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Today's Challenges to Economic Freedom

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Washington University in St Louis

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by Murray Weidenbaum

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Today's Challenges To Economic Freedom

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These days the air is full of talk of budgets being cut and taxes being reformed. As an educator, I find it useful to step back and ponder the fundamentals that underlie the heated debates of the moment.

When the frenetic events of the day are evaluated in the more leisurely light of history, I am confident that we will find that we have been engaged in an effort far more fundamental than raising the growth rate of the GNP or slowing the pace of the Consumer Price Index, worthy as these actions are.

The United States is currently making an unprecedented shift in the locus of decision-making, away from the federal government, toward the many diverse and smaller organizations and institutions that serve individuals. Thus, it is not a question of whether it is more desirable to cut taxes or to reduce the growth of government spending, or to curtail government credit programs or to provide relief from regulatory burdens. All of these are part of a larger endeavor: to strengthen the performance of the private sector by reducing the power, the burden, and the obtrusiveness of the public sector.

This shift in national priorities is based on the general proposition that private citizens do not need government officials to make their decisions for them or to direct their

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daily lives. Most people—workers, managers, investors, buyers, and sellers—know what they want and how to obtain it. Over time, the aggregation of these individual actions generally results in the most appropriate distribution of our economic resources and the highest levels of well-being.

The best government economic policy is the one that provides a stable environment in which private citizens can confidently plan and make their own choices.

The best government economic policy, therefore, is the one that provides a stable environment in which private citizens can confidently plan and make their own commitments and choices. Those who advocate departures from this approach bear the burden of proof that government intervention will do more good than harm. Advocates of intervention must show in any given situation that "market failure" is greater than the "government failure" that usually accompanies political and bureaucratic responses to economic and social problems.

This, in my opinion, is a useful and succinct statement of the principles of limited government consistent with an economic order organized primarily on the basis of private enterprises competing in a market system. It is hardly new. Adam Smith came to this same conclusion over two centuries ago when he first conducted his inquiry into the nature and causes of the wealth of nations. The society he envisioned surely was not anarchic. Rather, it was characterized by limited government, with the expectation that government would perform well the important tasks that only it could carry out, notably defense and those major public works we now call infrastructure. Unfortunately, many of us need to sift through the complications of current controversies and rediscover these fundamental truths.

Freedom and the Marketplace

Let us begin by looking at the basics of a free economy. It is a world where people sometimes win—and sometimes lose—in their economic pursuits. Given adherence to mutually accepted rules, a free enterprise system teaches individuals how to avoid failure and pursue success. In a healthy market-oriented economy, individual entrepreneurs and companies that are efficient in meeting consumer needs are profitable. Those that fail to meet those needs, or do so at too high cost, sustain losses. Thus, it is erroneous to refer to a "profit" system; more accurately, ours is a "profit-and-loss" system. The opportunity to earn a profit is only as available as the possibility of bearing a loss.

Government institutions, on the other hand, are not subject to any such discipline. No federal agency ever has been forced to declare bankruptcy. Rather, the typical response for a federal department living beyond its budget is to urge the Congress to increase its use of public resources. Government programs often continue beyond their original justification and develop a life of their own. There is no shortage of critics who comment about the shortcomings of the "invisible hand" in the market economy. But, as we have learned so painfully and so often in recent years, the "fickle finger"—or rather the hard fist—of government usually generates far greater problems when it intervenes in economic decision-making.

The last half century provides an almost endless array of experiences with well-intentioned governmental interventions in private decision-making that did not work out. These examples of government failure range from the scandal-ridden Reconstruction Finance Corporation of the 1930s and 1940s, to the waste-laden Office of Economic Opportunity of the 1960s and 1970s, to the counterproductive farm subsidies of the Commodity Credit Corporation that have extended throughout the period.

It is not a question of altruism, but of enlightened self-interest, that motivates the individual and the business firm. A private enterprise system takes advantage of that fact. As Adam Smith put it, "it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard of their own interest."

It is ironic to listen to thoughtless statements that free market institutions are heartless enough to let people starve. The fact of the matter is that the capitalist nations of the world are feeding the socialist nations—not on a purely charitable basis, but in the effective spirit of Adam Smith's baker.

The role of government in this context must be carefully defined. Let there be no misunderstanding of the true meaning of free enterprise. It does not mean being singlemindedly pro-business. That approach normally translates into a cozy partnership between government and business—subsidies and protection for failing industries, "incomes" policies, government planning, and other interventionist techniques usually justified on an "exceptions" basis.

Rhetoric of Management

Indeed, many day-to-day practices on the part of business executives merit our critical attention. We can begin with the very way in which the business community describes economic events. For example, employers rarely refer to competition in labor markets. The more widely-used term for other companies bidding away their workers by offering them higher wages and salaries is "pirating" employees. Similarly, in product markets competition is only favored in the abstract or in the case of potential suppliers to the firm.

We rarely hear the word "competition" used in the markets in which the company sells its goods and services. There, the preferred term is price "chiseling." That specifically refers to the ungentlemanly practice of lowering prices.

The expansion of foreign trade has given rise to its own specialized vocabulary. "Imports" is too technical a term for general business usage. More common is the phrase "unfair competition." The volume of foreign goods entering the U.S. is usually described as a "flood." And what is the desired response? Protection against imports is too blatant. "Fair trade" sounds much better. After all, it is only fair that we buy American-made products.

Protectionism is a politician's delight because it delivers visible benefits to the protected parties while imposing the costs as a hidden tax on the public. Some day the public will learn that too-well-kept secret, that the higher prices that invariably result from protectionism are paid by American consumers. Ironically, in all too many cases, such as textiles and apparel, this burden hits most heavily on the poorest people in our country.

As an aside, it does little to bolster citizen confidence in a private enterprise system when captains of industry, on one day, urge people on welfare to stop depending on government for handouts and, on the very next day, appeal to the same government for some special benefit. Subsidy, by the way, is a very selective term in business English. It usually is preceded by the word "farm."

Euphemisms are widely employed by corporate executives. Thus, in standard financial reporting, companies *earn* profits—a phrase that conjures up the notion of positive achievement of their own doing. In contrast, firms *suffer* losses. That sounds like an unexpected blow inflicted by some sinister force in the external environment beyond corporate influence.

Rhetoric of Special Interest Groups

By no means is the use of euphemisms limited to members of management. Take the example of the "corporate activists." Judging by their self-designated title, you would expect that corporate activists were engaged in the worthy enterprise of attempting to energize a sluggish company or were concerned with improving the economic performance of American business. Nothing could be further from the truth. The typical "corporate activists" are oblivious to the economic role of private enterprise. Producing and distributing the goods and services that meet consumers' needs is too humdrum a task to attract their interest.

Judging by their self-designated title, you would expect that corporate activists were concerned with improving the economic performance of American business. Nothing could be further from the truth.

Rather, they see the resources of the private enterprise system as a means for achieving their social ends. One term they love to use is corporate or economic democracy. But, on the contrary, they refuse to abide by the decisions of this nation's democratic political processes. They will buy a few shares of stock in a company—not as an investment—but to use the annual meeting as an opportunity to try to force the company to follow their pet social or political goals. These are goals which they are unable to convince Congress to adopt—such as imposing our internal social standards on other countries.

Some unions and other activist groups favor such high-sounding phrases as "pay equity" and "comparable worth" to describe the effort to raise arbitrarily the salaries of some members of the workforce above competitive market levels. As economists, we know the sad results, as in public education where there are chronic surpluses of gym teachers amidst continuing shortages of math and science instructors.

Descriptions of comparable-worth systems remind me of the Middle Ages, when the priesthood sat in judgment on economic matters, depending on theological concepts to determine what they called the "just price." Activists today attempt to play a similar role, forgetful of the costly impacts of imposing dogma on a modern market economy.

Of course, the private sector did not invent obfuscation, nor are business executives its exclusive practitioners. We can recall the tale—perhaps mythical—of the federal inspector who examined two very similar groups of government officials, neither of whom was working at the time. His report was simple and to the point: "duplication."

Actions and Appropriate Inactions

At times, adhering to the principles of economic freedom requires specific actions, and on other occasions it necessitates forbearance. For example, promoting the concept of free enterprise requires that no favored treatment be given to any specific interest group or industry. It means restraining the tendency to reallocate resources from those who are entitled to them by virtue of their own ability to those who receive them by political fiat.

I still recall meeting in Washington with the representatives of an industry seeking a federal bailout. After I pointed out that such action was the economic equivalent of welfare, the chairman of the group responded with great indignation, "Why, Mr. Chairman, welfare is for poor people."

We academics, of course, look at the world from our own vantage point. That is hardly unique. My concern is our unstated assumption that all others see the unfolding of events from the same viewpoint characterized by logic and consistency. That is hardly a universal phenomenon.

For example, economists may argue for a laissez-faire approach to hostile takeovers on the basis of free market principles. However, the heads of many large corporations see no problem in appealing to the federal government to intervene in their behalf. As a practical matter, they simply want to use the power of government to make it more difficult for "outsiders" to take over their companies. An extremely colorful vocabulary has developed in this sector of business: poison pills, junk bonds, shark repellents, wolf packs, white knights, greenmail, and golden parachutes.

Effects of Government Intervention

There is no need to argue that all or even most takeover attempts are constructive—or even benign. What should concern the business proponents of more government intervention in private business decision-making is the array of effects that usually follow. The long and intricate history of government involvement in the private economy does not provide an inspiring basis for expanding the role of the federal government in corporate governance.

Whether that intervention is made by the judicial, legislative, or executive branch, government regulation often does more harm than good. Study after study shows that much government regulation frequently fails to meet the most elementary benefit-cost test.

Moreover, economic history teaches us that government intervention usually begets more government intervention. In the present situation, for example, if government should limit the maneuvers by corporate raiders, that would tilt the balance of power. Invariably, it would lead to pleas to restrict the defensive actions of company managements (and vice versa).

Surely it is legitimate for well-financed groups of investors to attempt hostile takeovers of private companies. So, too, resistance by the target company's board of directors may be perfectly proper. To ascribe the public interest to just one side of the controversy is to ignore the fundamental role of competition in the marketplace.

Surely, leaders of other sectors of the economy also can be properly criticized for their intellectual shortcomings in dealing with important issues of public policy. An example is the inconsistent attitude of many proponents of government welfare programs. Especially in these days, where virtually every federal agency's budget is being cut, we hear howls of outrage from the supporters of food stamps, medicaid, public housing, and other so-called "payments in kind."

But how do these same advocates of higher federal spending reply when some of us raise the simple statistical notion that such "income in kind" should be included when the government attempts to measure the number of people in poverty? It is almost incredible, but the proponents of these expensive programs contend that such reporting is unfair. And why? The formal reason given is not that these more comprehensive measures of income would reduce the clientele of the social welfare agencies. Such an unusual display of accuracy would constitute too self-serving and unattractive an argument. Rather, the proponents of the status quo point out that a dollar of spending for these social programs does not generate a dollar of benefit to the recipients. One enthusiast for these social programs admits that food stamps ". . . certainly aren't worth their face value in cash." He suggests that these items, should they be included in any measure of poverty, be discounted by 20 percent or even 40 percent.

The cynic in me says that we have the makings of a deal here. Eliminate food stamps and other "payments in kind" and split the difference. Give the current recipients cash equal to one-half of the government's current cost for these programs and reduce the budget deficit by the other half! I readily forecast that the major complaints would not arise from the "clients" of these programs, but only from the newly unemployed social workers.

International Competition

Our concern for the principles of economic freedom needs to be broadly gauged. It cannot stop at the water's edge. Free-flowing international trade and investment—a free enterprise system writ large—offers greater economic welfare to people of all countries. The same specialization of labor and individual creativity that we see in our society can also be encouraged beyond our borders.

Our concern for the principles of economic freedom needs to be broadly gauged. Free-flowing international trade and investment—a free enterprise system writ large—offers greater economic welfare to people of all countries.

Special interests would have us close the door to the accomplishments of Japanese management, or to the natural abundance of French vineyards. But, when all the benefits of a more open economy are added up, it becomes clear that losses for domestic producers do not, and cannot, cancel out the gains that consumers receive from imports. Free trade, of course, must be a two-way street. To oppose protectionism here at home is proper but insufficient. We must also speak out just as strongly against restrictions on commerce imposed by other governments.

On reflection, some policy innovation may be useful; one was suggested a while ago by my favorite economic analyst, Russell Baker, the columnist for *The New York Times*. You may recall, back in 1981, the controversy about limiting the imports of Japanese cars. Baker, in his customary scholarly manner, examined the comparative advantages of both the United States and Japan. He found that the Japanese auto industry had productive capacity far in excess of its domestic

requirements. Similarly, he noted that the United States was producing far more lawyers than it needed.

Unencumbered by econometric analysis or weighty theory, Baker recommended a simple swap. For every 1,000 Japanese cars that enter the United States, we would send Japan 100 lawyers. He was not concerned about an ensuing flood of foreign-produced motor vehicles. Rather, he saw this type of tied trade as possessing self-limiting features.

As American attorneys entered the Japanese economy, he reasoned, that nation's productivity would decline. In contrast, the exodus of lawyers from the United States would contribute to a rise in the efficiency of our economy. Eventually, the economic competitiveness of the two nations would equalize. Baker felt so strongly about his plan that he suggested that we start the process by sending the Japanese 100 lawyers on the cuff!

The Costs of Economic Freedom

As in so much of life, there are real costs of achieving and maintaining important values such as economic freedom. Friedrich von Hayek has written eloquently on the neglected aspect of the relation between freedom and economics. In *The Road to Serfdom*, he cautioned with great foresight against the dangers of growing government. Even earlier, in a work that is quoted less frequently, he made a point that seems as appropriate to me now as it did to him then. In *Freedom and the Economic System*, he wrote: "Freedom and Democracy are not free gifts which will remain with us if only we wish it. The time seems to have come when it is once again necessary to become fully conscious of the conditions which make them possible, and to defend these conditions even if they should block the path to the achievement of competing ideals." Thus, we need to recognize the material costs that are involved in achieving and maintaining a free society.

Freedom and the free enterprise system have come under attack in recent years as public concern has shifted towards the achievement of a number of other goals, including a variety of social concerns such as ecology and income redistribution. But when these non-economic concerns sap the vitality of the economic system, and ultimately reduce or limit living standards, it becomes time to redress the balance. Our own society has clearly arrived at this point.

The Limits of Political Decision-making

In that spirit, let us also focus on the limits of political decision-making. In a political setting, it is appropriate that the majority should decide. Yet, that is hardly the way to meet the great variety of consumer desires. Following universally the approach embodied in voting and the political process can cause needless losses in economic welfare. Let me illustrate that point.

When the original Henry Ford declared that automobile buyers could choose any color so long as it was black, prospective purchasers with different preferences had recourse to the products of other companies. But if, instead, the same Henry Ford had been Secretary of a nationalized Department of Automotive Production, the minority desires would have remained unfulfilled.

In our daily lives, there is rarely a need for unanimity of choice. This is where the market system automatically meets individual wants far more effectively than the best-intentioned political process. Returning to the example of the automobile, if one percent of the population desire a car painted in blushing pink, the market can meet their demand—provided they are willing to pay the cost. There is no need to impose a single dominant viewpoint on all automobile purchasers.

In many cases where government does intervene in our daily lives, there may be no need for a standardized response by a federal agency having jurisdiction over the entire nation. Americans in different regions have different needs and priorities, and a decentralized public sector—which is a fundamental characteristic of our federal form of government—can respond to those citizen desires far more effectively.

Public Policy Changes

It is heartening to see the heightened public awareness of the tremendous ability of a private enterprise economy to meet the needs and desires of its citizens. This improved understanding is evidenced by and indeed it has been embodied in several basic changes in the American economy in recent years.

The pace of new regulation of business has slowed down measurably, as our warnings about the high cost of regulation have been taken seriously. Federal civilian spending has been cut back significantly, as concerns about containing the growth of the public sector have been heeded. Labor-management relations are sounding a more constructive note: the number of strikes is at an all-time low; many collective bargaining agreements have become more realistic, as workers and management alike respond to new economic realities.

Yet, it is too soon to say how complete or how durable these changes will turn out to be. Some counterpressures are already visible, notably in the area of environmental regulation, where emotionalism still dominates the public debates. On reflection, I have just employed the kind of euphemism that I criticized others for earlier.

The term "emotionalism" is too kind to describe some of the assaults on sanity that have occurred in the name of ecology. I have in mind, for example, the wanton and deliberate mutilation of trees in the national forests by "highminded" ecologists who would rather see this valuable natural resource destroyed than used by commercial loggers to meet consumer needs. Let us label such dreadful actions for what they are: the totalitarian mind at work, attempting to impose its will on all regardless of the consequences and the desires of others.

Many of the same issues that have faced the advocates of free markets and open competition over the last 10 years will still be with us in the next decade—just look at recent congressional action on the budget and taxes.

Looking out toward the future, it is clear that many of the same issues that have faced the advocates of free markets and open competition over the last 10 years will still be with us in the next decade. Clearly, this is no time to rest on our laurels. Just a look at recent congressional action on the budget and taxes shows that the key problems addressed a decade or two ago are yet unsolved. There is still need to continue urging tax reformers, in their future efforts, to pay adequate attention to the effects of their plans on saving and investment. Major cuts in government spending are still required in order to get the deficit down and to expand the private portion of our national economy. And public attention must continue to focus on the fact that federal credit programs are no free lunch, and that the costs of regulation, hidden by government, are ultimately borne by the consumer.

The development of sound economic theory is important and should be encouraged. But it is not enough. We must be relevant. It is essential that we relate sound economic principles to the important issues of the day. What is being described here is a challenge to economic education that goes beyond classrooms and scholarly journals. Truly, our "classrooms" must be forums that command the attention of large numbers of our fellow citizens.

Conclusion

We have much to do. We must realize that our concern for the free enterprise system is part of a larger national debate over fundamental values, and especially over the balance between the power of government and the freedom of the individual. Simultaneously, we must relate economic concerns to the broader interests of the public.

Capitalism has its faults. We should be honest enough to admit them and eager to correct them where we can—that is, where the well-intentioned attempts at improvement will not do more harm than good. We also need to be mindful of the fact that economic institutions, such as the business firm, are not multipurpose organizations. In the productive specialization of labor characteristic of a market economy the profit-seeking corporation is best suited to the production and distribution of goods and services to meet consumer needs.

Attempting to impose on the economic process a variety of seemingly high-minded social obligations erodes the ability of business to perform its true social function. That basic social function of business cannot be underestimated. It is providing consumers a rising degree of economic welfare. To restate the obvious (which often needs to be done), it is the private enterprise system that makes available food, clothing, shelter, and other necessities as well as luxuries of life. That basic social function of business also means creating the economic base upon which a society can meet its important non-economic needs, which range from ensuring the national security to caring for the sick and the disabled.

Finally, we should remind our fellow citizens of the importance of maintaining a society containing a great variety of diverse, independent, voluntary institutions—in both economic and non-economic spheres of activity. Seen in that light, the concern with the future of our economic system is a reflection of our more basic desire to maintain and strengthen the free and voluntary society of which the economy is a vital but only a constituent part. Political freedom requires economic freedom. We foster one as we pursue the other.

In corroboration of the last point, just take a globe and spin it. Point to those countries that have market economies and then point to those that are politically free. By and large, you will find that the two groups are the same: the nations with a large and strong private sector are the countries with relatively free political institutions. In striking contrast, those nations where the state dominates the economy tend to be the totalitarian societies. That is hardly coincidence.

I will conclude with one last point that I feel very strongly about. Any one generation in our country is but a small link in a long chain of time that reaches back to the founding of the Republic and hopefully extends out to the indefinite future. Clearly, there are sharp limits to the good that any one generation can accomplish. But there is an overwhelming duty to ensure that our link does not break—that we carry out our responsibility for maintaining our free society and transmit it to the future.