Free-market Thinkers

With bailouts and other unabashed socialist projects being embraced by both political parties to "save our economy," has free-market economics been proved faulty?

by Charles Scaliger

In the bailout-a-week political climate, it is all too easy to believe that free-market economics are as passé as powdered wigs. Everyone, it seems, is a socialist now, and the old gospel of laissez-faire and free enterprise has been discredited by a cascade of free-market failures that threaten to bring down the economy of the entire developed world.

"For too long, the prevailing attitude in Washington has been that the market always knows best," Congressman Henry Waxman (D-Calif.) said recently. Economist and newly minted Nobel Laureate Paul Krugman has counseled the new Obama administration to "figure out how much help they think the economy needs, then add 50 percent." According to Krugman, "it's much better, in a depressed economy, to err on the side of too much stimulus than on the side of too little."

In short, the free markets, we are told, have failed, and more government supervision and central planning is the only possible cure. In truth, the economic meltdown we are now experiencing is a result of government intervention, not the free market. But that does not stop the proponents of interventionism from blaming the market for the problem and advocating more intervention as the solution.*

In such times, we would do well to remember that free-market capitalism has been defended eloquently for over 200 years, and that the West, particularly the United States, has prospered because of the acceptance, mostly in the 19th century, of economic freedom, in principle if not always in practice. The men who gave us the theory of free-market economics were lonely, often misunderstood voices in their day as much as in ours, offering timeless economic truths to any who had, and have, ears to hear.

Adam Smith (1723-1790)

Generally regarded as the founder of the modern science of economics, the late 18th-century product of the Scottish Enlightenment, and a contemporary of Hume and Hutcheson, among others, Smith has a less-deserved reputation as a champion of free-market economics per se. By all accounts an eccentric if affable academician, Adam Smith popularized certain ideas that have come to be taken for granted by free-market economists, such as the notion that men in their economic activities are guided by self-interest (not necessarily selfishness), giving the appearance of an "invisible hand" that organizes human enterprise and guides it into maximally productive channels. "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner," wrote Smith in his most famous work, *An Inquiry into the Nature and Causes of the Wealth of Nations*, "but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages."

Elsewhere in that landmark work, Smith pointed out that the division of labor in a free market leads to much greater productivity because it permits greater specialization. A single person manufacturing pins, for example, might produce 20 per day, but many different people engaged individually in the various steps of pin manufacture might produce many thousands during the same interval.

Smith believed that value arose from the amount of labor required to produce a given product, a notion that came to be known as the "labor theory of value." This idea, unfortunately, was mistaken, as later generations of economists, especially in the so-called Austrian School, discovered. However, the labor theory of value was used by Karl Marx and other communist and socialist economists to justify central planning since, if value was a strict consequence of labor invested, then "correct" valuations could be determined by enlightened central planners. Some noteworthy economists, like Murray Rothbard and Joseph Schumpeter, believed Adam Smith's contributions to economics to be greatly overstated. Rothbard believed that Smith

* See, for example, Brian Farmer's article "Government Bailout" in our September 29 issue.

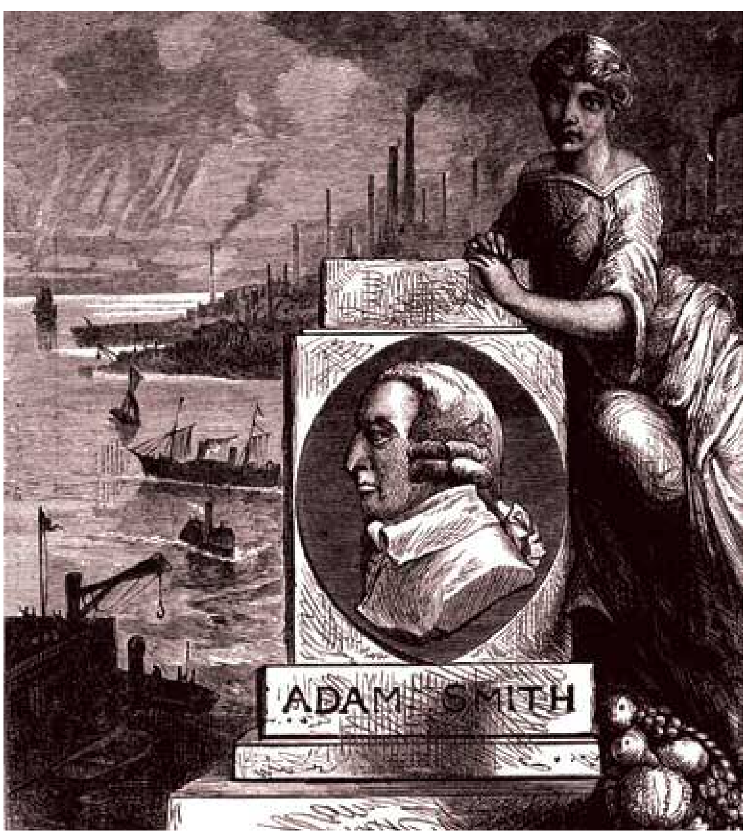
copied many of the ideas of the great French economist Turgot, while Schumpeter doubted his stature as a thinker of the first rank:

> Had he been more brilliant, he would not have been taken so seriously. Had he dug more deeply, had he unearthed more recondite truth, had he used more difficult and ingenious methods, he would not have been understood. But he … never moved above the heads of even the dullest readers. He led them on gently, encouraging them by trivialities and homely observations, making them feel comfortable all along.

Whatever his shortcomings, Adam Smith deserves to be remembered as one of the first popularizers of free-market economics, expounding in clear, still-readable language some of the most important precepts of free-market economics in an age when many were ready to hear the sweet doctrines of liberty.

Jean-Baptiste Say (1767-1832)

Best known for the law of economics that bears his name, Say was one of the first "pure" free-market economists. A survivor of both the French Revolution and the Napoleonic dictatorship, Say had experienced firsthand the ravages of Utopian social planning and its inevitable concomitants, oppression and terror. Censored by the Napoleonic regime and dismissed from a government post, Say quietly put his economic beliefs into practice, founding a successful cotton mill that employed roughly 500 people. Unable to publish his works while the dictatorship lasted, Say privately revised and rewrote his treatises in his leisure time.



Say's Law is sometimes understood to mean that supply creates its own demand, but it really means that supply and demand are but two sides of the same coin. In an economy, different products are exchanged for each other, with money as the medium of transfer; there is no mystical dividing line between supply and demand. Say devoted a good deal of scholarship to demolishing the old mercantilist fallacy — still lamentably fashionable among modern economists — that money is the source of wealth. Money, Say took pains to explain, has value only insofar as it is desired to mediate indirect exchange in the market; wealth per se consists in other goods for which money is exchanged. Say probably understood better than anyone else in his generation the workings of the free market. His *Treatise on Political Economy* remains one of the finest and most original works in the entire history of economic thought.

> Government, in Bastiat's view, cannot justly do anything that morality would forbid in individual action. If it is wrong for individuals to steal, defraud, or commit murder, then it is surely wrong for governments — which derive their powers from individuals — to do likewise.

Frederic Bastiat (1801-1850)

A Frenchman whom Karl Marx once dismissed as "the shallowest and therefore the most successful representative of the apologists of vulgar economics," Frederic Bastiat labored tirelessly throughout his short life to promote the philosophy of freedom, both economic and political, in trenchant, highly readable language that has influenced millions of readers over many generations. Best-known for his posthumously published pamphlet *The Law*, Bastiat authored many books, essays, and tracts on liberty and limited government that probably did more to popularize freedom than anything since the time of the American founding.

Bastiat had a gift for illustrating his points with clever, memorable examples. His "broken window fallacy," in which onlookers, observing a shop window broken by vandals, erroneously conclude that the act of destruction will be beneficial to the economy because it will make work for the glazier, is one of his most famous economic parables. For Bastiat, good economics was merely refined common sense; most onlookers would initially (and correctly) decry the broken window as a wicked and destructive act, and only later allow themselves to be led into the false rationalizing with which the science of economics is so unfortunately replete.

Such false rationalizing has led many to believe that World War II and the work it created were responsible for ending the Great Depression. In WWII, the military-industrial complex and the destruction were on a gargantuan scale compared to the glazier and broken window, but the economic principle illustrated by the parable is the same.

The cardinal error of bad

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economists, Bastiat explained, is to ignore the "big picture." In the case of the broken window, the vandals have indeed given the glazier work — but that work will merely replace a good that has been destroyed. What the confused onlookers forget is the other goods that the glazier might have produced, that would have added to the stock of wealth, had their energies not been diverted by a destructive act. Good economics recognizes both the seen (in this case, the broken window and its replacement) and the unseen (what might have been produced with the resources diverted to replace the window).

In his magnum opus, *The Law*, Bastiat explained as concisely as has ever been done the origin of rights and liberty, and their relationship to the state. God-given rights are superior to man-made government, and the latter, to the extent that it has any legitimacy, is derived from the former:

> Life, faculties, production — in other words, individuality, liberty, property — this is man. And in spite of the cunning of artful political leaders, these three gifts from God precede all human legislation, and are superior to it. Life, liberty, and property do not exist because men have made laws. On the contrary, it was the fact that life, liberty, and property existed beforehand that caused men to make laws in the first place.

Government, in Bastiat's view, cannot justly do anything that morality would forbid in individual action. If it is wrong for individuals to steal, defraud, or commit murder, then it is surely wrong for governments — which derive their powers from individuals — to do likewise. But government and laws are frequently abused, used to achieve collectively what most men would scruple to do individually. In this way, wealth is confiscated from some individuals and given to others in the time-dishonored pattern of socialist redistribution. This Bastiat called "legal plunder":

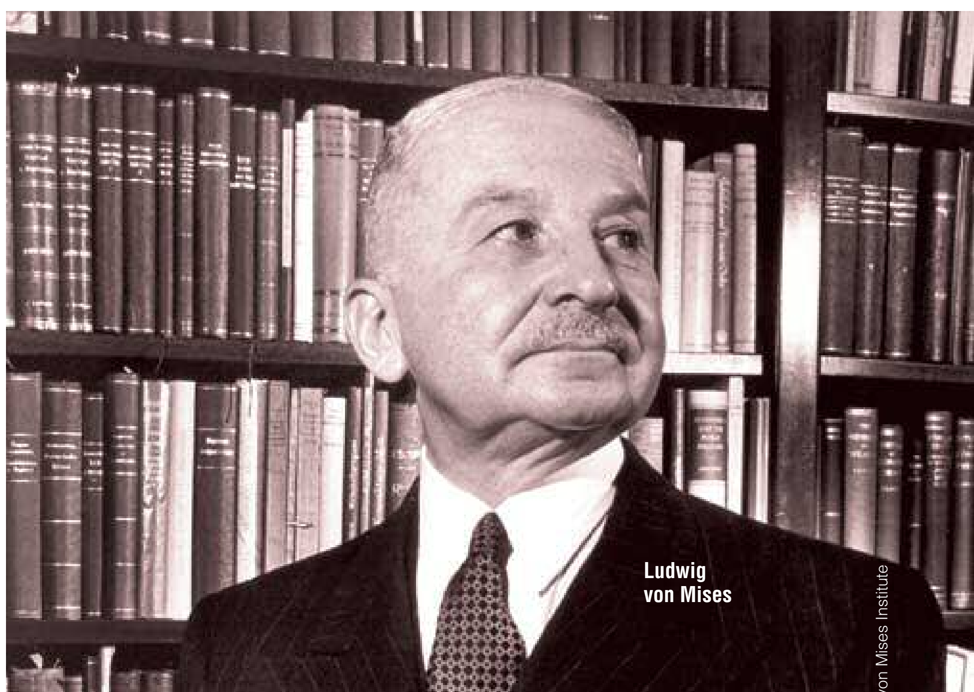
> But how is this legal plunder to be identified? Quite simply. See if the law takes from some persons what belongs to them, and gives it to other persons to whom it does not belong. See if the law benefits one citizen at the expense of another by doing what the citizen himself cannot do without committing a crime.

Bastiat, who believed unswervingly that "the solution to the problems of human relationships is to be found in liberty," probably gave his life in service to that belief. While traveling around Europe promoting his beliefs, he contracted tuberculosis and died at just 49. He was perhaps the purest of the so-called "classical liberals," a man who never deviated from his passion for liberty, and whose written works continue to inspire and enlighten.

Ludwig von Mises (1881-1973)

The best-known and most influential of the school of economics known as the Austrian School, Ludwig von Mises was the most eminent free-market economist of the 20th century. Forced to flee his native Austria by the Nazi invasion, von Mises took refuge in Geneva before emigrating to the United States, where he took an unsalaried position at New York University. Influenced by Carl Menger, the founder of the Austrian School, and Eugen von Boehm-Bawerk, another of the economic school's early eminenti, the precocious von Mises took Menger's ideas into then-unfashionable realms, criticizing socialism and credit

Frederic Bastiat



Ludwig von Mises

AP Images

In 1933, government work programs, which these New Yorkers were waiting to sign up for, were part of the socialistic New Deal program to save our economy. But these programs didn't work then — there was more unemployment in 1938 than 1932 — and they won't work now.

expansion by central banks, among many other state-sponsored evils.

The Theory of Money and Credit analyzed minutely the nature of money, banking, and finance, while *Socialism* showed how central planning was irrational and unworkable because correct economic calculation and decision-making cannot be achieved by state planners. Mises' magnum opus, *Human Action*, laid out a theory of what Mises called "praxeology," the study of human actions and their motives. His praxeology was the foundation for his entire economic and philosophical world view, and helped de-mystify the "dismal science" for a generation befuddled by the sophisms of John Maynard Keynes and other thinkers hostile to the free market. However, Mises was not a gifted popularizer like Bastiat; much of his writing is dense and subtly reasoned, compelling the reader to work hard for his intellectual rewards. Yet Mises is the towering figure in 20th-century free-market economic thought. Many other economists, as well as statesmen like Congressman Ron Paul, and innumerable partisans of liberty (including this humble author), count Ludwig von Mises among their most important influences. One cannot truly understand freedom without some familiarity with the man and his ideas.

Friedrich Hayek (1899-1992)

One of Ludwig von Mises' most eminent students, Hayek, also Austrian by birth, was the only Austrian economist to win the Nobel Prize in economics, thereby helping to confer scholarly legitimacy on a school of thought that collectivist economists like the disciples of John Maynard Keynes had worked hard to discredit.

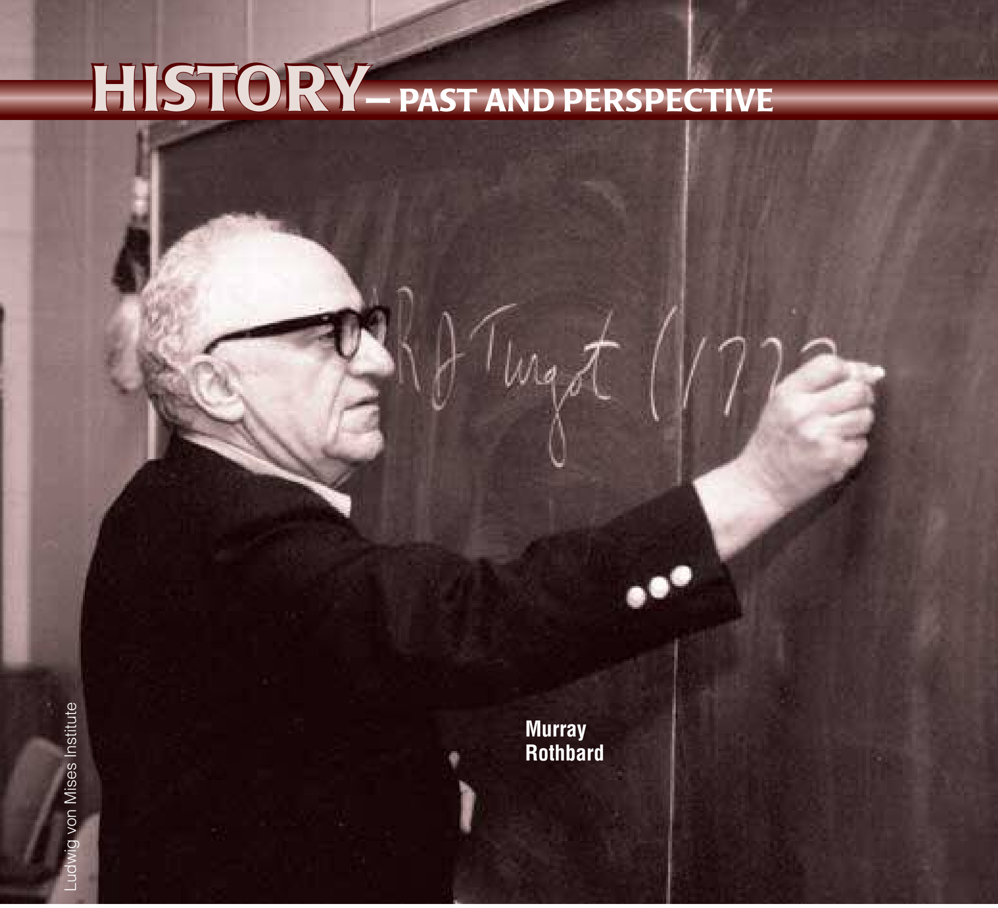
Although not as consistent a defender of aspects of the free market as his mentor von Mises (or his contemporary Murray Rothbard), Hayek's influential 1944 book *The Road to Serfdom* remains one of the most devastating attacks yet written on collectivism and its consequences. Written in an era of totalitarianism ascendant, the book was wildly popular, attracting acclaim from the likes of George Orwell (a professed socialist himself). *Serfdom* (which might more aptly but perhaps less memorably have been entitled *The Road to Tyranny*) argued that collectivism always leads to tyranny, as the inefficiencies and shortages brought about by central planning encourage the mistaken perception that more government is needed to "fix" all the problems. At the time of its publication, Nazi Germany and the Soviet Union were the preeminent examples of the extremes to which socialism eventually leads. Subsequent decades, which saw much of the "free world" move aggressively into socialist regimentation without being taken over by mass-murdering dictators, lulled many into the belief that, after all, socialism can be "done right" and totalitarianism averted.

This, of course, is precisely what left-wing pundits and politicians are saying in the context of the ongoing economic crisis. A little socialism, temporary and kept within strict limits, we are told, has become a necessary evil to save us from the consequences of too much economic freedom. The death camps and other extremities of totalitarianism are in the rearview mirror now, except in a few backwaters like North Korea, and serfdom is an impossible outcome in an age of information and economic plenty.

But the road to serfdom may follow different paths, or take longer to reach its destination in a country like the United States, where many more barriers, both legal and cultural, protect us from totalitarianism than was the case in Czarist Russia or Weimar Germany. But the early indicators of our likely destination (absent a change in course) abound: a declining standard in living, rising levels of debt both public and private, and most ominously, mushrooming government, including ever-more intrusive police powers over American citizens. We ignore the warnings of Hayek to our peril.

Murray Rothbard (1926-1995)

Of all of Mises' many students, Murray Rothbard was perhaps the most prolific and also the most unapologetic defender of economic freedom. His magnificent treatise on free-market economics, *Man, Economy, and State*, remains the most readable text on the subject ever produced. Both a historian and an economist, Roth-


Ludwig von Mises Institute

Murray Rothbard

bard wrote voluminously on economic history, particularly in the United States. His early book on the Panic of 1819 remains the best work on the subject, while a later history of the early years of the Great Depression (*America's Great Depression*) is the best explanation ever set forth for that turbulent period.

Drawing on the Austrian theory of the credit cycle, Rothbard showed that the Great Depression was triggered by the 1929 bust that followed reckless credit expansion in the 1920s by the Federal Reserve, the Bank of England, and other major central banks. The economic correction of 1929-1930 might have resolved itself fairly quickly (as had happened previously following the Panic of 1907 and the severe recession of 1920-1921), Rothbard explained, but the interventionist policies of Presidents Hoover and Roosevelt prevented the markets from returning to equilibrium. The New Deal exacerbated and prolonged the event in a textbook case of misbegotten government intervention worsening the very problems it was supposed to cure.

Rothbard devoted a lot of ink to demystifying banking and finance, believing fractional-reserve banking and its modern outgrowth, fiat money, to be among the very worst evils. His *The Mystery of Banking* is a concise explanation of that arcane science (if slightly dated, in light of the various new techniques for creating money that the Federal Reserve has adopted in recent months), while *A History of Money and Banking in the United States* shows how banking and banking interests have militated against liberty since the foundation of our republic.

Known for his aggressive and uncompromising defense of liberty in every domain of human activity (a philosophy he termed anarcho-capitalism), Rothbard was derided by neocons and "respectable" conservatives of every stripe, earning from the late William F. Buckley an especially bilious obituary in the *National Review*. A maverick he may have seemed, but the indomitable Rothbard understood better than most that liberty can only survive when it is defended without respite and without compromise.

Henry Hazlitt (1894-1993)

No list of eminent free-market thinkers would be complete without mention of Henry Hazlitt, the 20th century's answer to Frederic Bastiat. In an age of professional academics, Hazlitt was a rara avis, a self-trained economist without a college degree who wrote not for rarefied professional journals but for ordinary men and women.

A journalist by profession, Hazlitt, like Bastiat, used his considerable literary gifts to explain freedom and free-market economics in terms that were both easy and enjoyable to read. He wrote prolifically, authoring more than 20 books and numerous articles in his lifetime, including many pieces for the *Wall Street Journal*, the *New York Times*, and *Newsweek*. His best-known work, *Economics in One Lesson*, is in essence a modern restatement of certain of Bastiat's axioms applied to 20th-century statist sophisms. Like Bastiat, Hazlitt believed that the errors of bad economists arose from a failure to anticipate the consequences of a given policy over the entire economy (rather than just a given sector) and over the long term instead of just the immediate future. Hazlitt is probably the man most responsible for popularizing the ideas of Austrian economics (which is to say, free-market economics undiluted).

The Economic Road Less Traveled

Sadly, the arguments of the champions of the free market have yet to capture the popular imagination or sway the actions of political leadership in the way that socialism has done. These arguments, after all, are generally ignored or dismissed by our major cultural organs such as the media. Moreover, freedom entails both risk and personal responsibility, whereas shills for socialism offer false promises of emancipation from both without harmful side effects. Particularly in times of crisis, public ignorance of free-market economics can prove a costly liability as government takes advantage of a climate of hysteria to enlarge its powers ("You don't ever want a crisis to go to waste," Illinois Congressman Rahm Emanuel, President-elect Obama's chief of staff, has said).

Economics is one subject on which every man fancies himself an expert, but which few take the time to study. Yet economics affects every one of us every minute of every day. None of us can hide from the workings of the market, or escape the consequences of bad economic policies, whether or not we choose to understand them. A grasp of the fundamentals of the free market is an essential part of appreciating liberty. To cure economic ignorance, the writings of Smith, Bastiat, Hazlitt, Rothbard, and other free-market economists are very good medicine indeed. ■