

“The Changing Role of Private and Government Markets.” *World Capitalism Review* 1 (April 1993): 3-5, 10-13. Address accepting the Institution for World Capitalism Prize at the Institution of World Capitalism Spring Conference, Jacksonville, Florida, 13 April 1993.

Thank you, Felix, for that wonderful introduction. It's a great honor to be the first recipient of the award established by the Institution for World Capitalism. I applaud those of you who established the Institution for World Capitalism. Private efforts and private efforts alone will succeed, if anything does succeed, in preserving our free society. When Benjamin Franklin left Independence Hall after the signing of the Constitution, someone shouted to him, “We have a republic now.” And Benjamin Franklin answered, “You have a republic, if you can keep it.” Those words, “if you can keep it,” are very relevant to what is going on in our world today.

Attempts at socialism have collapsed. Everybody in the world agrees that socialism is a failure. Everybody in the world agrees today that capitalism is a success. And yet we observe every Western country drawing the conclusion that therefore we need more socialism—at least, to judge from their practice. That is the challenge that the Institution for World Capitalism faces.

As Felix was talking about the foundation of the Institution, I kept thinking back to the darkest days of the intellectual defense of freedom, immediately after World War II in the late 40s, early 50s. How was the flame of freedom kept alive? By a small number of private individuals and private institutions: Leonard Read's Foundation for Economic Education, which was started in the 1930s, strictly adhering to the principles of freedom; somewhat later, the Institute for Humane Studies started by Baldy Harper, the Intercollegiate Society of Individualists; the American Enterprise Institute converted by Bill Baroody into an effective defender of freedom. There was also the University of Chicago, which, almost alone among the universities of this country, maintained a core of people who were defenders of a free

society. There was Ayn Rand, the novelist, publishing books that influenced millions. There was Friedrich Hayek, and the Mont Pelerin Society that he founded in 1947. These and a few other private enterprises run by dedicated individuals kept a belief in a free society alive.

We have come a long way since then in the world of ideas. But we have retrogressed in the world of practice. At the moment, my wife and I are engaged in writing our memoirs. That has led us to recall and relive our earlier days—days when we were growing up. We have been struck by the extraordinary contrast between the situation in America as it was in the 1920s and 1930s and as it is now. We are vastly wealthier today than we were when I graduated from high school in 1928. We have all sorts of things that were never even in our dreams. I shall come back to that in a little bit. In every material sense one can think of, we are better off. And yet, we are less free, have less opportunity to pursue our own values as we see fit, and we are less secure in our personal lives. We are wealthier in a material sense and much poorer in a spiritual and moral sense. How can that be? What explains these contradictory results?

During that period of more than 60 years, we as a nation have used two very different markets for determining “Who gets what, when, and how,” to borrow from the title of a book by Harold Lasswell on politics. We’ve used a private economic market operating under the incentive of profit and a government political market operating under the incentive of power. What has happened over this period is that the relative importance of those markets has changed drastically. The private market has been employing a smaller and smaller fraction of our resources and producing more and more output. The political market has been employing a larger and larger fraction of our resources and producing less and less output. We have been devoting ever more resources to the market that has been a failure and ever less to the market that has been a success.

Let me explain more specifically what I mean. In the 1920s when I was in high school, total spending by government—federal, state and local—was only a little bit over 10 percent of the national income, and two-thirds of that was state and local. What was true then had

been true ever since the establishment of our nation. For close to 150 years after the ratification of the Constitution, we were able to preserve the original vision of the founders of our society, a vision in which people would be largely free to pursue their own objectives and in which government would play a minor role, and equally important, power would be dispersed, with the states dominant in internal affairs and the federal government concerned primarily with external affairs. Except in time of major war, the Civil War and World War I, that vision remained an effective description of our country. Can you imagine a federal government spending only 3 percent of the national income, half of that on the army and navy? A state and local government spending about 7 or 8 percent of the national income, half of that on roads and schools? That was the situation.

The political market was small and, equally important, highly competitive. If you didn't like the government you were getting in your city, you could move to another city. If you didn't like the government you were getting in your state, you could move to another state. There was also then, and to a lesser extent now, competition internationally. The flood of immigrants that came to this country and are coming now is evidence that there is movement across the borders of countries as well. But that is a much less effective form of competition than between local political units.

Today the situation is totally different. Government spending on all levels—federal, state and local—is now 43 percent of our national income, and two-thirds of that is federal. The federal government today is spending about 30 percent of the national income or ten times as large a fraction as when I was a boy growing up in a small town in New Jersey. In addition, via regulations and mandates, the government determines how other parts of our income are spent. Consider the many laws and regulations that require individuals to use their resources in specified ways: the Americans with Disabilities Act, the Clean Air Act, wage and hour regulations, and on and on. Many of these regulations may be good, they may be bad, they may be indifferent. But in terms of the scope of government, they mean that 43 percent is a gross underestimate of the scope of government. Mandates and regulations undoubtedly bring

the fraction of our total resources whose use and allocation are determined by government to well over 50 percent. Socialism means government control of the means of production. That's the old-fashioned definition and a good one. In those terms, the United States today is more than 50 percent socialist.

Other countries are still worse. We are still probably the least socialist of the major countries. But that is hardly cause for complacency. The collapse of communism has produced a curious situation in which the countries in East Europe are trying their best to move to where we were 50 years ago. And it sometimes seems as if we are doing our best to move to where they were ten years ago. We have to prevent that from happening. The Institution for World Capitalism is an important private attempt to do so.

To summarize, the fraction of our resources allocated through the private economic market has gone from 90 percent to less than 50 percent; through the government market, from 10 percent to more than 50 percent. That refers to input. What about output? The contrast is extraordinarily sharp.

The private market has generated tremendous increases in our living standards. One of the most eloquent descriptions of those changes that I have read in recent years is a poem that E. B. Lee, a graduate of the Class of 1934 of Harvard University, delivered at the 55th reunion of his class in 1989. He titled his piece, "As We Were." I'm going to quote that part of it which deals with material goods:

We were before frozen foods, computers, radar, credit cards and ballpoint pens.

For us, time-sharing meant togetherness, a chip was a piece of wood, hardware meant hammer and nails, and software was what you slept in during the hot weather.

We are also before icemakers, dishwashers, clothes dryers, electric blankets and disposable diapers.

When we were in college, it was a privilege to go; pizza, Cheerios, frozen orange juice and instant coffee were unheard of. Aids were acts of charity or breath mints.

In our day, grass was mowed, smoking was fashionable, pot was something you cooked in and fast food was what you ate during Lent....

Farmers and businessmen took risks without thought of going to government for help.

And I cannot resist quoting one statement from the non-economic part of his talk: “We were probably the last generation to think a girl needed a husband to have a baby.... We were young and gay.”

Speaking for myself, I would add that radio was in its very early stages, television was a futuristic dream, airplanes were all propeller driven, a trip to New York from where my family lived 20 miles away was a great event, and I never made my way west of the Delaware River until I went to graduate school at the age of 20.

Truly a revolution from that day to this. And almost wholly through the private economic market. Government did make a contribution and its contribution was essential. But it was not costly, didn't require much in the way of expenditures. Its major contribution was to protect property rights, to provide a means for adjudicating disputes, to provide a mechanism for preserving law and order, which it did much better when I was young than now. Of course, there were some spin-offs from wartime research that private industry later used. But certainly the bulk of the achievements came strictly through the private market, while all the time the private market was using a smaller and smaller fraction of the total resources available to the community as a whole.

Now, let's look at the government political market. Its greatly expanded role has produced primarily problems, not achievements. By trying to do much that it has no business doing, government has performed its proper business much less well. The contrast is sharp in our own personal experience. Both Rose and I came from low income families, families that by any modern definition would have been classified as below the poverty line though, I hasten to add, we never thought of ourselves as poor. We both went to public schools. They were good public schools and we think we got a pretty good education. It is very hard to say that today for people in the relative circumstances that our families were in then. And as

children we weren't afraid to walk in the streets. We didn't feel we were in any danger when we went to school. We didn't feel we had to worry about going out on the streets at night.

When I graduated from college in 1932, at the depths of the Depression, there was nothing like the present concern over personal safety. There were not many homeless beggars littering the streets. A dramatic example of the difference between public attitudes and mores then and now is that the truly impoverished, who were much more numerous than they are now, were standing on street corners trying to sell apples. They were not like the able-bodied people we encounter on the streets of San Francisco with their hands out asking for a handout in order to be able to get a shot for their pet cat or dog.

In those days, the fall was known as the moving season. People would give up their leases in the spring, go away for the summer, and come back in the fall to find a new apartment. Today, probably the best way to try to find an apartment in New York City is to watch the obituaries. Was that because of a failure of the private market? No, it was because of rent control which has destroyed New York housing. And it has had similar effects wherever it has been imposed.

Despite the current rhetoric, despite all the talk about economic problems and economic difficulties, the basic problems of this country are not economic. We are the wealthiest country in the world. We have the highest standard of living in the world. We've been going through a few ups and downs. Those aren't our real problems.

Moreover, insofar as the problems are economic, government isn't going to help. Let me give you a dramatic bit of evidence. One economic function that government has arrogated to itself in the post-World War II period has unquestionably been to assure full employment, as provided for in the Full Employment Act of 1946. Elections are waged in terms of which candidate can create the most jobs. Suppose you look at the evidence. From 1900 to 1929, the federal government's expenditures were about 3 percent of the national income, and no one would say that the federal government was responsible for creating employment. Yet in those twenty-nine years the average rate of unemployment was 4.6 percent. What do you suppose

the average level of unemployment has been since government has assumed responsibility for full employment? From 1948 to 1992, it's been 5.7 percent, or over a percentage point higher than before the government was involved. (I have left out the years after 1929, during the Great Depression, from that comparison because, as I have documented in great detail elsewhere, the depression was a result of government failure, notably by the Federal Reserve System, not market failure.)

The government has clearly been very ineffective in assuring full employment. Besides, full employment interpreted literally, is the wrong objective. If all you want is jobs, it's very easy to create as many jobs as you want. Simply hire people at the minimum wage (or less) to dig holes and fill them up again. What we want are not simply jobs, but the highest possible standards of life. What we want is opportunity. What we want is the opportunity and ability of individuals to pursue their own interests and make the most of their own talents as so many of the people in this room have been able to do over the past few decades.

Our major problems are not economic, they are social. Consider education. Why is education deteriorating? Is it because of the failure of private enterprise? Next to the military, education is the largest socialist enterprise in the United States. Ninety percent of our kids at elementary and secondary schools are going to government-operated schools, like every socialist industry in any country in the world, the government schooling industry produces a poor quality product at a very high cost, although small groups of people benefit a great deal from it. In this case, those groups of people are people who live in high-income suburbs and have government schools that are essentially private schools, plus the administrators of the educational establishment, and the officers of the educational unions, which are the strongest lobbying groups in the United States. So it's a government failure, not a private failure.

The collapse of family values—the rise in teenage pregnancies, the increased fraction of marriages ending in divorce, the number of children who are mistreated, you can go down the line with one statistic after another. Government isn't entirely responsible for that. Undoubtedly, there are private factors, changes in culture and values. But government bears a

lot of the responsibility. Anyone who has read Charles Murray's great book, *Losing Ground*, will recognize the extent to which misguided government welfare policies have played an enormous role.

What has happened in that area is that by taking over responsibility for the indigent, government has essentially killed private enterprise directed toward that objective. The great period of private charity and eleemosynary activity in the United States was the late 19th Century and early 20th Century when the U.S. came closest to free enterprise capitalism in its fullest sense. That's when the non-profit community hospitals were established, when private universities and colleges proliferated, when the Boy Scouts, the Red Cross, and most of the charitable organizations that now exist were founded. That's when Andrew Carnegie was responsible for starting public libraries.

When government takes anything over, private people no longer regard it as their responsibility. So you have inefficient socialist enterprises trying to do what was formerly done by efficient private enterprises. People interpret capitalism in very narrow terms, in terms of business enterprises whose only interest is the dollar. That is a false view. Private voluntary charitable activity is as much a reflection of capitalism as is the production of steel or automobiles. The Red Cross, the Boy Scouts, private voluntary hospitals, are as much capitalist enterprises as U.S. Steel and General Motors. The essence of capitalism is voluntary cooperation without coercion by people who have a common objective. That's what it's all about. The common objective may be making money though, even then, it's typically producing a product that the producers can be proud of, and from which they can realize their objective of earning an income.

There is always a great deal of talk about the bloated rich. The one thing the rich are is that they are not bloated. On the average, they are not fatter—more bloated—than the rest of the community. There is a sharp limit to the amount of food, housing, clothing they can consume. Some of our major social, cultural achievements, our great universities, our great museums have all come from the so-called bloated rich. There was a splendid article in the

Wall Street Journal (on April 12, 1993) by the president of the Cypress Semiconductor Company in California. The article essentially said that he could invest his money far more efficiently in venture industries than Bill and Hillary could. (Applause) That's my way of putting it, not his.

Consider the so-called crisis in medical care. Why do we have a crisis in medical care? Why do we have a situation in which medical care costs have gone from 4 or 5 percent of the national income, which it was for decades before World War II, to 14 or 15 percent, with most of the increase coming after the establishment of Medicare and Medicaid? You won't believe what I'm going to tell you, but it's true. The reason is an unintended consequence of wage and price control during World War II. I know that's hard to believe. What happened was that in World War II the government made the mistake of imposing wage and price controls to try to keep inflation down. It didn't keep inflation down, only suppressed it, because wartime spending put sharp upward pressure on prices and wages. Employers found it hard to attract the workers they needed since they weren't legally permitted to raise the wages they offered, so they started to offer fringe benefits as a way to attract workers. One fringe benefit that turned out to be very popular was the provision of medical care. Prior to that date, people were generally responsible for their own medical care. And so firms started to offer medical care as a fringe benefit. They understandably did not report it to the IRS as part of the worker's income. With its usual government efficiency, the IRS didn't catch on to what was going on for about three years. When it finally did, it started instructing employers to report the cost of medical care as part of the employee's taxable income. By this time, the employees figured non-taxable medical care was a right and so there was a big uproar, and Congress, in response, passed a law making it a non-taxable fringe benefit.

That led to the present absurd situation. There is no reason why employers should be responsible for employees' medical care. (Applause) Surely, food is more essential than medical care. If employers have to be responsible for medical care because it's so essential, should we require the employers to be responsible for food? I titled a recent piece in the *Wall*

Street Journal, “The Folly of Buying Health Care at the Company Store.” We have a system in which most persons who receive medical care have no incentive whatsoever to be concerned about cost. I guarantee that the cost of food would go up very sharply and you would have a real crisis if you gave everybody tickets that enabled them to get all the food they wanted to acquire. Anything that is free to the consumer is going to be overused. And then we added insult to injury by adopting Medicare and Medicaid in 1965, which made the government a prime player. Needless to say, government displayed its usual efficiency. And now we’re on the road to universal government provision of medical care. I am not very optimistic about stopping that trend, but I’m sure it will have very unfortunate consequences.

One major problem after another, whether it’s education, medical care, homelessness, the collapse of family values, the unavailability of housing, the increase in crime, turns out to be produced by the well-intentioned efforts of government gone astray.

It’s easy to understand that government is the source of our many problems. The more difficult task is to understand why. One part of the explanation that we’re all aware of is the power of special interest groups. It used to be the American Medical Association. I bemoaned their special interest and attacked them very strongly many years ago. But there’s only room in an industry for one monopoly at a time and now that the government has become the chief monopolist in medical care, the AMA is no longer a major special interest group. However, the National Education Association and the American Federation of Teachers are certainly enormously strong pressure groups and have prevented reforms that would enable private schools to offer effective competition to public schools. And you can name many other special interests.

Nonetheless, I believe that the power of such special interests is only part of the explanation for our overgrown government, and no longer a major part. A more fundamental part is the difference between the self-interest of people when they are operating on their own behalf, when they’re operating through the private competitive market, and their self-interest when they’re operating through the government. You mustn’t blame the people in

government. The people in government are no different (from) the rest of us. I assure you that if a random selection of people in this room were to be sent to Washington, they would do all the bad things that the people there now do. Because nobody does bad things out of bad motives. As an old friend of mine, Armen Alchian, always says, the one thing you can depend on everybody to do, absolutely everyone, is to put his or her interests above yours.

There's a different bottom line when you go to Washington than when you are on your own. If you're spending your own money, if you engage in a new venture, if you start a new way of distributing medicine or anything else, if it's a failure, if it doesn't work, your only choice is to dig into your own pockets to keep it going or to close it down. If you start exactly the same venture as a government official, and exactly the same thing happens, you have a different alternative. It's very easy to say the only reason your venture is not working is because we haven't done it on a large enough scale. And you have a much bigger pocket than your own to dig into. You have the taxpayers' pocket to dig into. The result is a general rule to which I challenge you to find any exceptions: if a government enterprise fails, it is expanded. I've tried hard to find exceptions, but I've only been able to find about three examples of government ventures that were actually closed down in the course of many decades.

This difference in the bottom line has led to an expansion in government to the point where now the people no longer rule. We have literally nothing to say about what goes on. We elect people to Congress, true, but once they get to Congress, they're essentially bureaucrats with tenure.

In a study that was made not long ago of hearings on spending bills before the Congress, it turned out that something like 60 percent of the people who testified in favor of additional spending came from the government itself. The government has become a self-generating monstrosity over which the people have little control. You referred to Abraham Lincoln who talked about "government of the people, by the people, for the people." What we now have is

“government of the people, by the bureaucrats, for the bureaucrats.” Our big challenge, and the challenge of the Institution for World Capitalism, is how to break that pattern.

What is it that we can do? It will do no good to elect the right people; we’ve tried that and it hasn’t worked. We have to change the structure of government so as to alter the self-interest of the people who are in government. The most promising, feasible change that I see on the horizon is term limits. (Applause) Term limits were on the ballot in fourteen states last year and it passed in fourteen states. It got more votes in those fourteen states than Mr. Clinton did (in the entire nation).

We are a great country. It’s an enormous tribute to the private enterprise market that with less than half the resources of the country it can produce the kind of level of living we have. It is an enormous problem for us that with more than half the resources in the country, the government market has produced primarily problems and difficulties. That’s our challenge. How do we cut government down to size? Unless we succeed in doing so, we shall not be able to preserve a free society.