistant sorghum hybrid developed in the Sudan that appears to have the potential to triple yields in much of East Africa. Also available is a new sorghum for the dryer region of the Sahel that apparently can double yields there. In West Africa, there is the potential to become self-sufficient in rice by shifting from upland to swamp rice production. Nigeria has a new corn variety that yielded nine tons per hectare in the midst of last year's drought (the

current average yield is one ton). New peanut varieties with yields several times those of current varieties are being tested in Senegal, Mozambique, Zambia, and Zimbabwe. Improved pest control and new varieties helped bring about a seven-fold increase in yields of cowpeas in West Africa. The fact that available technology has not been more widely applied in Africa is not only a highly visible human tragedy but also an indictment of the government policies of African nations.

Farm Programs in Developed Countries

Agricultural success in the less developed countries is also adversely affected by farm programs in the United States and other highly developed countries that subsidize domestic agricultural output. When domestic prices of farm products are raised above the world price, imports must be restricted to prevent domestic users from buying lower priced imports. As a result of the U.S. sugar price support program, for example, domestic sugar price was four times the world price in late 1984. This import quota system, imposed by the world's biggest sugar market, is highly detrimental to Caribbean sugar producers.

In addition, subsidies, easy credit terms, and reduced interest rates are often used in the United States, the European Economic Community, and other developed countries to increase agricultural exports. Regardless of the type of subsidy, producers in the exporting country receive an artificial advantage at the expense of producers in the countries where the products are "dumped." This dumping of agricultural products in developing countries permits governments to keep the price of food cheap to the detriment of local farmers. Dependence on cheap imports discourages agricultural development and food production. The conclusion is that in assisting developing countries, the United States, the E.E.C., and other highly developed countries should stop subsidizing their own farmers. While government farm programs in the United States are often sold to the public on the basis of helping "feed the world," these programs actually impede economic development and food production in less-developed countries.

Economic Aid

The conventional wisdom for the past generation has been that poor countries cannot develop without financial aid from the highly developed countries. Foreign aid, however, is not indispensable to

economic progress. Indeed, P.T. Bauer shows that aid is more likely to obstruct development than to promote it.⁹ Foreign aid reduces incomes in the donor countries and enables the recipient country to follow counterproductive interventionist policies. Aid, for example, enabled Tanzania to pursue economic and social policies that are antithetical to both economic progress and individual freedom. The effects on farm output of the Tanzanian experiment (which involved forcibly herding millions of people into collectivized villages) were described above.

The Population Problem

Neo-Malthusians frequently cite the population "explosion" as an insurmountable barrier in alleviating world hunger. The prophets of doom typically reach their conclusions on the basis of projecting past trends. However, there is no reason to expect population to continue to increase at the same rate in developing countries as economic development occurs. When income levels rise in developing countries, the birth rate can be expected to decrease.¹⁰ Thus, the relationship between population and food must be considered in the context of economic development. There is no evidence that Draconian population controls (such as compulsory sterilization or abortion) are required for economic development.

Implications and Conclusions

The world is currently undergoing a major increase in agricultural productivity. World agricultural production is at a record high and is increasing rapidly. Agricultural output is increasing rapidly in the developing countries—rising from 2.7 percent per year in the early 1970s to 3.3 percent annually from 1977 to 1982.¹¹ This growth rate would have been even higher if not for the dismal record of agricultural production in Africa.

The famine in Africa emphasizes the urgency of modernizing African agriculture. Fortunately, much of the required technology is presently available. The coupling of technology with economic incentives can increase agricultural output in Africa just as it has in many countries throughout the world.

There is no easy or quick solution to world hunger or economic development. Production of food and other products is limited by available resources, and the only realistic goal in any country is to make the most efficient use of these resources. The only effective way

of increasing incomes is to increase capital formation and productivity. Foreign aid is no substitute for voluntary savings by the millions of people living in low-income countries.

Programs and policies affecting physical inputs will have little effect on output in the absence of the proper social and economic climate. Political controls of agriculture and other sectors of the economy inevitably stifle individual initiative, capital accumulation, and productivity. It is no accident that every country that has launched experiments in collectivized agriculture has witnessed a decrease in agricultural productivity. Hong Kong, Singapore, South Korea, and Taiwan are examples of countries that have prospered by shunning collectivist economic policies. The effect of recent limited privatization measures on agricultural output in China provides another dramatic example of the effect of economic incentives.

Increases in agricultural technology present a challenge to highly developed as well as to less developed countries. The temptation by government officials in both cases is to "manage agriculture." In the developed countries, domestic farm product prices are increased above competitive levels by expensive farm programs. Surpluses acquired in the operation of price support programs are often "dumped" in less developed countries. These policies are inimical to food production in less developed countries and to economic progress.

Rising farm productivity throughout the world now holds the promise of undermining these protectionist farm policies. There seems little doubt that farm producers in all countries will face more competition in domestic and foreign markets as currently available technology is adopted more widely. There is no way to determine now what the ultimate effects of these developments on world agriculture will be. We can be confident, however, that a more productive agriculture holds the potential to improve the lot of the world's hungry people. The challenge to governments in developed and less developed countries then is to abstain from policies that restrict competition and trade. Such restrictions prevent farmers and other workers in all countries from engaging in those activities in which they are most productive. Only through widespread use of decentralized competitive markets can agricultural resources throughout the world be used most productively, yielding maximum benefits to people in all countries.

1. The productivity figures cited in this section are from two papers by Dennis T. Avery, Senior Agricultural Analyst, Bureau of Intelligence and Research, U.S. Department of State. "The Dilemma of Rising Farm Productivity" was presented before The Agribusiness Roundtable, September 10, 1984. "The Bad News for Farmers Is That the

Global Bad News Is Wrong" was presented before the N.C. Society of Farm Managers and Rural Appraisers, February 28, 1985.

2. "Business Brief: In Praise of Peanuts," *The Economist*, February 2, 1985, pp. 86-87.
3. *Ibid.*, p. 87.
4. *Ibid.*
5. "Peasants Rising," *The Economist*, February 2, 1985, pp. 11-12.
6. Avery, 1985, *op. cit.*, p. 3.
7. Avery, 1984, *op. cit.*, pp. 6-7.
8. Avery, 1985, *op. cit.*, p. 4.
9. P.T. Bauer, *Dissent on Development*, revised ed. (Cambridge, Mass.: Harvard Univ. Press, 1976), pp. 95-132.
10. Ludwig von Mises, *Human Action* (Chicago: Henry Regnery and Co., 1966), p. 669.
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III. THE POLITICS OF ENVY

Profit-Maker—Friend or Foe?

by Howard Baetjer Jr.

Is one who makes profits an exploiter, as is so often claimed? Or is that person a social benefactor? Do profits arise from harming others or making them better off? Do profit-makers deserve resentment or gratitude? To examine this question, we will need to look at opposing economic theories of value and profits. But before that, we had better be clear about the nature of wealth, what it is and how it comes to be.

What is wealth, precisely? Is money wealth? Suppose you could wave a magic wand, and become owner of millions of dollars, billions of marks, trillions of yen, and gold and silver coins by the truckload. Would that be sufficient to make you wealthy?

Suppose that as you waved that magic wand, you found yourself, with all that money, on the very spot you now occupy, in 1585. If you are in North America, there would be nothing in sight but the rocks and trees and grasses and streams, and maybe a stray Indian.

You would be a trillionaire, but would you be as wealthy as you are at this moment, no matter how meager your bank account might be? No. Real wealth is not money. Wealth in the strictest sense is valuable things—things we can use to support and enrich our lives. It is goods and services: food, clothing, shelter, electric light, symphony orchestras, diesel engines, milkshakes, and so on. That is the first point: *wealth is valuable goods and services.*

For the second point, how does wealth come to be? Does it shower down like manna from heaven, or grow out of the ground all ready for our use? Do houses spring up from the earth and furnish themselves for us; do big jetliners lay eggs from which hatch little jets? No. These things have to be created; they have to be built; they have to be brought into existence by the ingenuity and labor of people. That's the second point. *Wealth is created by people.*

But, out of what do people create this wealth—with what do they build it? Do they snap their fingers or wave a magic wand, and produce it from nothing? No. They build it out of what is already here. To take a phrase from my colleague Bettina Greaves, we have pro-

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gressed from caves to computers simply by moving things around—most thoughtfully and exactly, to be sure—but just by moving things around. The clay, iron, and other substances that compose buildings have existed as long as the earth has, but they are more usefully arranged now into cinder-blocks and steel beams. The electrons going through fluorescent lamps were here, too, but not arranged in that clever combination with glass tubes and vapor so as to make light. What makes *wealth* of raw substances is the value of their arrangement. The third point, then, is that people create wealth *by cleverly rearranging and recombining the natural things that make up the earth.*

To sum up, *wealth* is valuable goods and services, which ingenious people create, by rearranging and recombining the physical stuff of the earth. The last part of this is most significant: wealth comes to be when somebody discovers and produces a better, *more valuable arrangement* of things.

What Determines Value?

We can accept the above proposition that wealth is essentially a valuable arrangement of things, but that invites the questions: What makes something valuable? Why are some things wealth and other things worthless? Why do Cadillacs cost more than matchbox toys, sirloin steak more than hamburger, tickets to see Michael Jackson more than tickets to see the Chicago Symphony? *What determines value?*

This is a fundamental question, on the right and wrong answers to which are built right and wrong theories of profits, and entirely different answers to our main question about whether the profit-maker is an exploiter or a benefactor. We begin with the generally accepted theory, which also happens to be wrong.

Labor?

One of the greatest economists ever, Adam Smith, misunderstood value, and thereby started a long chain of confusion. Smith was a proponent of *the labor theory of value*, which holds in essence that the value of a thing is determined by the amount of labor that went into making it. To quote from *The Wealth of Nations*, "Labour, therefore, is the real measure of the exchangeable value of all commodities." Notwithstanding the brilliance of most of Smith's other ideas, this is an error.

Karl Marx picked up Smith's error and added more mistakes on

top of it to produce his theory of *profit*. He argued that since the value of a thing is determined by the labor that went into it, laborers—and laborers only—are responsible for the thing's value.

If you are a worker on a ranch, for example, and you fertilize a field, plant alfalfa seed, irrigate it, cut the ripe alfalfa, bale it and stack it up for delivery, you, the laborer, are responsible for transforming the alfalfa seed and other raw materials into, say, \$1,000 worth of feed for cattle. Suppose the raw materials—the fertilizer and seed, the gasoline for the cutters and balers, the baling wire and the like—cost the owner of the ranch, your employer, \$400. The "labor value" Marx says *you* added, then, is \$600.

But all you get for your work is your wages, say, \$500. This leaves your employer a hefty profit of \$100. But he didn't labor at all; how is it that he has extra money? According to Marx's theory, this profit for your employer is "*surplus value*," the labor value you put into the hay, that he didn't pay you for. You did \$600 worth of work, but only got paid \$500. You deserve all \$600. Your employer has appropriated from you—stolen from you—\$100 worth of the product of your labor.

To move on to the third part of this foolish but widely believed theory, in this way employers "exploit" their workers. Your employer takes his profit, the "*surplus value*" of your labor, at your expense. It was created by you; therefore it rightly belongs to you, according to this theory. The very fact of profit, then, shows there has been exploitation.

The "Zero-Sum" Idea

This whole ideological package—the labor theory of value, profits as surplus labor value, and the exploitation of working for wages—depends on and illustrates another fair-sounding but wrong idea, the *zero-sum* view of the world. This is the idea that if somebody profits, somebody else must be harmed, because after all there is only a certain amount to go around. If we add up, or sum the changes in economic condition of everybody, we must always come out to zero, because one person can gain only what another loses. Business activity simply shifts around existing wealth. That's the zero-sum view.

Those who believe in the labor theory of value—who hold the zero-sum view of life—*necessarily* see the profit-maker as an exploiter. This includes not just Marxists, but also milder leftists. A congressman, for example, once criticized the oil companies for making "obscene profits." And, sad to say, many men and women in business somehow think all this is true. They want to make profits, of course, and they

strive very hard to make them. But they feel guilty about it. They worry that they are profiting at the expense of others, that in truth, they are exploiters—vicious capitalists who prey on their fellows.

This worry shows how very powerful error can be, because it *just isn't so*.

The Subjective Theory of Value

Though the labor theory has a certain plausibility, we can see that it is false by a simple example. Suppose the amount of work that went into making a commodity *did* determine its value. Then suppose that on neighboring ranches, two different crops are produced, each requiring and getting the same amount of labor. Suppose one ranch raises alfalfa, and the other raises poison ivy. If the labor theory of value were true, the two crops would have to be worth the same!

But obviously they are not worth the same. People will pay much more for hay, which nourishes cattle, than for poison ivy, which makes people itch. And therein lies the key to the true theory of value. People's personal *preferences* determine value and price. They will pay more for what they *want* more. The true theory of value is a *subjective theory of value*. Value exists not in the thing valued, but in the minds of the valuers.

This subjective theory of value is a critically important economic concept, one of the crucial insights on which the so-called "Austrian" school of economics is based. It was discovered by three economists, Carl Menger, Stanley Jevons, and Leon Walras, all working independently, at just about the same time—the early 1870s. With it they cleared away Adam Smith's labor theory error, and opened up the way to a proper understanding of profits.

Once the labor theory of value goes, of course, the Marxian theory of profits immediately goes with it. Since there is no such thing as "labor value," then clearly the Marxian notion of profits as "surplus labor value" is false.

An accurate view of profits is built on two implications of the "Austrian" subjective value theory. The first is this: a certain thing does not have one value for all people in all different times and situations. Values are different for different people, and they change all the time. (I might add that in speaking of values as subjective I do not mean moral values such as courage and honesty, which are always fundamentally valuable in their way, but only personal valuations of marketable goods.)

Values change and vary. This is crucial. The same thing can have

different values for the same person in different times and situations, and it can have different values for different people at the same time and in the same situation. For example, right after you have eaten a full meal, you probably would not pay much for a large milkshake. But as time goes by you start to get hungry again, and gradually the price you would pay for a milkshake increases. If you have to go without food for a long time, especially in hot weather, you might eventually be willing to pay five or six dollars for a milkshake. Its value for you changes with your situation.

When Trade Is Voluntary Both Parties Benefit

This obvious truism, that values vary and change, leads in turn to a second important insight: When an exchange is made in a free setting, *both* parties to the exchange *benefit*. The things exchanged are not of equal value, as has so often been thought, but of different value—to the people exchanging. Indeed, that is why they make the exchange. Consider yourself, for example, when you do business with a milkshake vendor. The value you put on the milkshake in your situation is greater than that of the people selling it. You value the milkshake more than the money; they value the money more than the milkshake. Otherwise there would be no exchange at all. You give up your money; they give up the milkshake. Both parties say thank you; both parties are happy; both have benefited.

The situation is similar where the exchange is not of ice cream for money, but of *labor* for money. Consider those of us who worked as summer laborers on a Nevada ranch harvesting alfalfa. We drove the machines, built fences, painted storage tanks and so on, earning slightly over minimum wage. When we took those jobs, offering the ranch owner our work in exchange for his money, we valued the money he gave us more than the time and labor we gave him, and he valued our work more than the money he gave us. There was benefit on both sides.

Marx's exploitation theory thus reverses the truth. Workers are not exploited by their employers. On the contrary, in a free exchange they are benefited by their employers—and vice versa. That's the nature of free exchange. True, we might have wished that our efforts were worth more—that we could have commanded a higher wage—but in our particular situation in that time and place, that job at that wage was better than any other available use of our time and effort.

Free Exchange Is Positive Sum

In a free exchange, both parties benefit. Note that this fact disproves the zero-sum assumption of economic life. In a free-market exchange, neither party loses for the benefit of the other; both parties benefit, or they would not exchange at all. Free exchange in a market setting is not a zero-sum game, but a *positive sum* game.

While we're on it, let's make another point about this zero-sum idea. Those who believe it often remind us that resources are finite: they imply by this that therefore *wealth* is finite. True, resources are finite, if by resources they mean only raw materials. But the ultimate resource, as Julian Simon has pointed out in a book by that name, is people—human ingenuity and creativity. Of that resource there seems to be no limit at all. Human beings are astonishingly ingenious, creative creatures. They have a seemingly unbounded capacity to figure out better arrangements for these finite raw materials.

And for this reason, the finiteness of physical resources does not put any bounds on wealth. Wealth, as we saw at the outset, is not in substances, but in their arrangement. With the same physical substances, creative people can increase the amount of wealth until the crack of doom, through ever-better arrangements of those substances.

Profits

To understand fully what profits are and how they are made, we need to add one more concept to those we have already observed. We have seen that people create wealth by favorably rearranging and recombining physical things, and that different people place different values on things. To these concepts we add one more thought: our *knowledge is imperfect*. Most importantly, we have very imperfect knowledge about the most valuable ways to arrange and combine things. Often we do not know of mutually beneficial exchanges we might make with others. Or, knowing of exchanges we would like to make, often we don't know how to manage them inexpensively enough. And nobody knows of valuable products and methods that have not yet been discovered.

With these three concepts we can define profits. *Profits are what result from somebody's overcoming imperfections of knowledge, discovering, and producing a more valuable arrangement of things.* Put another way, profits are a person's reward for increasing value, for increasing wealth. Remember that wealth is in the arrangement, not in the sub-

stances: he or she increases wealth who comes up with a more valuable arrangement.

Let's illustrate this with an example.

Suppose Mr. Phelps, the owner of the ranch where I worked, has a number of big stacks of hay that he would like to sell. In that situation, Mr. Phelps puts a relatively low value on hay. Let's suppose he would take as little as five dollars a bale for it. His knowledge is imperfect. He knows that there are lots of dairy farmers in California and New Mexico and Nevada who would like to buy his hay, but he does not know exactly who they are, how much they need, or what they would pay for it. Furthermore, he does not know where to get trucks and drivers to ship his hay. At the same time there are lots of dairy farmers who put a relatively high value on hay. They would be glad to pay up to six dollars a bale for it. They know there are ranchers with hay to sell, but they aren't sure where those ranchers are, or how much they can deliver. And they don't know where to get trucks and drivers either. This is a problem for both Mr. Phelps, who has the hay, and the dairy farmers, who need it.

These folks are in a situation where they *might* make a mutually beneficial exchange, but they can't manage it. What they need now is for somebody to discover this unfavorable arrangement, figure out how to fix it, and do so. They will be glad to reward someone who does. At the same time there are people leasing eighteen-wheeled flatbed trucks that might be used to ship hay, but they don't know about Phelps and the dairy farmers. And there are oil distributors, selling diesel fuel that could run those trucks from Nevada to California, but they don't even know what alfalfa is. And there are truck drivers who would like to make the run, if somebody told them where to go, and offered them a better deal doing that than something else.

All the potential is there for half a dozen mutually desirable exchanges. But so far, nothing happens. The hay sits in the lot, the dairy farmers fret, and the trucks, the gas, and the drivers are being used to deliver things less important than that wonderful, high-protein hay. All these resources need somebody to coordinate them properly, to rearrange and recombine them into greater wealth than they make up in their present arrangement. What is needed is an *entrepreneur*.

The Role of the Entrepreneur

Along comes the hay broker. He leases the eighteen-wheeled trucks, buys the diesel fuel, and hires the drivers, giving each one

directions to Mr. Phelps' Ranch and from there to the dairies. He negotiates with Mr. Phelps to buy hay at, say, \$5.25 a bale, and with the dairy farmers to sell it at, say, \$5.75 a bale.

Now, is Mr. Phelps better off? Yes, he has made 25 cents a bale more than he would have accepted. Are the farmers better off? Yes, they had to pay 25 cents less than they would have paid. Is the leasing company better off? Yes, they expect to be, or they never would have rented out their trucks. Likewise the fuel distributor and the drivers would not have dealt with our entrepreneur unless they thought they would benefit by it. So everything our entrepreneur has done so far has meant benefits for those around him.

Now let us suppose the entrepreneur's expenses add up to 25 cents a bale. This includes all the costs of doing business: wages for the drivers, fuel costs, maintenance on an office, payments for the trucks, insurance premiums, clerical costs, phone bills, the wage value of his own time and so on. Added to the \$5.25 he paid for the hay, that brings the total market value of the starting arrangement of things (call it the cost of inputs) to \$5.50 a bale. But since the market value of the final arrangement (call it the yield) is \$5.75 a bale, he has 25 cents a bale left over.

That is his *profit*. It is the yield minus the costs. It is his reward for *increasing wealth*, for taking what is valued less, and transforming it into what is valued more. It is his payment for discovering and producing a more valuable arrangement of things. He does not profit at the expense of those around him; he profits precisely because the result of his activity, when all is said and done, is more valuable than the state of affairs that existed when he started—by 25 cents a bale.

Note that the size of the profit depends on the amount of improvement overall, the size of the difference between the less valuable starting arrangement (the costs) and the more valuable finishing arrangement (the yield). It depends on *the overall increase in value*. The hay broker does not just have to discover who has hay and who needs it, and sell it for more than he buys it. He also has to discover good trucks to use, quick and efficient means of loading and unloading, cheap fuel, good mechanics, dependable drivers, short routes and so on, so that all these costs together are less than what he makes on the hay itself. His profit, if any, depends on his efficiency, on his producing more value than he consumes.

This efficiency is itself a social service, because it saves valuable goods for other purposes. The quicker his loads are delivered, the less hay is spoiled and wasted. The less fuel he burns and driver time he uses, the more of these are left over to deliver other valuable goods.

Losses

The opportunity for profit always involves the possibility of loss. Profits are never guaranteed in this uncertain world. The entrepreneur loses when his costs, the total value of the resources he uses up, are greater than the yield, the value of the new arrangement. He loses, and society loses, because the total stock of wealth is decreased. Suppose our hay broker is inefficient. Suppose he wastes fuel, that his drivers waste time loading and unloading, and get lost making deliveries. Suppose he leases smaller trucks than he should, so that he needs more trips to deliver the same amount. These inefficiencies might push up his total cost of delivering each bale to 50 cents, instead of 25. And his slow delivery will allow more spoilage of the hay, so that perhaps he will be able to sell it for only \$5.65 a bale, instead of \$5.75. Now his costs are greater than his yield, so instead of profits, he makes losses, of 10 cents a bale. This means—indeed, it is the same thing as saying—that he has used up more valuable resources than he has produced, at a rate of 10 cents a bale. He loses, because society overall loses.

Mr. Phelps still gains, of course, as do the dairy farmers and the truck leasers and the fuel sellers and the drivers. They would not deal with him if they did not see an advantage in doing so. But the society overall is worse off; it would have been better on the whole if this hay broker had never made the deliveries, if the trucks, the fuel and the drivers had been left at their previous uses (assuming *they* were profitable).

The greater the entrepreneur's profit, the better off his society must be. Bigger profits mean bigger improvements, bigger differences between the resources consumed and the value produced. (They also encourage competition, of course, which tends to increase supply, lower prices, and thus reduce profits; but that's another subject.) Profits cannot be obscene; the bigger the better! They are all to the good for society. Far from being exploiters, entrepreneurs who make profits are social benefactors of the first order, for they are the ones who create wealth, who increase the total amount of valuable goods in the world.

Who Deserves the Profits?

I first appreciated the importance of entrepreneurial brainwork, and the difficulty of the entrepreneur's job, after work the first day I drove a baler. At the same time I realized how silly is the popular notion of "unfairness" in the laborer's doing "all the work" for nothing

more than wages, while the entrepreneur does no labor but earns all the profits.

I had been on the baler all day, the usual ten hours, from seven to six with an hour for lunch. The Nevada sun was hot, and the work was dusty. As usual, Mr. Phelps had been cruising around, checking on us from his air-conditioned, white Lincoln Continental. We were sweating for just over minimum wage. He wasn't working, but he was making the profits. It doesn't look fair, does it? It didn't to me—until I looked closely.

I had had fun, and when I saw him in the machine shop talking to his foremen I called out proudly, "Hey, Mr. Phelps, I learned how to run a baler today!" He gave me a smile with a friendly sneer and said, "Baetjer, you didn't learn to *run* a baler, you learned to *point* a baler." In a moment of insight I understood how dependent the laborer's contribution is on that of the entrepreneur, and why the entrepreneur deserves every penny of his profits.

What he said was true. I had baled a whole lot of hay that day, but I didn't know a thing about it. I couldn't even fix the small problems I had with my machine, let alone service it properly or make a major repair. Any worker could do what I had done, steering the tractor up and down the fields, but it took skilled mechanics to keep the balers running, and adjust them so that the bales would be the right size and weight. It had taken careful planning and inventory control to see that there was always baling wire and fuel on hand, and to keep spare parts in stock (they say they have them for every part of every machine!). The effectiveness of my simple, thoughtless work pulling that baler was utterly dependent on Mr. Phelps, who had arranged to get it there, had it prepared for use, and put me aboard it in a field of new-cut hay.

Sure, I had baled the hay, but who got it there to be baled? Think of the extraordinary sequence of precise, interdependent rearrangements of physical resources, labor and technical know-how that Mr. Phelps had arranged in order to produce that crop. The soil chemistry of the land had to be analyzed; on the basis of that analysis fertilizer had to be chosen, ordered and spread. The fields are not naturally even, so they had to be smoothed as well as possible, and sloped at the ideal rate for irrigation. (Most recently this smoothing of the fields is done by a laser-plane, in itself an extraordinary entrepreneurial achievement of hydraulics and laser technology.)

The alfalfa seed had to be chosen from among different strains, bought and sown, at the right time and in the right amounts. Since the valley gets very little rainfall, a complex irrigation system had to be

built and maintained, and the irrigation carried out on time, in the right amounts, and at the right rate. When the alfalfa started to bloom, it had to be cut, weather permitting, as close as possible to that brief time when the protein content in the plants is highest. The drying hay had to be monitored for moisture, so that the bales would be neither damp nor dried out.

At each step of the harvest process, the necessary machines, costing tens of thousands of dollars each, had to be ready. There are the "swathers," which cut, crimp and pile the hay into windrows; the balers; and the harobeds, computerized marvels of levers and platforms, which pick up, load and stack the bales. All must be in use on time, because once the hay is cut, it must be dried, baled and stacked without delay to maintain its value. During the harvest, the hay broker must be contacted and negotiated with, the fields and irrigation ditches repaired, and the next round of irrigation planned.

Every step of this extraordinary process must be directed by Mr. Phelps, the entrepreneur. Each crucial decision, on which depends success or failure, profit or loss, must be made by him, either directly or through the men he has hired to make them. In any case, the responsibility for the result, be it credit or blame, is his. One good decision made in that white Lincoln Continental was worth a whole day's worth of pointing a baler, and a whole summer's worth of baling could not make up for one bad decision. All I did was steer. He did the *thinking*. That is why the entrepreneur deserves the profits: he makes them possible!

The successful entrepreneur, one who makes business profits in a market economy, is a social benefactor. (In a mixed economy, with government intervention and privilege, things are often different, but that, too, is another subject.) Indeed, the profiter is the most important, most significant kind of benefactor any society has, because such a person provides, in ever greater measure, the wealth all the rest of us depend on to support and enrich our lives.

Scalping and Envy

by Gary North

"Scalpers." What a terrible-sounding word. It almost rivals "scab." In each case, the detractors have singled out an important function in a free market society. The "scab" is anyone who is willing to work for a businessman for less than a labor-union member is willing to accept. A "scalper" is anyone who wants to bear the uncertainties of the market for entertainment tickets. Every so often, especially the night of the regional "big game," we see a television interview on the evening news. The interviewer goes to the scene of the Big Event and starts asking people about ticket availability. Invariably, he approaches someone who complains about "all the scalpers who are ripping off the public." Once in a while, he may even get a "scalper" to discuss his business.

Another less familiar aspect of the scalping business also gets reported occasionally. The "patriotic" radio news commentator announces with glee that at the Detroit appearance of The Rolling Stones, scalpers could not sell all their tickets and had to take less than they had paid for them. Or: local TV announcer interviews scalpers; finds tickets "going begging." Big news. Man bites dog. Market bites scalpers. Justice reigns. The bad guys finished last.

Why the hostility to scalpers? What is it about scalpers that makes people so angry? Why is "buying low and selling high" so reprehensible when amusement tickets are concerned? After all, we are not talking about life and death. We are talking about "State vs. Tech." We are talking about the price of having one's eardrums blown out at a rock concert.

Bad Vibrations

The *Los Angeles Times* published a series on ticket scalping in April of 1976. The introductory paragraphs of the April 8 article reveal the general attitude toward scalping ("Hard Day's Night at the Box Office"):

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There wasn't a single advertisement preceding the recent sale of tickets for Paul McCartney and Wings' two upcoming Los Angeles concerts, but some 1,500 people were in line when the Forum's box office opened. And while only brief items in that day's newspapers announced the sale, every seat in the 18,500-seat arena was gone in less than five hours.

Box-office smashes like that may make a lot of people associated with the coming McCartney tour happy, but they make a lot of other people quite angry. So many fans are competing for so few spots to major rock concerts that selling tickets on a first-come, first-served basis is no easy task. Instead, determining just who's first and serving him or her has become a complicated and controversial affair.

Concertgoers, backed by legislators and law-enforcement officials, are concerned about how tickets are sold and, often, resold. Some complain, for example, that by the time they hear that tickets are going on sale, the event is sold out. Others complain of waiting in line all night or longer to wind up with only fair seats. And nobody likes it when \$9 or \$10 prime tickets for sold-out concerts emerge at licensed ticket brokers for \$20, \$30 or more.

Let us examine some of the details of this critical analysis. (The author went on to consider in greater detail the actual sales of tickets in Los Angeles, so the article was not totally hostile to "scalping.")

First, Mr. McCartney and the promoters were displaying eminently good sense in not spending a small fortune on advertising when word-of-mouth advertising was sufficient. They could bank on his fame as a former Beatle to draw the crowds to the Forum. No one would suggest that it would have been wise for him to spend money to jam up the box office with extra thousands of ticket buyers who were bound to be disappointed.

The fact is, at least 1,500 people had heard in time to take steps to insure their presence at the Great Event. Or at least, they insured the legal right to attend; if they decided to sell this property right to someone else, then that legal title was transferred. Each ticket was a *property right to a seat* at the Forum.

It was true that "so many fans are competing for so few spots," that selling tickets on a "first come, first served basis is no easy task." From one viewpoint, it is also no sensible task. Why sell tickets that way? Why not hold an auction?

Competition

No one wants to suggest that the fans are in competition with Mr. McCartney. Mr. McCartney is the seller of his services. He no doubt delegated the task of selling legal access to his performance to other profit-seeking entrepreneurs, who guaranteed him and Wings a specific price, plus (perhaps) a percentage of the gate. But the public does not perceive the *initial* seller as a competitor with the public. The public sees the fans as competing against each other. This is the proper perception. *Sellers compete against sellers.* Mr. McCartney was not, I feel certain, the only performer scheduled to appear in Los Angeles that night, or that week, or whatever period of time that affected the spending preferences of amusement-seekers in Southern California. Likewise, *buyers compete against buyers.* All those fans lining up in single file were acknowledging the reality of the competition. The seller (Mr. McCartney) was not in competition with buyers (fans).

Concertgoers may well be concerned with how the tickets are sold and resold. But why should legislators be concerned? No doubt, some people *did* complain that by the time they heard about the concert, it was sold out. *Information is not a zero-price commodity.* It travels along peculiar paths. No doubt others *did* complain about standing in line all night and only receiving mediocre seats. Mr. McCartney is a popular fellow. Is this blameworthy?

Complaints About Price

What people were complaining about was this: *at zero price*, not all those who wished to see Mr. McCartney perform in a public auditorium could squeeze into the auditorium. But they did not want to admit this openly. So they complained about the price. Some complained by not attending. Others complained about having spent (the proper word) so much time waiting in line. They forfeited time, plus a few dollars, and got second-rate seats. Problem: there were not enough first-rate seats to go around. Any seat was a good seat in the eyes of those who wanted to go but who chose not to stand in line, and who then paid scalpers a higher price.

True, nobody likes to pay \$30 for a \$9 ticket. But, then again, nobody who is willing to pay \$30 for a \$9 ticket is happy when nobody will sell him the \$9 ticket for \$9. What is it that people like least? Paying \$30 or missing the concert?

Why organize sales of tickets on a "first come, first served" basis?

Why not organize sales some other way? The article showed how devious the distribution was. Thousands of tickets are set aside in the entertainment industry for friends of promoters, or disc jockeys, or others connected to the industry. The public is not aware of these sales (for the tickets eventually get sold, says the reporter). The public may know that college athletes at major universities are paid off in tickets each week, which are sold for cash, but that's only "innocent graft." Besides, they go to cheer these athletes, so who cares if athletes get a piece of the action? The seller, in this case, is the performer, and for some reason, nobody ever regards the seller as an enemy of the attendee, when sports or entertainment is the market in question.

Boxing has ringside seats. Sports teams have "season tickets," where rich people, or entrepreneurial fans who expect a losing team to start winning next season, can "stake their claim" to the "mother lode," namely, the best seats in the house. The public expects the best seats to be taken by others. The yelling starts when the *second-best seats* go on sale. (Note: the wealthy buyers are not envied—*social distance*.)

The Risk Factor

How are competitors channeled? How do profit-seeking entrepreneurs get the best return on their investments? By buying low and selling high. By seeing a factor of production which is presently being underbid in the producer goods market, buying it at this low price, and then selling later into an enthusiastic final market. But there is risk involved (more properly, unpredictable uncertainty). No one can be sure that the crowd will show up. In the case of rock concerts, no one can be sure that the entertainers will show up. People bear uncertainty. They pay their money and they take their choice. People buy low, *hoping* to sell high. There are no guarantees.

Why not charge \$30 at the box office for those seats that everyone is willing to pay \$30 for? Why sell \$30 seats for \$9? After all, in the final analysis, they were not \$9 seats; they were \$30 seats. They were \$30 seats that sold for \$9 *originally*, just as much as they were \$9 seats that sold for \$30 *finally*. Somewhere in between "originally" and "finally," there was a lot of *uncertainty*. "In the final analysis": what a loaded phrase. In the final analysis, meaning the night of the performance, there was more demand for \$9 tickets than supply of \$9 tickets. So tickets traded at prices higher than \$9. There were more buyers at \$9 than sellers at \$9. Buyers were competing against buyers the night of the performance. There was, however, one difference: the compet-

ing buyers were no longer standing in line to buy. They had entered the quiet auction market for tickets. (It had to be quiet, since it was officially illegal.) Cash had replaced the line.

Lining Up

There is some peculiar mystique about forming a line. All over the world, people dutifully line up. They line up in grade school, they line up at the Post Office, they line up to buy tickets. They certainly line up to spend ration coupons in socialist nations. In fact, a balloonist who lost his way in Europe could find out whether he was over a socialist nation or a free nation simply by looking down and checking the length and number of lines. People also line up to get out of socialist nations, in order to escape into nations that substitute other forms of economic competition. *We line up when someone is charging below-market prices.*¹

The concertgoers, on the night of the Great Event, know that all tickets are sold out. There is no reason to stand in line any longer. So they substitute a different form of economic competition. They offer \$30 for \$9 tickets, meaning tickets bought for \$9 *before* the Great Event had sold out. These were tickets that cost \$9 *plus 15 hours in line*. They were "\$9 and 15-hour" tickets. They were "word of mouth information before the crowd shows up" tickets. Now demand at \$9 is much higher.

For most people, \$30 is a lot less expensive than 15 hours in a line overnight. Whose time is worth under \$2 an hour (\$30, minus \$9 = \$21 for 15 hours)? Those who value their time more than they value \$30 can exercise their preference in a voluntary transaction. Why do legislators try to ban such transactions? Why do voters demand that legislators pass laws against scalpers? Why is it considered legitimate to *spend hours* to buy a ticket, but not to *spend money* above the listed purchase price? Why are initial sellers the friends of the public, and secondary sellers the enemies of the public welfare? If Mr. McCartney is not the public's enemy, and the box office is not, then why is the scalper seen as the public's enemy?

Motivated by Envy

I will offer my suggestion: Because we are a nation of incipient socialists who are motivated by envy. We want those who are *close to us socially and economically*, and who prosper (perhaps) temporarily,

to be deprived of their benefits. This has been pointed out by sociologist Helmut Schoeck, in his brilliant book, *Envy*.

... envy is not directly proportional to the absolute value of what is coveted, but very often concentrates upon absurd trifles to such a degree that, in some situations, the best means of protection against the envy of neighbour, colleague or voter is to drive, say, a Rolls-Royce instead of a car only slightly better than his, or, if Brighton is his resort, to choose a world cruise rather than a holiday in Sicily. In other words, overwhelming and astounding inequality, especially when it has an element of the unattainable, arouses far less envy [than] minimal inequality, which inevitably causes the envious man to think: "I might almost be in his place."²

We worry about someone receiving \$30 for his \$9 ticket, but not at all about Mr. McCartney receiving \$150,000 for three hours of work. If we view Mr. McCartney's performance as having nothing to do with his years as a Beatle, then he is earning, say, \$45,000 an hour (\$150,000, minus expenses, divided by three), while the person selling the so-called \$9 ticket is earning under \$2 per hour for his 15 hours in line. Yet we are outraged at the scalper. *He has exploited the public.*

What is the difference? The *social distance* between us and Mr. McCartney. The awe and even reverence we show for Mr. McCartney's talents as a performer place him beyond envy. (Also, he has a British accent, making us feel terribly inferior, thereby increasing his social distance.) But that scalper who makes someone pay 30 whole depreciating dollars—*there* is a man to be squashed!

We stand in line to see Mr. McCartney. He has put us in our place. But the scalper has no right to put anyone in his place. He is a *secondary* seller, indicating his social proximity to us. He seeks to deprive us of our funds, unlike the performer, who deprived the scalper of *his* funds.

When standing in line is seen as a legitimate way to gain access to any event as a *primary consumer*, but asking someone else to pay money above the listed purchase price is seen as exploitation by a *secondary seller*, then the ideology of socialism has done its work. When men refuse to acknowledge that they are unwilling (or unable) to pay the price to become primary consumers—i.e., people who will stand in line overnight—and resent it when a primary consumer asks the secondary consumer to pay a premium for his own procrastination, or his unwillingness to stand in line, or his late access to the news

about the Great Event, or his impulse-buying attitude, then the free market economy is in trouble.

Middlemen

The late-night TV ad blares the message: "Yes, we can offer you these fabulous prices because *we have eliminated the middleman*. We sell direct to the consumer, and we can pass along these bargains to you."

What a fabulous opportunity! At last, we can buy direct from the producer. No more having to shell out our hard-earned money for middlemen. After all, what do middlemen ever do except stand around in the middle? At last, some inventive seller has found a way to eliminate the middleman. And it only took 6,000 years!

There are producers. There are buyers. Where did the middlemen get into the act? Why should we pay anything to them? Aren't they economic exploiters? Why should business tolerate middlemen? These are questions implicitly asked by those who despise scalpers.

All right, there are producers. They made a decision to buy low and sell higher. They entered the market for producer goods—raw materials, labor services, capital equipment, land, buildings, and so on—and bought up what they then believed were underpriced goods. They now are sitting on top of a pile of merchandise. How do they get the highest return?

The tried and true method is to sell it to nonproducers (retail sales people) who in turn will market the finished products to the final consumers. They take over the economic burden of predicting an uncertain future. The producer wants out. He takes his money and runs. Occasionally, some producer decides to "sell direct to the consumer." Fine. Who rents the warehouse space? Who insures against fire and theft? Who decides how much to spend on advertising, and in which media? Who tries to predict the final purchase prices that the buyers will be willing and able to pay in the future? Who rents the showroom space? Who dreams up the credit terms, locates the creditor, and convinces the buyer that "now is the time to buy"? Who, in short, enters the market in between *originally* and *finally*? Someone has to bear these expenses. Someone has to be compensated for bearing these uncertainties. Something "in the final analysis" has to lure people into the uncertainty-filled marketplace to pick up this burden. That person is the *middleman*. He is also called the entrepreneur, or the speculator. And, in the case of tickets, he is called a scalper.

The Box Office Dilemma

The box office sells at a specific price. Sometimes the people who own the box office are not sure what to charge. They want to fill the arena, so that everyone who wants to get in can do so, with nobody waiting outside, and not a single seat empty. That is accurate forecasting. That is the way to make money. And that is what nobody can do all of the time, or even some of the time, if the arena is large enough. A perfectly priced set of tickets will "clear the market": a packed arena, and nobody left in line.

So the owner of the box office, or the Ticketron outlet, or whoever is the primary seller to the primary buyer, decides on a price. The tickets get sold, let us say. The market then determines what the proper price should be in the moments before the performance. Sometimes the price was set too high. Sometimes it was set too low. The middlemen lose, or they win. The middlemen bear the burdens of uncertainty.

Why are the original sellers so foolish? Why did those who had the right to hire the services of Mr. McCartney in April of 1976—to become the *first middlemen* in the distribution of Mr. McCartney's services—not charge \$30 per ticket right from the start? Why did they pass on the \$21 per seat profit (or whatever it was) to *secondary middlemen*? Why did they give up 18,500 times \$21? Were they fools? Why were they, as professional middlemen involved in the entertainment business, such poor forecasters? If they are so smart, why are there scalpers?

Seeking a Scapegoat

I have put this question to people associated with box offices, and I have never had a convincing answer. They are hiding something. I believe that they are hiding something very specific: *the fear of envy*. They do not want to become "middlemen"—"gouging" middlemen—in the eyes of local ticket buyers. They do not want to face the wrath of buyers at the auction, when buyers shout and claw to get access to the tickets. They want to be as unobtrusive as possible, collecting their percentage. They do not want to be seen as "enemies of the fans."

It is also possible that they do not want to have to guarantee an even larger fee to the performer, since the performer will know in advance the price of the tickets. If the box office man takes too great a risk, and then cannot sell the tickets (rain, emergency, or whatever), he loses a fortune.

Another possibility: the performer is also guilt-ridden and envy-avoiding, and he fears being labeled an enemy of the fans. They will blame him if he asks \$30 per ticket, so he demands that ticket prices be kept low, meaning *initially* low.

Thus, the brunt of the envy burden is borne by the scalper, who performs a fundamental function in society, namely, *envy-absorption*. If the scalper is to fulfill his role, the box office managers, performers, and ticket buyers need to establish scalping as immoral, illegal, and against the public interest. They all agree that there should be a law against this wantonly antisocial act. As the sociologist Kai Erikson notes, following a line of thought in the writings of Emile Durkheim, one of the founders of sociology: "... the term 'deviance' refers to conduct which the people of a group consider so dangerous or embarrassing or irritating that they bring special sanctions to bear against the persons who exhibit it... The only way an observer can tell whether or not a given style of behavior is deviant, then, is to learn something about the standards of the audience that responds to it."³

By establishing by law the *deviance* of scalping, those who would otherwise be faced with the problem of envy pass it along to another group, whose economic self-interest in profiting from the price spread is greater than their fear of envy. In short, scalpers exist primarily because of economic uncertainty and widespread envy.

The Price of Envy

The hostility of the public against scalpers is indicative of almost universal hostility to entrepreneurship in general. There is an unstated assumption in the minds of people that profits that come strictly from the successful prediction of the future demands of consumers, and from one's willingness to enter capital markets as a preliminary buyer, are immoral profits. We are still caught in the Marxist web of the exploitation theory. We still act as though profits from anything except physical labor are "unearned profits."

The scalper is probably the least harmful "exploiter" in the world. He makes his profits from the purchase and sale of tickets to entertainment events. Ironically, the few profits any scalper can make, and the envy he receives from those who are helped by his actions (latecomers who would not be able to get in if someone else had not had the foresight and courage to buy up tickets), are the direct result of Americans unwillingness to stand in line. The very feature of socialism that is so repulsive to Americans—long lines—is encouraged by the poten-

tial envy shown toward box office managements, who become fearful of successfully forecasting future consumer demand. The auction market for tickets is one of the most resisted auction markets in America, yet those who resist the auction process are also repelled by lines. *Below-market pricing creates lines.*

Scalping is not that critical to the daily lives of most Americans. We seldom attend sold-out performances. We are too busy watching television. What we expect when we do schedule a night on the town is a price structure rather close to television's pricing—without the ads, of course—and time spent in getting a ticket not much longer than the time spent in switching *on* the T.V. set. When we find that others just like us have also waited until the last minute to show up, and the under-priced tickets are all gone, we vent our wrath on the scalpers. They are, in effect, professional wrath-receivers, people who take the heat of envy off of the timid shoulders of performers and box office managers.

If we all appreciated the economic service scalpers perform, the market for scalping would dry up rapidly. If there were no wrath, no envy, and no complaints about high prices—*complaints really against all of our competitors* who are also trying to buy tickets to the Great Event—then performers and box office managers would get into the market and begin to "sell directly to the public." They would bear more of the burdens of middlemen. (Of course, they might announce that "We can sell you tickets at low, low prices because we have *eliminated* the middleman.") We would get professionals who ought to be the best forecasters of consumer tastes in entertainment to enter the forecasting market. We would see a better fit between the price *originally* charged and the *final* size of the audience. There would be less waste. There would be far shorter lines. And there might even be more advertising, thereby allowing those of us who are always the last to hear about anything, to find out in time to get on board. But if the scalpers are going to make all the profits, why should the performers or box office managers advertise? Conclusion: *with less envy, there would be better information available to the general public.* Of course, such information is not free. We would all pay for it in the purchase price of the ticket. But isn't that better than avoiding the advertising costs by not hearing about the opportunity in time? We will pay the scalper anyway. Or miss the event.

Men resent the fact that they are willing to pay "outrageous" prices for sports events and entertainment, meaning live entertainment, one-night-only entertainment. They resent the fact that people

get some profits as secondary middlemen who cater to their "base" desires. The very rich—performers, Forum owners, and Sol Hurok—are entitled to their profits, but not people sufficiently like ourselves to bring out our envy, yet sufficiently unlike us to stand in line all night, or go out immediately to buy some extra tickets. Such people are our sworn enemies, so we wind up paying more for our base desires than we otherwise might have paid, had the Forum or Ticketron been uninhibited by fear of the public's envy to charge "all the market will bear" right from the beginning.

Conclusion

Are we resentful? Against whom? Do we resent long lines? Then let us pay the higher *monetary* price which will shorten the lines. By pressuring the *initial sellers* of tickets to keep monetary prices lower than true market (auction) prices, we grant a kind of subsidy to those who value their time spent in lines relatively low. They get the tickets, either to use personally or to sell to those of us who value our time more highly. Below-market *monetary* pricing does not lower the *economic* price of any asset; it merely substitutes other forms of payment. The auction is merely delayed until the night of the performance, when late-comers and scalpers get together to transact business at true market monetary prices. Time has its price.

Do we resent the fact that we never hear about the Big Event in time? In time to do what? Stand in line? But we probably choose not to stand in line. If prices are set below the market's true monetary price, we still will miss the Big Event, unless we pay the scalpers their due. Hearing about the Big Event earlier cannot do us any good if monetary prices are set below market. Why not encourage higher monetary pricing for the initial sale—the prices stamped on the tickets—and thereby encourage the seller to advertise heavily to all of us who hate to stand in lines, and who are *ready to pay* for our preference? If we are not ready to pay higher monetary prices, why should we be resentful about not hearing in time? Time has its price.

In an age of envy, the scalpers will get their due. We live in an age of envy.⁴ No economic resource is free, including the indulgence of our propensity toward envy. The scalpers let us indulge ourselves . . . at a price.

1. Gary North, "Step to the Rear, Please," *The Freeman* (March 1975).

2. Helmut Schoeck, *Envy: A Theory of Social Behavior* (New York: Harcourt, Brace, Jovanovich, 1970), p. 62.

3. Kai T. Erickson, *Wayward Puritans: A Study in the Sociology of Deviance* (New York: John Wiley & Sons, 1966), p. 6.

4. Gary North, *Successful Investing in an Age of Envy* (Sheridan, Indiana: Steadman Press, 1981).

The Business Bogy

by John K. Williams

Myths die hard.

Everybody knows that the words, "Alas! poor Yorick! I knew him well," are taken from Shakespeare's *Hamlet*. Everybody knows that Sherlock Holmes was given to muttering, "Elementary, my dear Watson!" Everybody knows that Cinderella wore glass slippers to the handsome prince's ball.

Unfortunately everybody is wrong. The relevant lines in *Hamlet* read, "Alas! poor Yorick. I knew him, Horatio . . ." Sherlock Holmes' famous dictum doesn't occur even once in the 56 short stories and four novels Sir Arthur Conan Doyle penned about his celebrated detective. The seventeenth-century French text of *Cinderella* asserts that the good lady's slippers were *vair* (ermine) not *verre* (glass); Charles Perrault, who translated the tale into English in 1697, was responsible for a mistranslation which condemned generations of readers to bewilderment and poor Cinderella to a thoroughly uncomfortable evening's dancing.

But try convincing a "true believer" of his error about Hamlet, Sherlock Holmes, or Cinderella. Argument is an exercise in frustration, indeed futility. The "true believer" just *knows*, and that is that!

Similarly with business. Everybody just *knows* that business exists to "rip off" consumers, that business profits are evidence of exploitation, and that men and women engaged in business are a shady lot.

- Ralph Nader visited Australia recently. His public addresses were well received. His audiences listened with an intensity and responded with a fervor an "old-time religion" preacher would envy. The words "business," "corporation," "businessman," and "business executive" were clearly "bad" words, and the audience recognized them as such, booing and hissing on cue. His suggestion that many executives of "big businesses" should be imprisoned for defrauding the public received rapturous applause.

The Reverend Doctor Williams has been a teacher and is currently a free-lance writer and lecturer in his native Australia. This article appeared in the January 1981 issue of *The Freeman*.

- A recent Harris poll in the U.S.A. revealed that public confidence in the "essential honesty" of business had dropped some thirty percent over ten years, most significantly among the young. Australian young people share this attitude. Career guidance programs in secondary schools frequently include materials enabling students to "clarify" their values when making a career choice. They are asked to rank a number of career areas in terms of these careers' "moral worth," usefulness to the community, and prestige enjoyed (or prestige the students believe them to enjoy). Out of sixteen career areas listed, business ranks, on the average, fourteenth.
- A recent interview by *TV Guide* with Mike Wallace, star interviewer and investigative journalist of the *60 Minutes* program, included the question, "Do you handle someone who may have something to hide differently from a Baryshnikov or a Horowitz?" Mr. Wallace replied, "Of course . . . In both cases the interviewer 'role-plays.' With the businessman he may play prosecutor, or if the individual responds better to lulling, then the interviewer goes that way." (*TV Guide*, November 24, 1979) The shift is significant. Mike Wallace simply assumed that a person who has "something to hide" is a "businessman."

No government ever lost office for underestimating community sympathy for business; no newspaper ever suffered a massive decline in readership for criticizing business; no clergyman ever emptied his church by denouncing business. Business is, apparently, fair game for attack. "Until proved innocent assume business has something to hide."

Why Pick on Business?

Yet it is all very odd. Are businessmen striving for advancement more ruthless than academics plotting their next promotion?

Is the world of art conspicuously free of the confidence tricksters allegedly crowding the world of business?

It is not enough, however, sadly to observe that individuals who are deceitful, lazy, negligent or fraudulent in the practice of their profession are universal, and leave it at that. It is necessary to ask why dishonesty—indeed, crime—is widely perceived as an alien intruder

in most professions, but an expected inhabitant of the world of business.

Answers are plentiful. "Marx's rhetoric about 'exploitation' has filtered down to common parlance." "Frustration welcomes a scapegoat and many sources of frustration—rising prices, a declining job-market, even the failure of a family's washing machine—can conveniently and with some semblance of rationality, be attributed to the shadowy villain 'business'." "The masses are woefully ignorant of economic reality, hence misperceive the nature of business.

Maybe. But such answers merely delay the significant question. What is there about business that gives Marx's rhetoric any degree of plausibility? What feature of business makes it a popular scapegoat? Why should a misperception of economic reality invariably result in business being cast as a "villain"?

The answer is the same to each question. *Whereas most professions are perceived primarily in terms of a service rendered and only secondarily in terms of financial gain achieved, business is perceived primarily—perhaps totally—in terms of gain.*

The Heart of the Problem

For centuries significant professions have "justified" themselves essentially by reference to the way they enhance the lives of those served by these professions; that human beings acquire for themselves what they need to enjoy the "good life" by laboring at these professions has been politely downplayed. The doctor, according to this fiction, labors primarily to further the art of healing; the teacher battles to defeat the ogre of ignorance; the opera singer exhausts herself in the service of her art. The beneficiaries are those healed, instructed, or inspired. To be sure, the doctor, the teacher, and the opera singer gain financially by exercising their skills, but the initial answer to the question as to what these people do relates to their professions and those benefited, not the professionals' reward. Ask what the businessman "does," however, and the answer is invariably, "he makes money."

Wisely, some businessmen have attempted to correct this strange contrast. They are wise to do so because public attitudes control, within limits, politicians' actions. That an economic proposal is damaging to business is widely heard as a point in *favor* of such a proposal; the politician who attacks business invariably receives a more enthusiastic hearing than the politician who defends business. Irving Kristol is correct to observe that at the moment corporations have no constitu-

encies, no one ready to defend them and come to their aid when they are attacked.

Bluntly, the gap between the public's perception of business activities and the activities of other professions must be closed, or business enterprise may find itself being closed. Lewis Powell, Associate Justice of the U.S. Supreme Court and author of the well-known *Powell Memorandum*, was right to observe that "business and the enterprise system are in deep trouble, and the hour is late."

Yet frequently businessmen, seeking to defend their profession, do so by pointing to external consequences of their activities. They point to revenues gained by government through company taxes; they point to the jobs private businesses create; they even point to charitable programs supported by business! And this "defense" is madness! It increases, rather than diminishes the seeming "gap" between business and other professions. Doctors "justify" themselves by reference to what they do, not by reference to the taxes they pay or the nurses, drug company salesmen, and debt collectors they employ! Teachers refer to their teaching, not the chalk they consume and the textbook market they create! Opera singers refer to their music, not the theater ushers and program sellers whom they keep in a job! Business must be "justified" by what the business professional does.

What Does the Businessman Do?

Before specifying what it is that the businessman does, it must be acknowledged that the businessman exchanges his skills and time for money—more precisely, for the goods and services for which the money can be exchanged. Similarly with the doctor who forgoes leisure and exchanges his time for his patient's fee, and the patient who forgoes some other goods and services that fee could have procured in favor of the doctor's time and skills. The situations are parallel. And as is the case with any voluntary exchange, each party gains what he values most. After all, in the absence of coercion two parties only make an exchange because each believes he will benefit by so doing.

Yet, what skills does the businessman exercise?

They vary. Consider the businessman as an entrepreneur. He is an expert at perceiving information gaps in a complex society and acting to close those gaps. He observes, say, that apples are available in a particular locality for thirty cents a pound. The person growing those apples wishes to exchange them for thirty cents, preferring what that money can purchase to the apples. He observes further that peo-

ple in a distant locality are willing to pay seventy-five cents for one pound of apples, preferring to forgo other goods that sum of money could purchase. Neither party is aware of the other's existence. The entrepreneur observes the information gap, and locates a further party who is prepared to exchange his time and the use of his truck to transport apples from the producing locality to the consuming locality for, say, five cents per pound. The parties are brought together and all, including the entrepreneur, benefit. Each has made the exchange he wished to make. Each has parted with what he values less for what he values more. The entrepreneur has exchanged his skills of noting and closing information gaps for the goods and services his "profit" can purchase.

And his role is vital. In a complex society information gaps are inevitable. The noting and closing of these gaps is essential if people are to make the exchanges they wish to make. The entrepreneur's initially large profit will, of course, tend to decline, for large profits signal to other apple growers, transport drivers, or "co-ordinators" what they can do to achieve lesser but real profits. Fairly rapidly the market price of apples in the consumer district will drop and remain constant. The gap has closed and a state of equilibrium obtains. But the entrepreneur is by now off to close yet a further information gap he has noted—this time, perhaps, a gap between a consumer need and the capacity of a new but undeveloped product or process to meet that need.

What about the producer? Again he co-ordinates: he co-ordinates countless separate and distinct skills to manufacture one particular product. And to do that he must *deal in time*. In a sense his peculiar trait is a *preference for future as against present goods*. By forgoing present consumption, he has accumulated capital, enough capital to enable him to exchange money here and now for labor here and now. The seller of labor thus acquires his desired present good. The producer, however, is prepared to wait until the object being produced is completed, brought to the attention of purchasers, and sold before receiving his reward. He has exchanged his skills as a co-ordinator, and his capacity to wait for a future good, for the "profit"—the payment—he at last receives.

The businessman is also an anticipator. He must anticipate what consumers will want in the future, then efficiently co-ordinate the suppliers of raw products, of labor, of advertising space or time, and of transport so that the needs of consumers are met when they arise, more efficiently and more cheaply than competitive producers could meet them.

The information-gap perceiver and bridger. The skill co-ordinator. The anticipator. And the risk-taker, for the businessman usually has to exchange a present and *certain* good for materials leading only to a *possible* future good for himself.

Are these tasks contemptible? To be sure the picture presented is grossly simplified; the complex reality of business life involves more skills than this simple sketch has noted. And more than professionals, the businessman's success depends on his enabling other people to achieve what they want. He can only make "huge profits" if he satisfies and keeps satisfying the actual needs of real people more cheaply or more pleasingly than do others. He does not enjoy the coerced custom guaranteed the teacher. The numbers of competitors entering his profession are not as tightly controlled as are those entering medicine. His customers are just as fickle as—perhaps more fickle than—those of the adored opera singer. He is hardly to be condemned.

The Death Wish of Business

Yet, there may be in the behavior of the businessman one tragic and fatal failing. He acts quickly to close information gaps between the seller and eater of apples, but he does little to close the information chasm between his own profession and a critical public. He daily exchanges present certain goods for future possible goods, but he chooses "business-as-usual" today at the expense of the possible non-existence of a free market in the future. He draws upon the expertise of those able to inform the public as to the excellence of his products, but he either will not or cannot employ such experts to sell himself and what he does to a grossly uninformed community.

That is his failing, and possibly his fatal failing. Popular myths about Hamlet, Sherlock Holmes, and Cinderella's slippers are harmless. Contemporary myths about business could be lethal.

Like all myths, these myths "die hard." Yet, attacked intelligently enough and determinedly enough, die they will. That they are attacked is important. For if they do not die, business enterprises will, and all of us—including thankless consumers—will be the poorer.

Defending the Rich

by William H. Peterson

Listen. The winds of egalitarianism still blow. . . . Listen, for example, to Representative David R. Obey of Wisconsin, then chairman of the Joint Congressional Economic Committee, issuing a 1987 Committee report (later withdrawn as incorrect) alleging that the so-called "super-rich" have become 38 percent richer in the last 20 years:

"This study is proof that the rich get richer. A continuation of this trend erodes the basic confidence of the American public in our entire system. It increases cynicism, and adds to the us-vs.-them attitude about all institutions, economic and governmental."

Or, listen to economics professor David M. Kotz of the University of Massachusetts last fall writing à la Robin Hood in *The New York Times* on the annual *Forbes* listing of the 400 richest people in America: "How many billionaires are enough? The share of income and wealth flowing to the rich has been expanding at the expense of the poor. The free-market policies that lie at the heart of the Reagan program have produced this redistribution, while conferring no compensating economic benefits. Instead, we have the worst of all possible worlds: rising inequality amid sluggish growth."

Or, listen to Professor David Gordon of the New School for Social Research and co-author of the newly released Democratic Party study, "Democratic Alternative to Economic Decline": "The most important story about the U.S. economy in the '80s is the economic warfare that the wealthy and powerful have been waging against the vast majority of Americans." His proof: "The real median income of families in the U.S. dropped by 5.7 percent from 1979 to 1984."

Handling charges like these has been my lot in a professional teaching career spanning almost four decades. As an ingrained supporter of freedom and free market policy, I have long found myself having to defend what many critics deem the undefendable: the rich. Or, having to put down personal innuendos, usually getting them second- or third-hand, that I am perforce a lackey, a sycophant for the rich.

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Sometimes my defense is technical. To Messrs. Obey, Kotz, and Gordon, for example, let me remind them of a new Joint Economic Committee study by Ohio University Professors Lowell Gallaway and Richard Vedder. Professors Gallaway and Vedder note family erosion in America and accordingly think that income per family or household *member* is the appropriate measure. They then show a "real household income growth per household member of nearly 5.9 percent" from 1980 to 1984.

Moreover, a recent U.S. Census Bureau Survey on Household Wealth and Asset Ownership finds a long-term *declining* trend in family wealth concentration. This finding ties in with those of University of Chicago economist Yale Brozen. Brozen determined from U.S. Government statistics that in 1929 employee compensation amounted to 60 percent of national income while the top 5 percent of all families received 30 percent of national income. In the next 40 years the share of the top 5 percent steadily eroded while the employee share rose. By 1969 the employee share reached 72.5 percent while the top 5 percent share dropped to 16.5 percent, almost down to half of what it was in 1929.

To be sure, employee share improvement has slowed since 1969. But Brozen notes a declining U.S. savings rate (net national savings as a percent of net national product) from 15.2 percent in the 1961–1970 decade to 11.7 percent in the 1971–1980 decade. Thus the pace of business investment also slowed, with the upshot of much slower growth in labor productivity. Output per manhour fell from a postwar annual average of around 3 percent through 1970 to under 1 percent in the 1971–1980 decade.

With such data as this, Yale Brozen has unabashedly formulated Brozen's Law: *Whenever the government attempts to redistribute income from the rich to the poor, it creates more poor people, impoverishes the nation, and decreases the portion of the tax burden borne by the rich.*

I concur, heartily.

Why does more investment lead to a more equal distribution of income? The reason: Capital, mainly in the form of plant and equipment, complements labor: more capital per employee means greater employee productivity—and higher pay. Thus capital, Karl Marx to the contrary, turns out to be labor's best friend, with labor exploiting capital rather than the other way around. Indeed, the greater the capital investment relative to labor the lower the return to capital and the higher the return to labor. This is the history of the "exploited" working man with his ever-rising living standards under capitalism.

But sometimes my defense of the rich is less technical and more

philosophical. I have to remind my critics that eventually rich entrepreneurs like Henry Ford, Andrew Carnegie, John D. Rockefeller, and Thomas Alva Edison, as well as more recent commercial pioneers like David Sarnoff (RCA), Edwin Land (Polaroid), Ray Kroc (McDonald's), and Sam Walton (Wal-Mart—Mr. Walton, who started from scratch, is *Forbes'* No. 1 billionaire), helped make America great, that they forged millions upon millions of jobs, that they mightily boosted capital formation and thereby advanced America's living standards, that, accordingly, they belong in America's pantheon of heroes. It follows that all incomes are not created equal—nor should they be. Equality of opportunity, yes, equality of outcome, no.

I have also to remind my critics of the wisdom of my graduate teacher, Ludwig von Mises, whom I lucked into at New York University in 1950 as a result of his being a refugee from Hitler's *Festung Europa* (Mises escaped in 1940, working his way to New York City). Said Mises in his 1956 book, *The Anti-Capitalistic Mentality*:

Nobody is needy in the market economy because of the fact that some people are rich. The riches of the rich are not the cause of the poverty of anybody. The process that makes some people rich is, on the contrary, the corollary of the process that improves many peoples' want satisfaction. The entrepreneurs, the capitalists and the technologists prosper as far as they succeed in best supplying the consumers.

Moreover, critics, hear this: Investment inevitably involves risk, while pushing up all incomes, including those of the poor. Stocks, bonds, real estate, and so on are ever subject to the vagaries and risks of the market, and a number of historians have propounded the thesis of "from shirtsleeves to shirtsleeves in three generations."

Hence, Mises argued in *Human Action* (1949) that wealth is in reality a "social liability," very much subject to loss:

Ownership of the means of production is not a privilege, but a social liability. Capitalists and landowners are compelled to employ their property for the best possible satisfaction of the consumers. If they are slow and inept in the performance of their duties, they are penalized by losses. If they do not learn the lesson and do not reform their conduct of affairs, they lose their wealth.

One more thing: Is there a hidden agenda in the attack on the rich? Is envy, one of those ancient Seven Deadly Sins, at work? Scores of Latin, German, Russian, Polish, Spanish, Chinese, and Jewish proverbs tell us, *inter alia*, envy has never made anyone rich, envy cuts its own throat, envy makes life bitter, envy envies itself, envy sees faults rather than virtues, the envious die over and over before they finally keel over, and so forth and so on. Dryden put it this way: "Envy, that does with misery reside/The joy and the revenge of ruin'd pride."

To me, the attack on the rich ties in with the theology behind the progressive income tax—with the opposition toward flatter tax rates. Interestingly, the first modern supply-sider was not Ronald Reagan but John F. Kennedy. In pushing for a reduction of tax rates from a top bracket of 91 to 65 percent and a bottom rate from 20 to 14 percent, enacted into law in 1964, President Kennedy voiced a simple truth: "A rising tide lifts all boats."

Entrepreneurs and the State

by Burt Folsom

The big story in the U.S. auto industry during 1987 was the sharp growth (+ 35%) in sales for Honda and the decline (- 23%) for Chrysler. While Honda sold cars as fast as it could make them, Chrysler struggled with a huge backlog of 1987 models. These results should not surprise us—they are part of a long historical pattern: federally aided companies, like Chrysler with its federally guaranteed loans, rarely outperform those that have to succeed on their own merits.

Those risk-takers who have sought and received help from the state we will call political entrepreneurs; those who have succeeded without it we will call market entrepreneurs. In steamships and railroads, two of the largest industries in the U.S. during the 1800s, these two groups of entrepreneurs regularly clashed, just as they do today.

Almost from the time of the first trans-Atlantic voyage by steam in the 1830s, the governments of England and the United States subsidized steamship travel. Samuel Cunard, a political entrepreneur, convinced the English government to give him \$275,000 a year to run a biweekly mail and passenger service across the Atlantic. Cunard charged \$200 per passenger and 24 cents a letter, but still said that he needed the annual aid to cover his losses. He contended that subsidized steamships gave England an advantage in world trade and were a readily available merchant marine in case of war. Parliament accepted this argument and increased government aid to the Cunard Line throughout the 1840s.

Soon, Edward Collins, a political entrepreneur across the ocean, began using these same arguments for federal aid to the new U.S. steamship industry. He said that America needed subsidized steamships to compete with England, to create jobs, and to provide a military fleet in case of war. If the government would give him \$3 million down and \$385,000 a year, he would build five ships, deliver mail and passengers, and outrace the Cunarders from coast to coast.

Congress gave this money to Collins in 1847, but he built four

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enormous ships (not five smaller ships as he had promised), each with elegant saloons, ladies' drawing rooms, and wedding berths. He covered the ships with plush carpet and brought aboard olive-wood furniture, marble tables, exotic mirrors, painted glass windows, and French chefs. Collins stressed luxury, not economy, and his ships used almost twice the coal of the Cunard Line. He often beat the Cunarders across the ocean by one day, but his costs were high and his economic benefits were nil.

With annual government aid, Collins had no incentive to reduce his costs from year to year. He preferred to compete in the world of politics for more federal aid than in the world of business against price-cutting rivals. In 1852 he went to Washington and lavishly entertained President Fillmore, his cabinet, and influential Congressmen. Collins artfully lobbied Congress for an increase to \$858,000 a year.

It took Cornelius Vanderbilt, a New York shipping genius, to challenge this system. In 1855, Vanderbilt offered to deliver the mail for less than half of what Collins was getting. Congress balked—it was pledged to Collins—so Vanderbilt decided to challenge Collins even without a subsidy. "The share of prosperity which has fallen to my lot," said Vanderbilt, "is the direct result of unfettered trade, and unrestrained competition. It is my wish that those who are to come after me shall have the same field open before them."

Vanderbilt's strategy against Collins was to cut the standard first-class fare to \$80. He also introduced a cheaper third-class fare in the steerage. The steerage must have been uncomfortable—people were practically stacked on top of each other—but for \$75, and sometimes less, he did get newcomers to travel.

Vanderbilt also had little or no insurance on his fleet: he built his ships well, hired excellent captains, and saved money on repairs and insurance. Finally, Vanderbilt hired local "runners" who buttonholed all kinds of people to travel on his ships. These second- and third-class passengers were important because all steamship operators had fixed costs for each voyage. They had to pay a set amount for coal, crew, maintenance, food, and docking fees. In such a situation, Vanderbilt needed volume business and sometimes carried over 500 passengers per ship.

All this was too much for Collins. When he tried to counter with more speed, he crashed two of his four ships, killing almost 500 passengers. In desperation he spent one million dollars of government money building a gigantic replacement, but he built it so poorly that it could make only two trips and had to be sold at more than a \$900,000 loss.

Finally, Congress was outraged. Senator Robert M. T. Hunter of Virginia said: "The whole system was wrong . . . it ought to have been left, like any other trade, to competition." Senator John B. Thompson of Kentucky concurred: "Give neither this line, nor any other line, a subsidy. . . . Let the Collins Line die. . . . I want a tabula rasa—the whole thing wiped out, and a new beginning." Congress voted for this "new beginning" in 1858: they revoked Collins' aid and left him to compete with Vanderbilt on an equal basis. The results: Collins quickly went bankrupt, and Vanderbilt became the leading American steamship operator.

And there was yet another twist. When Vanderbilt competed against the English, his major competition did not come from the Cunarders. The new unsubsidized William Inman Line was doing to Cunard in England what Vanderbilt had done to Collins in America. The subsidized Cunard had cautiously stuck with traditional technology, while William Inman had gone on to use screw propellers and iron hulls instead of paddle wheels and wood. Inman's strategy worked; and from 1858 to the Civil War, two market entrepreneurs, Vanderbilt and Inman, led America and England in cheap mail and passenger service. The mail subsidies, then, ended up retarding progress: Cunard and Collins both used their monopolies to stifle innovation and delay technological changes in steamship construction.

Unfortunately, this cycle of government subsidy, mismanagement, and bankruptcy repeated itself a few years later in the railroad industry. With California and the Rocky Mountains safely in the Union, some people wanted a transcontinental railroad to tie the country together. Political entrepreneurs of the day convinced Congress that without federal aid the nation could not be linked by rail. Most historians have bought this argument, too. The late Thomas Bailey, whose textbook, *The American Pageant*, has sold over two million copies, said, "Transcontinental railroad building was so costly and risky as to require government subsidies." Congress adopted this logic and gave almost 100 million acres and \$61 million in federal loans to four transcontinentals.

With massive federal aid came unprecedented corruption. The Union Pacific and Central Pacific built shoddy lines very quickly just to capture the federal subsidies. Also, the Credit Mobilier scandal, in which Union Pacific officials bribed Congressmen with cheap stock in return for favorable votes, rocked the Grant administration and branded the whole railroad industry as corrupt. Eventually, negative public reaction helped lead to the establishment of the Interstate Com-

merce Commission. Congress, in effect, said that federal regulation was the solution to the problems created by federal aid.

Fortunately, James J. Hill, a market entrepreneur, showed the country how to build a different kind of transcontinental. From 1879 to 1893 he built the Great Northern Railroad from St. Paul to Seattle with no federal subsidy. Slowly, methodically, and with the best technology of his day he built a model line—relatively straight, on an even grade, and with high quality steel. He made each piece pay for itself before he moved further west. During the depression of the 1890s, when the subsidized Union Pacific, Northern Pacific, and Santa Fe Railroads went bankrupt, Hill ran his line profitably each year.

State aid—and this includes tariffs as well as loans—is always well intentioned. From Edward Collins to Lee Iacocca those who seek such aid really believe they have their nation's best interest at heart: they are protecting jobs, helping local industries compete, and preserving the industrial future of the nation. It is sad to see the opposite so often happen. Chrysler did pay back its loans—but it appears to be following the historical pattern set long ago in steamships and railroads.

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