

THE ARGUMENT FOR FREE MARKETS: MORALITY VS. EFFICIENCY¹

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Freedom can be preserved only if it is treated as a supreme principle which must not be sacrificed for any particular advantage.--F. A. Hayek

Freedom's First Principle

Freedom's first principle is: *Each person owns himself*. The transition from socialism to capitalism and the preservation of capitalism require what philosopher David Kelley calls the entrepreneurial outlook on life, which he describes, in part, as "a sense of self-ownership, a conviction that one's life is one's own, not something for which one must answer to some higher power" (Kelley 1994: 4). Once we accept self-ownership as a first principle, we readily discover what constitutes just and unjust conduct. Unjust conduct is simply any conduct that violates an individual's property rights in himself when he himself has not infringed upon the property rights of others. Therefore, acts like murder, rape, and theft, whether done privately or collectively, are unjust because they violate private property. There is broad consensus that government-sponsored murder and rape are unjust; however, not as much consensus is reached regarding theft. Theft being defined as forcibly taking the rightful property of one person for the benefit of another.

For individual freedom to be viable, it must be a part of the shared values of a society, and there must be an institutional framework to preserve it against encroachments by majoritarian or government will. Constitutions and laws alone cannot guarantee the survival of personal freedom as is apparent where Western-style constitutions and laws have been exported to countries not having a tradition of individual freedom. U.S. articulation of the right to individual autonomy is enunciated in our Declaration of Independence:

We hold these truths to be self-evident, that all men are created equal, that they are endowed by the Creator with certain unalienable rights, that among these are life, liberty and the pursuit of happiness.

That statement, which played such an important role in the rebellion against England and in the establishment of the U.S. Constitution, was the outgrowth of libertarian ideas of such thinkers as John Locke, Montesquieu, and Sir William Blackstone.

Even in societies with a tradition of freedom, such as the United States, the values supporting that freedom have suffered erosion and have proven an insufficient safeguard against encroachment by the state. As is so often the case, political liberty (democracy) has been used to redistribute income and wealth. The redistributive state, in turn, has had a stifling effect on economic liberty and has reduced individual freedom. Ultimately, the struggle to achieve and preserve freedom must take place in the habits and minds of individuals. And, as admonished by the Constitution of the State of North Carolina (Art. I, Sec. 35), "The frequent reference to fundamental principles is absolutely necessary to preserve the blessings of liberty." It is those fundamental principles that deliver economic efficiency and wealth, not the other way around. Fundamental moral principles or values are determined in the arena of civil society. Values such as thrift, hard work, honesty, trust and cooperative behavior, based on shared norms, are the keys to improving the human condition and provide the undergirding for a free-market economy. Just as important are such social institutions as respect for private property, sanctity of contracts, educational institutions, clubs, charities, churches, and families. All those institutions provide the glue to hold society together in terms of common values and provide for the transmission of those values to successive generations. Too often informal institutions and local networks are trivialized and greater favor is given to the intellectual's narrow conception of what constitutes knowledge and wisdom.

The importance of informal networks such as friends, church members, neighbors, and families cannot be underestimated--as demonstrated in the following example of small proprietorships.[1] The critical determinants of a proprietor's success are perseverance, character, ability, and other personal characteristics. Banks seldom finance the establishment of such business. Most small businesses are financed through friends and family. The reason is that those are the people who have the lowest cost in acquiring the necessary information about the proprietor's characteristics deemed critical for success. Also, friends and family, who lend the proprietor money, have a personal stake in the business and have an incentive to moderate their likely bias in favor of the borrower. Clearly, a formal lending institution could query friends and relatives. However, the information obtained would have greater bias because friends and relatives would not have sufficient stake in the business to offset any personal bias they had in favor of the borrower.

¹ <http://www.cato.org/pubs/journal/cj15n2-3-3.html>

Institutions and Wealth

F. A. Hayek refers to the rules of several property determined by traditions and values. Those rules consisted in what David Hume called "the stability of possessions," "transference by consent," and "the keeping of promises" (Hayek 1984: 321). Nations that have respected the rules of several property have produced social and economic climates far more conducive to the welfare of their citizens than nations that have failed to respect property rights. People in countries with larger amounts of economic freedom, such as the United States, Canada, Australia, Hong Kong, Japan, and Taiwan are far richer and have greater human rights protections than people in countries with limited free markets such as Russia, Albania, China, and every country in Africa.

The role of private property and free markets in creating wealth is often overlooked. Factors such as natural-resource endowment, population size, and previous conditions (colonialism) are claimed to explain wealth. Yet those factors cannot explain human betterment. The United States and Canada have relatively small populations, abundant natural resources, and are wealthy. However, if low population density and abundant natural resources were adequate explanations of wealth, one would expect the former Soviet Union and countries on the continents of Africa and South America to be wealthy. Instead, the former Soviet Union, Africa, and South America are home to many of the world's poorest and most miserable people.

A history of colonialism is often given as an excuse for poverty but that is a bogus hypothesis. The world's richest country, the United States, was formerly a colony. Canada, Australia, and New Zealand were colonies--and Hong Kong remains a colony. A far better explanation of wealth are the values and traditions that produce the rules of several property. Economics is not an independent variable whose laws are unaffected by the institutional framework within which it operates. Economic efficiency is a by-product of pre-existing cultural and moral norms.

The Intellectual Defense of Liberty

All too often defenders of free-market capitalism base their defense on the demonstration that capitalism is more efficient in terms of resource allocation and, hence, leads to a larger bundle of goods than socialism and other forms of statism. However, as Milton Friedman frequently points out, economic efficiency and greater wealth should be promoted as simply a side-benefit of free markets. The intellectual defense of free-market capitalism should focus on its moral superiority. In other words, even if free enterprise were not more efficient than other forms of human organization, it is morally superior because it is rooted in voluntary relationships rather than force and coercion, and it respects the sanctity of the individual.

The wealth created by free-market capitalism also cultivates civil society. For most of human history, individuals have had to simply eke out a living. With the rise of capitalism and the concomitant rise in human productivity, people were able to satisfy their physical needs with less and less time. Economic progress made it possible for people to have the time to develop spiritually and culturally. The rise of capitalism enabled the gradual extension of civilization to greater and greater numbers of people. As the wealth of nations grew, people had the means to become educated in the liberal arts and to gain greater knowledge about the world around them. The rise of capitalism enabled ordinary people to attend the arts, afford recreation, and contemplate more fulfilling and interesting life activities, and engage in other culturally enriching activities that were formerly only within the purview of the rich.

Demystification of the State

A. V. Dicey (1914: 257) wrote:

The beneficial effect of State intervention, especially in the form of legislation, is direct, immediate, and so to speak visible, whilst its evil effects are gradual and indirect, and lie outside our sight.... Hence the majority of mankind must almost of necessity look with undue favour upon government intervention. This natural bias can be counteracted only by the existence, in a given society, ... of a presumption or prejudice in favour of individual liberty, that is of laissez-faire.

One can hardly determine the casualties of war simply by looking at survivors. We must ask what happened to those whom we do not see. Similarly, when evaluating interventionist public policy we cannot evaluate it simply by looking at its beneficiaries. We must discover its victims. Most often the victims of public policy are invisible. To garner greater public support against government command and control, we must somehow find a way to make those victims visible.

In all interventionist policy there are those who are beneficiaries and those who are victims. In most cases the beneficiaries are highly visible and the victims are invisible. A good example is the minimum wage law. After enactment of an increase in the minimum wage law, politicians accompanied by television crews readily point to people who have benefitted from the legislation. The beneficiaries are those with a fatter paycheck. Thus, the politician can lay claim to the wisdom of his legislation that increased minimum wages. Moreover, the politician is also a beneficiary since those now earning higher wages will remember him when election time comes around. By parading minimum wage beneficiaries across the stage, those who oppose minimum wage increases can be readily portrayed as having a callous, mean-spirited disregard for interests of low-wage workers.

A political strategy of those who support liberty should be that of exposing the invisible victims of minimum wage laws. We need to show those who have lost their jobs, or do not become employed in the first place, because their productivity did not warrant being employed at the minimum wage. We should find a way to demonstrate jobs destroyed by minimum wages such as busboys, gasoline station attendants, and movie ushers. We must show how marginally profitable firms have been forced out of business, though surviving firms may have the same number of employees. We should show how capital was artificially substituted for labor as a result of higher mandated wages and how firms have adjusted their production techniques in order to economize on labor. The particular adjustments firms make in response to higher mandated wages are less important than the fact that adjustments will be made.

A more dramatic example of the invisible victims of interventionist state policy can be found in the regulation of medicines and medical devices, as in the case of the Food and Drug Administration (FDA) in the United States. Essentially, FDA officials can make two types of errors. They can err on the side of undercaution and approve a drug with dangerous unanticipated side effects. Or they can err on the side of overcaution, not approving a useful and safe drug, or creating costly and lengthy drug approval procedures. Errors on the side of undercaution lead to embarrassment and possibly loss of bureaucratic careers and promotions because the victims of unsafe drugs will be visible through news stories of sick people, congressional investigations, and hearings. However, errors on the side of overcaution, through extensive delay in the approval of drugs--as in the cases of propranolol, Septra, and other drugs--impose virtually no costs on the FDA. Victims of FDA errors on the side of overcaution are mostly invisible to the press, the public, and politicians.

Those victims should be made visible. Once the FDA (or some other approving agency) approves a drug widely used elsewhere with no untoward effects, we should find people who died or needlessly suffered as a result of the FDA's delay. For political efficiency we cannot simply offer intellectual arguments. We must get pictures and stories of FDA victims in an effort to appeal to a sense of fair play, decency, and common sense among the citizenry. But there is also a role for intellectual arguments in the sense of teaching people that any meaningful use of "safe" must see safety as a set of tradeoffs rather than a category. The attempt to get a "safe" drug means that people will die or needlessly suffer during the time it takes to achieve greater safety. That toll must be weighted against the number of people who might die or become ill because of the drug's earlier availability and attendant unanticipated harmful side effects. People should also be taught to understand that if a 100 percent safe drug is ever achieved, it will be the only thing in this world that is 100 percent safe.

Another area of state interventionism, which particularly applies to less developed nations, is restrictive import laws and regulations. Restricting foreign imports as a means to save jobs sounds plausible. Adding to the appeal of restrictive trade policy is the fact that its beneficiaries are highly visible while its victims are invisible.

Using an example of the American experience may suggest a political strategy. Most people fully understand that import restrictions raise the cost of products but may have little understanding of its systemic effects. Arthur Denzau of the Center for the Study of American Business found that "voluntary restraints" on imported steel saved nearly 17,000 jobs in the steel industry. However, the higher steel prices, resulting from the restraints, led to a loss of 52,000 jobs in American steel-using industries. On balance steel restrictions led to a net loss of 35,400 jobs (Denzau 1987: 12). The process is easy to understand. Caterpillar Company uses steel to produce heavy construction equipment. Trade restrictions caused higher steel prices that in turn raised Caterpillar's production costs. Higher costs made Caterpillar less competitive in both domestic and international markets, which led Caterpillar to downsize its labor force. As a result, we see more Japanese and Korean-produced heavy equipment in the United States. Importing finished products, by the way, is just another way to import steel.

In addition to causing a net loss of jobs, trade restrictions are costly to consumers. According to estimates, the Reagan administration's "voluntary import restraints" on Japanese cars increased the price of Japanese cars sold in the United States by \$900 and increased the price of U.S. cars by \$350, for a total cost to American consumers of \$4.3 billion. That price tag translates into a cost of \$200,000 per year for each job saved in Detroit (Tarr and Morkre 1984: 57). It would have been cheaper to have given each Detroit auto worker, laid off by freer trade, a check for \$60,000 a year so they could buy a vacation residence in Miami. That way, collectively, we would have been better off to the tune of \$140,000 per job saved. Of course, that policy choice would not have been politically feasible because the costs would have been apparent and taxpayers would have refused to pay for the free vacation. It is not only auto workers with whom the nation could have made the trade. According to the Federal Trade Commission, quotas on textile products from Hong Kong cost consumers \$34,500 per year for each job saved for American textile workers earning \$7,600 to \$10,700 annually (Morkre 1984: 27).

Identifying the invisible victims of trade restrictions may suggest a political strategy to fight such restrictions. One such strategy is to organize companies adversely affected by import restrictions, such as steel-using companies in the case of the U.S. import restrictions on steel.

Justice: Process vs. Results

At the heart of most interventionist policy is a vision of justice. Most often this vision evaluates the presence of justice by looking at results.

Social justice has considerable appeal and as such is used as justification for interventionist statism. There are several criticisms of the concept of social justice that Hayek has answered well, but defenders of personal liberty must make a greater effort to demystify the term and show that justice or fairness cannot be determined by examining results. The results people often turn to in order to determine the presence or absence of justice are educational and occupational status, income, life expectancy, and other socioeconomic factors. But justice or fairness cannot be determined by results. It is a process question.

Consider, for example, that three individuals play a regular game of poker. The typical game outcome is: individual A wins 75 percent of the time, while individuals B and C win 15 percent and 10 percent of the time, respectively. By knowing the game's result, nothing unambiguous can be said about whether there has been "poker justice." Individual A's disproportionate winnings are consistent with his being an astute player, clever cheater, or just plain lucky. The only way one can determine whether there has been poker justice is to examine the game's *process*. Process questions would include: Did the players play voluntarily? Were the poker rules neutral and unbiasedly applied? Was the game played without cheating? If the process were just, affirmative answers would be given to those three questions and there would be poker justice irrespective of the outcome. Thus, justice is really a process issue.

The most popular justification for the interventionist state is to create or ensure fairness and justice in the distribution of income. Considerable confusion, obfuscation, and demagoguery regarding the sources of income provide statisticians with copious quantities of ammunition to justify their redistributionist agenda. Income is not distributed. In a free society, income is earned. People serving one another through the provision of goods and services generate income.

We serve our fellow man in myriad ways. We bag his groceries, teach his children, entertain him, and heal his wounds. By doing so, we receive "certificates of performance." In the United States, we call these certificates dollars. Elsewhere they are called pesos, francs, marks, yen, and pounds. Those certificates stand as evidence (proof) of our service. The more valuable our service to our fellow man (as he determines), the greater the number of certificates of performance we receive and hence the greater our claim on goods and services. That free-market process promotes a moral discipline that says: Unless we are able and willing to serve our fellow man, we shall have no claim on what he produces. Contrast that moral discipline to the immorality of the welfare state. In effect the welfare state says: You do not have to serve your fellow man; through intimidation, threats, and coercion, we will take what he produces and give it to you.

The vision that sees income as being "distributed" implies a different scenario for the sources of income never made explicit. The vision that sees income as being distributed differs little from asserting that out there is a dealer of dollars. It naturally leads to the conclusion that if some people have fewer dollars than others, the dollar dealer is unfair; he is a racist, sexist, or a multi-nationalist. Therefore, justice and fairness require a re-dealing (income redistribution) of dollars. That way the ill-gotten gains of the few are returned to their "rightful" owners. That vision is the essence of the results-oriented view of justice underpinning the welfare state.

People who criticize the existing distribution of income as being unfair and demand government redistribution are really criticizing the process whereby income is earned. Their bottom line is that millions of individual decisionmakers did not do the right thing. Consider the wealth of billionaire Bill Gates, the founder of MicroSoft. Gates earned billions because millions of individuals voluntarily spent their money on what they wanted--his products. For someone to say that Gates's income is unfair is the same as saying that the decisions of millions of consumers are wrong. To argue that Gates's income should be forcibly taken and given to others is to say that somehow third parties have a right to preempt voluntary decisions made by millions of traders.

When sources of income are viewed more realistically, we reach the conclusion that low income, for the most part, is a result of people not having sufficient capacity to serve their fellow man well rather than being victims of an unfair process. Low-income people simply do not have the skills to produce and do things their fellow man highly values. Seldom do we find poor highly productive individuals or nations. Those who have low incomes tend to have low skills and education and hence low productive capacity. Our challenge is to make those people (nations) more productive.

Another explanation of low income is that the rules of the game have been rigged. That is, people do have an ability to provide goods and services valued by their fellow man but are restricted from doing so. Among those rules are minimum wage laws, occupational and business licensure laws and regulations, and government-sponsored monopolies. Hence, another argument for free-market capitalism is that it is good for low-income, low-skilled people.

The Vision of Black Markets

We should always keep in mind the resiliency of markets. Despite the efforts of socialist regimes, markets tend to survive to one degree or another; they are an irrepressible part of human nature. As Adam Smith ([1776] 1976:

17) wrote, "It is the necessary ... certain propensity in human nature ... to truck, barter, and exchange one thing for another." During the 70 years of the Soviet experiment, with massive attempts to suppress markets (including jail, banishment, and death), markets in one form or another survived. The conditions for the formation of markets are always present and explain their resiliency. Those conditions are: (1) private ownership of property, (2) interaction between people who place different valuations on goods, and (3) individual will and self-interest.

Those conditions give rise to markets be they legal or illegal (black) markets. According to some estimates, up to 84 percent of the Soviet people purchased goods and services through the black market or *fartsovshiki*. The *fartsovshiki* was also a source of additional employment, and hence income, for as many as 20 million Soviet citizens (Galuszka 1989). According to Automotive News (1985), 60 percent of Soviet citizens used black-market mechanics for auto repairs and another 30 percent purchased gasoline and parts from black-market distributors.

Soviet officials could never eliminate black markets and one doubts that they wanted to. After all, the Soviet system may have survived as long as it did because some of its more uglier consequences were mitigated by the presence of black markets. Given the periodic shortages of life's necessities such as food and clothing, there may have been uncontrollable social disorder if Soviet citizens had to do without rather than have a black-market outlet to which they could turn to for relief.

The Soviet experience proves that man is by nature a capitalist. The transition from socialism to capitalism requires only that human nature be permitted to flourish.

Conclusion

The struggle to extend and preserve free markets must have as its primary focus the moral argument. State interventionists stand naked before well-thought-out moral arguments for private ownership of property, voluntary exchange, and the parity of markets. People readily understand moral arguments on a private basis--for example, one person does not have the right to use force against another to serve his own purposes. However, people often see government redistribution as an acceptable use of force. In a democratic welfare state that coercion is given an aura of legitimacy. The challenge is to convince people that a majority vote does not establish morality and that free markets are morally superior to other forms of human organization.