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# American Capitalism at High Noon

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# American Capitalism at High Noon

One of my ancient and mighty ancestors preached with irresistible persuasiveness that a laborer who specializes in one type of work acquires astonishing knowledge and dexterity in performing that work. By and large we Chicago economists have accepted Adam Smith's argument.

This argument implies, to be more specific, that you businessmen and businesswomen invest appropriately large amounts of resources in learning the facts relevant to your problems, and that you possess a large store of specialized, current information. It asserts that you employ this information to design programs which on balance will pay off for both you and your company. In short, you know more about your business than anyone else (except possibly a few rivals or colleagues), certainly more than your superiors! Of course, you know more than Washington knows. And here is my lament: you know more than an economist knows.

An occasion such as this almost demands that I gently reprimand you for follies such as seeking tariffs, or point out the correct way to deal with the next crazy proposal, if you will excuse the redundancy, coming out of Washington. Yet I have just said that you are much better qualified than I or economists as a whole to deal with such issues.

Many of my fellow economists have been less modest in this respect than they should be. Milton Friedman has felt free to advise you on how much to give to colleges and universities—a sum not calculated to strain the resources of the smallest business. John K. Galbraith has complained for years of so technical a matter as the design of American automobiles, and for all I know he has actually been designing automobiles in recent years for Chrysler. But I must repeat: my disavowal of business expertise is sincere, and you will not receive advice today.

Yet there is one area of common interest where in principle the academic economist is the equal of the businessman: discerning the near and long-run prospects of the private business system. In this discussion, I hope to shed some light on a fundamental question of our times, namely, the roles of the state and private enterprise in the organization of the economy. My general argument will rest on several propositions, which I view as axioms but some of you may view as bold hypotheses.

### **Consumers and Regulation**

The first proposition is that consumers have a primary interest in the efficiency of the economy's operation. If I am a wealthy person, I wish to have my mansions and psychiatric treatment and racks of lamb produced and sold at the lowest prices compatible with the maintenance of their quality. If I am a middle-class person, I will have the same desire with respect to my suburban home, college instruction, and golf club memberships. That is obvious enough.

What may be less obvious is that the welfare recipient's desire for economic efficiency is even stronger. Not only will a dollar go farther in an efficient economy, but also, there will be more dollars to give to, or to be taken by, those on welfare. Whatever the political power of the welfare classes, or the benevolence of the taxpayers who provide the funds, the absolute amount that goes to welfare will rise with the national income. There should be no paradox in the fact that he who milks the cow prays for good pasturage.

There are two kinds of exceptions to this rule that consumers are, and in their own interest should be, the supporters of a highly efficient economy, which I will identify with an unregulated private economy.

The first kind of exception is illustrated by the rent controls of New York City. A particular group of tenants—those in possession of premises on the day the rent control is imposed—clearly gain at the cost of a set of landlords who lack either of two defenses: as many votes as the tenants, or the ability to withdraw their immobile investments from the regulated area and rent them elsewhere.

In the long run almost everyone else loses by this kind of regulation. New tenants must pay in one way or another for access to the regulated properties; landlords are despoiled; and since rental properties are not maintained or new units built, the tax base and the community's supply of housing are impaired. There may be other winners besides the original tenants, for example, owners of single-family dwellings. If we strike a balance, however, the losers lose much more than the winners gain—national income is reduced by rent controls.

However, there are not many opportunities for a group of consumers to play this type of game. The game requires an immobile victim, like a landowner, and immobile victims can be found only on a local level (zoning provides another example). Nationally the consumers are too numerous and too diverse in their interests to be able often to launch effective expropriations of suppliers.

There is a second class of cases in which consumers may employ regulation to achieve their ends: when the market does not provide what they want. The textbook case is air pollution, for example, from an automobile. If my automobile costs \$200 more a year if it is equipped with antipolluting devices, I bear this whole cost and receive (in Chicago) about one four-millionth of the benefits. That is a trade-off that I will not accept; but it is acceptable if all other drivers undertake

the same improvement, with total benefits to Chicagoans per improved automobile of more than \$200. This is a modern instance of the old-fashioned role of the state in bringing about joint action where individual action would not pay.

If we force all the regulatory activities we can into these two categories of expropriation by particular groups of consumers and the correction of market defects, we still do not account for any large fraction of the regulatory policies of the United States. Consumers do not benefit from regulation of public utilities, energy, financial institutions, labor markets, imports and exports-literally thousands of regulatory policies of almost inconceivable variety. For example, there is a federal compensation scheme for the owners of bees whose death may have been due to pesticides. The introduction of this policy a few years ago, one U.S. Department of Agriculture employee has observed, has led to the utter disappearance of bees who die a natural death. The consumers of honey did not get this program adopted, nor did consumers support state licensing laws requiring barbers to have as many hours of training as airline pilots need. If consumers had their way, our economy would **be** relatively free, productive, and progressive, filled with consumers buying vast quantities at low prices and taxing the rich the maximum amount that their political power or a prudent regard for the health of the golden-egg-laying geese allowed.

Thus I return to my first proposition: consumers, especially poor consumers, have no interest in efficiency-destroying regulations of the economy. Maximum output is their goal, laissez-faire their creed.

### **Businessmen and Regulation**

Proposition number two is that entrepreneurs and managers are the elite class in any

society; they are the people with energy and ideas, and they end up controlling the society's resources. This is true whether they are high-born aristocrats, the army of functionaries of a communist state, or the public bureaucrats and business executives of a modern so-called mixed society. The proposition is true, I believe, whether the society is democratic or dictatorial and whether the energies of these entrepreneurs are bent to pleasing consumers, pleasing voters, or currying the central party committee's favor.

The entrepreneurs and managers are, almost by definition, the movers and shakers. But the kind of economic organization in which they operate affects their behavior considerably. In a socialistic system their explicit salaries will be smaller than in a private enterprise system, but their perquisites will be larger. In a socialistic system the rivalry for power will eliminate the weak from control, but the winners will probably differ from the winners in a private enterprise system. It is hard to believe that a Henry Ford would get a chance to control large resources in modern England or Sweden, utterly impossible that he do so in Russia, and it would be harder in the United States today than it was in 1910.

So powerful is this class-so powerful was it in the United States in the closing decades of the nineteenth century-that it is quite impossible to believe that large political interferences in the economic system could have taken place without the permission of the industries that were regulated. Imagine the railroad industry under the unwilling control of the Interstate Commerce Commission in 1890. The industry had 700,000 employees, \$10 billion in capital, and dozens upon dozens of powerful, able entrepreneurs. The ICC had five commissioners, a staff of sixty-one, a budget of \$150,000, and

infinite respect for the members of Congress—who in turn were not lacking in respect for the great industry of railroading. If told that the ICC controlled the railroads, the Duke of Wellington would have repeated himself: anyone who believed that would believe anything.

Thus the larger part of the regulations to which businessmen are subjected must be of their own contriving and acceptance. It is they who persuaded the federal and state governments to initiate the controls over financial institutions, transportation systems, communication systems, extractive industries, and so on. The railroad industry is a suitable example: it was scarcely born before it began requesting loans from local governments and land from the federal government, and it has now advanced to such eleemosynary forms as Amtrak and Conrail. Even the burial of industrial enterprises has become a public activity, as Chrysler Corporation rides toward its grave on a hearse provided by the U.S. Treasury.

If the lamented Joseph Schumpeter, that alternately profoundly wise and infinitely clever economist, were here, he would tell you that I am quite wrong in my explanation for the luxuriant growth of public regulation. He would tell you that despite the immense contributions of the private enterprise system to the economic prosperity of the Western world, the system is being undermined by its critics. Some are intellectuals; some are activists, meaning that their mouths, not their minds, are active; some are simply people who will gain power by increasing governmental controls. All view the unregulated private enterprise system as their primary enemy.

I am not prepared to deny that there are more than enough of such critics of private enterprise and that they have achieved a

good deal of public attention for many years. However, I do deny that they would be remotely a match for the American business community if that community were united in its opposition to public intervention in economic life. The American business community includes vast numbers of people of high ability, with many more on the horizon because professors in leading business schools are now teaching an elite class of recent college graduates. The American business community has ample financial resources, even in these days of onerous taxation. What the American business community lacks is the will to eliminate most business regulation.

The fact that the intellectuals were the chief pleaders for regulation and the business community was verbally opposed to regulation in general may well underlie the illusion that the intellectuals have been responsible for the regulatory policies that were adopted. If mine is a correct reading of history, the intellectuals, miserable souls, were basically serving the business community they profess to dislike by creating a facade of public interest for the regulatory regime.

The recent actions of the new administration, dedicated as it is to deregulation, are instructive with respect to the desires of the business community. The financial community does not wish to see a serious curtailment of the SEC's powers, and an informed and responsible figure in that industry is named the new chairman of the SEC. The opening demand that the FTC withdraw from antitrust enforcement is hastily modified in response to small-business pressures. The ICC is apparently moving back from an antiregulatory to a proregulatory stance and so, too, the FCC. I am even in genuine doubt that the attack on environ-

mental protection laws will gain the widespread support of the business community.

I must hasten to add that it is not only the business community, as we commonly understand that phrase, that has urged and obtained those bountiful regulatory favors. The agricultural industries have secured many regulatory boons, especially in the last fifty years. The labor unions, and particularly groups such as the employees of railroads and coal mines, have done very well in Washington. It would be more precise if I said that most regulatory policies have been sought by producer groups, of whom the business community is the most important and the academic community by no means the least important.

### **Capitalism at High Noon**

Thus I have argued for two propositions: (1) consumers are opposed to most regulations and (2) businessmen are selectively in favor of most regulations. If I add to these propositions the commonplace that regulations are both pervasive and perhaps increasing, should I conclude that we are in the golden age of business? Should we tell people who write of the twilight of American capitalism that they are mistaken and in fact it is really the high noon of capitalism?

At this point some of you will say that I have achieved a misreading of the American scene with my perverse arguments: American business wishes to be freed of its regulations. I hope that you will reexamine my arguments at your leisure and consider whether our ocean of regulations could possibly have been achieved under high capitalism except by the consent of the capitalists. American business likes what it is getting and complains publicly only because so many intellectuals take affront at the sight of a happy businessman. Since I promised

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the pace of regulation has been in America in recent decades. If we put aside the consumer-oriented regulations such as rent control and environmental protection (and perhaps if we do not), we do not know whether the economy is regulated more in 1981 than it was in 1971. One can count up regulatory statutes and the areas of the economy to which they pertain (although no one has seriously undertaken that simple but vast task), but a statute and its regulations are hardly a measure of effective regulation. Effective regulation changes the course of events and is much more than a legal rule.

As this question about measurement implies, there are forces working for deregulation as well as for regulation. The rise of an industry which makes a good substitute for the product of a regulated industry may wreak havoc with the regulated industry and its regulations. Thus the money market funds have restored competition to the market for personal savings, and it may well be that the essential deregulation of the savings and loan industry will emerge-unless the current drive to regulate the money market funds succeeds. The railroad industry lost control of the ICC to the trucking industry: it is a rule of life that dogs wag tails, tails do not wag dogs. The far-reaching changes in American agriculture and in synthetic fibers have demoted cotton from king to earl or count.

Some organizational changes in American businesses take on new significance in this light. One pervasive concern with the age of political regulation is that it seems calculated to accommodate the interests of established firms and industries. How can I, who would perhaps enter the widget industry if it is not expensively regulated into near or complete nonexistence, find the other prospective entrants and form an effective political lobby?

Clearly, those who are already on the scene have large advantages in politics: the system of regulation is hostile to industrial mavericks.

Nevertheless, the answer I give for new industries holds here: the computer has become so overwhelmingly efficient as a compositor that the International Typographical Union eventually will be swept away by it. Another response is the conglomerate corporation, which is equipped with ready access to capital and extensive experience in dealing with legislators and bureaucrats. These conglomerates are eager searchers for the new industry and the small firm with an excellent idea. Are they not an efficient tool for restoring the receptivity of the economy to new industries and new methods of operating old industries?

I suspect that a full canvass of modern industrial and financial trends would reveal methods of political action to assist business which have so far escaped academic attention, but it would also reveal new methods of circumventing the obstacles that regulations put in the way of economic progress and its inseparable friend, large profits. There is no sound evidence that high noon is rapidly passing for semiprivate enterprise.

I wish to address some concluding remarks to my fellow economists. They may well have become restive at my praise of a world so different from that which Chicago economists have customarily honored. They will even begin to suspect that I have come to recant a fundamental article of faith: that the open, competitive economy is considerably more efficient, and not obviously less fair in its distribution of income, than the heavily regulated economy which constitutes American capitalism today.

The standard case for a free, competitive economy, I freely grant, is valid: it has a solid

theoretical structure, and it rests on a vast amount of empirical evidence. If I and my likes could design the American economy, it would have a national income larger by possibly 10 to 20 percent, without forfeiting any social goals that are widely desired. If I employed Milton Friedman as an independent contractor-that's the only kind he ever is-we would also do a good job on inflation.

But notice: these good things come only because you turned dictatorial powers over to me. That might work once-I have never been a bad dictator-but it is not a practice to be recommended. Frank Knight once remarked that to expect a benevolent and moral man to become a dictator is as reasonable as to expect such a person to be put in charge of discipline on a slave plantation.

We have a political system that presently has only modest defenses against use of the state's power to help politically cohesive groups. I conjecture, by the way, that an authoritarian society is even more vulnerable to such practices: the ruling class may be able to repress the demands and incomes of agricultural classes, labor unions, tenants, or consumer industries, but only to treat even better the military caste or the upper-level bureaucracy.

Moreover, we cannot presently devise a set of political institutions that would prevent the uses of regulatory powers that help some groups but reduce the nation's income. I do not despair of finding political reforms that will mitigate our problems in this respect: after all, hardly anybody has been looking for such changes. We economists in particular have been content to preach self-restraint to businessmen and tenants and farmers-when we are not writing strong letters to Washington to deplore the catastrophic effects of the reduction in the appropriations which are proposed for the National Science Foundation.

Until and unless we devise political reforms which are appealing to the nation, we have American capitalism, and we had better love it. It has warts and even an occasional boil, but for all of that it is a magnificently productive economy, providing ample livelihoods and a variety of choices of livelihood greater than history has previously seen, as well as the armament of defense against the forces of totalitarianism. And all this with no more impropriety than this world should have become accustomed to. I for one salute American capitalism at high noon.