

## 01 Overview

This chapter gives an overview of capitalism, including strengths, flaws, and problems that come from the flaws. The intent is neither to praise capitalism too much nor to blame it too much but to provide ideas so that we can be realistic about what we face, want to preserve, and need to change. This chapter also gives basic ideas about systems.

This chapter is a series of annotated lists. The sections look at the same ideas from different angles. Most sections start with a jargon statement, and then go on to examples for clarity. Do not try to memorize the lists or the jargon. Get a sense of capitalism as a whole. The rest of the book explains in more detail.

**01 Overview; Synopsis.** Capitalism is a system like the global ecosystem, the weather, your car, and a forest. The capital in capitalism is like the trees in the forest. Not all trees are alike but all the trees have in common that they are the basic production of the forest on which everything depends. The workers and consumers are like all the animals in the forest including deer, rabbits, bugs, snakes, ants, and even unglamorous slugs, mushrooms, and bacteria. Plants and animals are tied together in a mutually supportive and mutually limiting cycle. Plants make food for animals to eat. Animals take food from the plants, and, in return, supply nutrients through the carbon dioxide they breathe out, their urine, and their excrement. Plants and animals circulate particular nutrients that we can use to understand how they are tied together, such as energy, water, oxygen, carbon dioxide, and nitrogen. These nutrients are like money in capitalism.

Usually the forest keeps its own balance. It finds its own best size and composition. If there are too many trees, animals eat them until just the right number of trees remains to feed the animals. If there are too few trees, or too many animals, then some animals die from hunger, and more trees grow, until there are just enough trees to feed the animals and just enough animals to trim the trees. If capitalists take too much wealth from the economy, then consumers can't buy all the products, and capitalists have to pay more in wages or have to scale down. If consumers want a lot and can afford to buy it, then more factories open up until consumers are satisfied. The forest does best when left alone. Usually, that is true of capitalism as well.

Sometimes the forest does get out of balance naturally, such as after a new disease or a fire. Even then, eventually the forest restores itself. A great forest manager might be able to help a little bit in these cases but the best thing is to make sure the forest does not suffer any more shocks until it recovers by itself. This is like capitalism recovering after a moderate recession or an "oil shock".

Some natural forests do have chronic problems, but that situation is rare. Unlike natural forests, all capitalism does have some chronic problems, such as unemployment, poor employment, and periodic booms and busts. The managers of capitalism try to correct these problems by some kind of intervention, such as by changing the rate of interest, the amount of money, the rate of taxes on some people, or the size of savings. In the forest, this would be like trying to change the amount of water, how

fast water circulates, or the amount of water in air versus the amount of water in soil. Sometimes these corrections work. Too often, these corrections serve the interests of one group in the economy rather than the whole economy. If soil bacteria managed the forest, they would insist on moving water to the soil; they would say that more water in the soil is a way to help the trees grow and so to correct all problems of the forest, regardless of whether that is true. To avoid these mistakes, we have to be realistic and non-partisan.

This chapter identifies elements of the capitalist economy and describes some ways in which they fit together, leading both to a self-correcting balance and to some problems. Later chapters go into more detail.

**Some Definitions.** Traditionally, social science books start with a definition of the subject. Capitalism is not unique so much in what features it has as in how it develops and combines features. Social scientists have not come up with one accepted definition of capitalism. Nearly all the readers of this book live in a capitalist society, and so have a good feel for capitalism already. Formal definitions of things that we already understand often confuse us. So it is not worth trying to give a long, precise definition of capitalism here.

Capitalism includes the following features but it is not only about them because these features exist in other societies and economies:

Self-interest Fair competition An abundance of goods Wealth Greed Striving to get ahead of the neighbors Markets Merchants Money Profit Interest Savings Re-investment of wealth Secure private property Factories Ventures Links between business, science, and the arts Business firms provide all the means to life A working class that has to seek livelihood only through work in firms Class society The perpetuation of wealth across generations Big business Ties between the state and business

These features are not unique to capitalism but are characteristic of capitalism: -A "good" is any material good such as a car, any service such as a visit with a doctor, or any activity such as watching a ball game. It is easiest to phrase arguments in terms of material goods, and so most of the examples in this book use physical goods. Any idea that can be explained with physical goods is also true of non-physical goods, and could be re-phrased using non-physical goods.

-Modern economies have two main kinds of actors: individual people and business firms. The government can also be an actor. It is described below.

-People pursue goods.

-Business firms provide goods to sell to people.

-Business firms provide goods so as to be able to pursue profit.

-Goods have a subjective value to individual people. People know the value of the good for themselves. A pizza does not have the same value for everyone. Everybody knows how important a pizza is to him/her.

- Goods also have a public price (value) in general for exchanging, buying, and selling.
- Everybody pays the same public price for the good even when the subjective value of the pizza might not be the same for everybody.
- The standard price is expressed in money.
- With money, the prices of all different kinds of goods can be compared.
- Labor is a good with a value too, paid through wages.
- Capitalism has many different ventures, such as a family restaurant, a car repair shop, a shopping mall, a cable TV channel, or a software company.
- Capitalism has many instances of each kind of venture, so that there are many car repair shops or beauty parlors in the same town.
- Capitalism is pervaded by low-grade interest that applies to the purchase of many goods, such as a house, and to the undertaking of many ventures, such as building a new shopping mall.
- Low-grade, pervasive interest allows us to compare values between many goods and ventures.
- “Capital” is abstract value that is not tied to any particular good such as a house.
- Capital can “flow” to ventures and between ventures. People can invest and can disinvest.
- Most people think of capital in terms of money but capital is more often credit.
- “Capitalists” are the owners of large amounts of capital.
- Pervasive interest allows business people to compare ventures so as to seek the greatest value for their capital.
- The financial institutions in capitalism can generate large pools of value (capital) to flow into ventures and between ventures.
- Capitalism has a large class of consumers that is supposed to buy all the goods that are produced.
- Consumers and laborers are almost exactly the same group of people.
- Consumer-laborers are supposed to be able to buy all that is produced with the wages they earn from producing those same goods.
- Business firms have to sell all the goods to the same worker-consumers that they pay to make the goods.

-Some business people are called “entrepreneurs”. They take on risk, sell innovations, deal with fluctuations and problems, and keep the economy moving.

-Business firms do best by giving consumers the products that consumers want.

-Competition leads business firms to serve the interest of consumers. Fair competition makes sure that they do this. The technical word for fair competition that leads to this result is “perfect competition”.

-“Demand” is how much of a good that people generally want, particularly at certain prices. For example, people “demand” ten million Honda Accords at a price of \$20,000 apiece.

-“Supply” is how much of a good that business firms are willing to provide, particularly at certain prices. For example, Honda will provide one million Accords at a price of \$20,000 apiece.

-“Welfare” can mean the familiar program to help poor people, but, in economics, more often the term refers to the well being of people in general. It is the sum of satisfactions for all goods for all people. The particular meaning of “welfare” will always be clear in context.

-Besides people and business firms, government is also an actor in the economy. The term “state” means not any particular state such as Ohio but “government of all kinds, especially the central federal government”.

-“State officials” means politicians and powerful civil servants. State officials do the acting on behalf of the state.

-State officials often have “clients”, often known as “special interest groups”: business people, labor unions, opponents of abortion, proponents of gay marriage, rich people, poor people, the Religious Right, the Politically Correct, farmers, software companies, Blacks, Whites, women, and Native Americans.

-We can look at the state as if it were an autonomous single large actor with a single will of its own, as if “Uncle Sam” were a real person. More often, state officials use the mechanisms of the state to act in their own interests and in the interest of their clients. They do not always hurt the general interest when they act this way, but too often they do.

-We need to design state institutions as much as we can so that state officials act in the general interest when they act in their own interests.

-We need to design all institutions as much as we can so that people and business firms lead to the general welfare when they act in their own self-interest.

**Prosperity.** Capitalism brought the highest standard of living to the most people of any economic system ever. Capitalism made more people more equal in material wealth than any other system ever did. Capitalism made possible sustained political power for the masses, that is, modern democracy. Modern democracy only developed after capitalism had provided the material base (property and reliable wages)

for a mass of people to feel as if they had a real voice. Capitalism has been the economic foundation for the amazing advances in science of the last two hundred years. Capitalism provided the dams, roads, airlines, buses, movie theaters, TV stations, recording studios, and all the mass communications of modern life. It created the means for the mass entertainment and mass arts. Capitalism built the schools, athletic fields, bridges, skyscrapers, and other engineering marvels for which our time will be remembered. Together with science, capitalism put reality behind the slogan “a woman can do any job a man can do”. Without capitalism and science, women would still be farmwives, housewives, domestics, low-grade clerks, grade school teachers, or giving sex services. All these achievements of capitalism do not excuse its problems or excuse the abuses by some people in capitalism, but any problems or abuses should be weighed in the balance against its benefits. The benefits far outweigh the faults. It is hard to make this point any more forcefully by extending words. The reader should keep this point in mind throughout the book.

**When Capitalism Works Well: Static Ideal.** To understand when real capitalism works well and when it does not, we need an ideal to compare the real to, as when we go house hunting we have an ideal house in the back of our minds to which we compare the real houses that we see. We start with a static ideal, which is called “general equilibrium”. The static ideal is like a house that is alright “as is” and needs no “fixing up” now. There are both good and bad deviations from the static ideal.

Good deviations help to create a dynamic ideal that actually works better than the static ideal. Bad deviations distort the static ideal and dynamic ideal, leading to a loss of welfare. It is hard to tell good deviations from bad ones, so we can get confused and we can be misled by ideologies. We have to be clear about the static ideal, the dynamic ideal, and bad deviations.

The static ideal and the dynamic ideal differ in the same way that a predictable trip through familiar country to a warm bed in a familiar place differs from an eventful trip through unfamiliar country to a warm bed in a new place. It is the difference between driving an old station wagon versus driving a new sports car. The dynamic ideal is what makes “road trip” movies so much fun. Both ideals are good, but in different ways. To appreciate this difference, we first have to review the benefits of the static ideal.

A precise definition of the static ideal (general equilibrium) is best put off until the middle of the book but a working definition can be given here. Some of these points will seem unrealistically good, but that is part of what it means to be an ideal. We will measure them against reality all through the book. If you see ideas that have been left out, or if you see other problems, that is good; do not worry now. Ideas will be added, and problems will be addressed, later.

The features divide into two groups: features that create the economy and features that result from the operation of the economy. “Self-regulation” is “on the cusp”. Self-regulation arises out of the first set but then it acts to create the rest of the features.

(1) *Self-Interested.* People are self-interested but not necessarily selfish. People seek their own desires. Business firms are also self-interested in that they seek profit.

(2) *Strategic.* People and business firms use the best means to achieve their interests. People and

business firms are strategic, or they act strategically. People and business firms are efficient.

Economists combine the ideas of self-interest and strategic action when they say that people and business firms are “rational”.

People might be altruistic sometimes, as when they save a drowning child, and business firms sometimes make donations to charity; but we cannot understand the normal operation of the economy according to those unusual actions. We can only understand the normal operation of the economy by thinking of people and business firms as self-interested rational strategists.

(3) *Freedom*. People and business firms are free to participate only to the extent that they wish and are free to not participate to the extent that they wish. Everybody has to participate to some extent because, these days, people can only make their living within the system – see below. Participating means that a person can seek whatever legal good he/she wishes; can decide to work at a job as hard as he/she wishes; or can decide instead to pursue leisure as much as he/she wishes.

(4) *Private Property*. People, business firms, and the state, all respect private property. People and business firms feel fairly secure that they can keep what they own and what they earn. Having secure private property in most respects is important but having absolute private property in every respect is not vital.

(5) *Closure*. People can make a living only by getting a job or by operating a business firm. Everybody has to work within the economy. Later in this chapter, I return to this trait when I discuss systems.

In the modern world, “not participating” does not mean opting completely out of the system to “be your own person”; it does not mean living free in the wild or as a rebel on the fringes of society. Usually it means starving to death in a hovel in a slum.

(6) *Consumers as Workers*. Consumers and workers are the same people in different roles. People have to buy what they need only with the wages that they get from working. Business firms have to sell all that they make to the people to whom they collectively give wages. Wages have to buy all the goods that are made from giving wages.

(7) *Parts Determine the Whole*. The economy is made up entirely out of the strategies of people and the strategies of business firms. The economy comes entirely out of people seeking goods and seeking jobs, combined with business firms making goods to seek profit. The actors in the economy build the economy entirely from the bottom up. Later I call this feature “reductionism”.

(8) *Self-Regulation*. The economy self-regulates automatically. Self-regulation means that the economy can successfully respond to changes in taste, changes in the availability of resources, to political events, natural events such as hurricanes, and to innovations such as the Internet. When the economy self-regulates, it returns to a beneficial balance. The economy self-regulates through individuals and business firms pursuing their self-interest. The economy rarely needs state help. Exactly how the economy self-regulates automatically is the subject of later parts of the book.

Now we begin the characteristics that result from the features above.

(9) *Partial Equilibrium*. Particular markets “clear” nearly all the time. At some price, corn farmers can sell all the corn that they grow, and consumers will wish to buy all the corn that farmers grow. At some price, Toyota can sell all the Camry cars that it can afford to make at that price, and consumers will wish to buy at that price all the Camry cars that Toyota can make. At some salary level, all the trained and certified electricians can find steady jobs.

(10) *General Equilibrium*. When all particular markets clear nearly all of the time, the entire economy also clears: All the goods that are made can be sold to the people that wish to buy them. When the particular markets for steel, rubber, land, corn, cars, fish, computers, and labor all individual clear, then they all have to clear together too. All the goods that are made can be sold to the people that wish to buy them for what the people receive in wages by making the goods. There is full employment so that there is no unemployment. There is a set of prices, one for each market for each good, for which all this happens.

(12) *Public Price System*. The price of any good arises out of the operation of the economy. The price of a six-pack of soda arises out of the economy from the demand for a six-pack of soda combined with the prices of water, sugar, flavor, “fizz”, aluminum, and labor. In turn, the prices of all the ingredients arise from the demand for them combined with their availability. The prices of all goods and resources make the prices of all goods and resources. This is not a circle, once we understand how it works. Once prices arise, they keep the economy going normally. Prices arise out of the system but then keep the system going.

(A) Prices are public. The price of a good is the same for all people and all business firms, with some minor variations because of location or quantity. The price of a gallon of gasoline is about the same to everybody but does vary a bit from around the country (it is cheapest around the Louisiana refineries). The price of a loaf of bread is about the same for everybody everywhere, rich or poor.

(B) Prices are signals that tell people what they can buy and how much they can buy. Low prices mean we can buy more, such as new shoes. High prices mean we can buy less, and have to make do with something else, such as our old shoes. Prices tell business firms how much it costs to make something, and how much the firm can expect to sell of something. The price of steel tells carmakers how many cars they can make. Since wages are a price for labor, prices tell business firms how many people they can hire. Prices are the information that people and firms need to rationally strategically their best self-interests.

(C) The economy is in good static balance (general equilibrium) when a single set of stable public prices prevails. When gasoline costs the same for everybody everywhere then the economy is near general equilibrium.

(D) We can understand how the economy operates by looking at how public prices arise out of the strategies of people and business firms. Chapters Four and Five are about that topic.

(E) We can also understand problems in the economy by problems in the public price system, as we do in Chapters Six and Seven. In particular, any policy that interferes with the normal public price system is

liable to cause a problem.

I say more about the public price system below.

(13) *Optimum Resource Use*. Resources are used most efficiently to provide just the goods that consumers wish for. Petroleum is divided in use between making plastics, heating homes, and powering cars in just the proportion that gives consumers the most benefit. Milk is divided between drinking, making yogurt, making ice cream, and use in cooking in just the proportion that gives consumers the most benefit.

(14) *Greatest Capacity*. Because resources are used most efficiently to make just what people want most, the economy is at greatest capacity. It makes the most out of what it has got. It provides as much as possible out of the resources that are available.

(15) *Full Employment*. Full capacity means that everybody can work to the extent that he/she wishes, and is paid according to the extent of his/her abilities, training, and diligence. There is full employment; there is no involuntary unemployment. Full employment arises because all markets clear, including the market for labor; and because resources are used most efficiently, including labor. Full employment does not mean that everybody gets an easy job regardless of talent, training, or laziness. Everybody has to work for a living and everybody gets a chance to work for a living by getting a job.

(16) *Greatest Practical Welfare Achievable*. Recall that “welfare” means “general satisfaction among all people”. The economy achieves the greatest welfare that is practically available in the real world. Everybody is better off than he/she would be otherwise. Nobody loses, and everybody benefits, even if not everybody benefits equally. The greatest number of people are as satisfied as they can practically expect.

This happy outcome of greatest practical welfare does not mean the economy achieves the greatest welfare imaginable, only the greatest welfare that is practically available. It does not mean that the total sum of satisfaction is as great as it could be but only that the total sum is as great as can be practically negotiated. Each of us can imagine good situations that are not achievable. We can imagine situations in which the whole group is better off than is practically possible, or situations in which we personally are better off. The static ideal cannot make either of those alternatives happen for sure.

(17) *Fairness*. This outcome of greatest practical welfare is about as fair as can be practically achieved but that does not mean that this outcome is fully fair to all people. Nobody is worse off by participating. Everybody benefits to the extent that they choose to participate. Even so, some kinds of unfairness persist through the normal operation of a good system or even arise out of the normal operation of a good system. The poor still have to spend a large share of their income on food and housing, and not everybody can afford good medical care.

(18) *Equality*. Achieving the greatest practical welfare does not mean that people are more equal in wealth after than before, only that everybody is better off after than before. Differences in wealth can persist even through the ideals. People are rarely less equal after than before but they do not have to be more equal and they are almost never exactly equal. The static ideal is not a great equalizer.



(19) *Automatic Growth.* The economy grows automatically by incorporating innovations. Innovations include new technology such as bio-technology and new ways to organize such as the Internet. The economy grows to the full extent that the innovation increases general welfare. The economy does not need to grow in any other way, such as by deliberate government stimulus. When the economy has fully implemented the innovation, it also stops growing automatically.

The following features are important aspects of the public price system.

(20) *Demand, Scarcity, and Price.* The price for any good reflects both the demand for the good and its natural scarcity. Generally, the greater the demand and the scarcer the good, the higher is the price, such as for gold. The less the demand for the good, and the more naturally abundant the good, the lower is the price, such as for copper.

(21) *Investment and Price.* The scarcity of a good can be modified to some extent by deliberate investment in producing the good. Apples are much more abundant and cheaper because of apple farms than they would be if people had to search for them in nature. Modifying scarcity also affects the price. Demand, natural scarcity, and investment all together determine price.

(22) *Imputation.* In the short run, the costs of a good determine the price of the good. A Lexus costs more than a Camry because it has more expensive parts and takes longer to build. In the long run, contrary to intuition, the cost of a final good such as a car does not depend primarily on the cost of its components. Rather, the demand for the final good determines the value of the components. People are willing to pay for expensive components in a luxury car because they want a luxury car, and the expensive components are part of “the package”. The price of steel depends on the price people are willing to pay for cars and for other products made of steel. The price of steel does not determine the value of cars.

**Good Deviations, and the Dynamic Ideal.** Good deviations from the static ideal produce a dynamic ideal in which the economy runs better than in the static ideal. There is no particular term for when the economy deviates from the static ideal in good dynamic ways. When the economy deviates from the static ideal in good dynamic ways, it should always tend to return to the static ideal. These are some good deviations:

Everything real “jumps around” a little bit. A real economy is risky. Airlines can guess how many people want to fly during the holiday season but they cannot be sure. All firms have to guess. Firms that guess well do well while firms that guess badly do badly. This is part of beneficial self-regulation.

Innovations in technology (the automobile) or in organization (the assembly line) move the economy away from the static ideal until the economy has adjusted to the new potential, and the innovations are completely absorbed. The economy makes progress through innovations. It becomes more efficient and it presents new goods. The system benefits in the long run even though it might suffer some disorder in the short run.

Unforeseen discoveries of a natural resource such as diamonds or oil are also good deviations. They cause uncertainty, and they create benefit just as does a technical innovation.

Depletions of natural resources such as oil, natural disasters such as storms, and political changes such as an election can be good deviations as long as they do not occur too fast and are not too large.

All these changes can annoy the people most affected by them but they actually help the real system to more closely approach the static ideal and are not something to worry about. Every time an electronic innovation makes our current phone obsolete, we get annoyed, but we soon see the benefit. As these good deviations work through the system, the system tends to return toward a new version of the static ideal, toward a new general equilibrium.

The economy adjusts primarily through business people making decisions to seek profit. Their actions lead to the adjustments that benefit everybody, make the system more stable, and tend to return the system back to the static ideal.

Of course, in the real world, the economy never fully returns to any static ideal but always makes adjustments.

**Bad Deviations.** Bad deviations also make the static ideal real. They are among the flaws of capitalism. They open the door for people to suggest schemes for the public welfare that really benefit particular groups more. A list of bad deviations appears below. This section describes a few so we can get a sense of how they allow excuses.

We can think of bad deviations as distortions and unfairness. When Microsoft captured the market for operating systems with Windows, it gave the world one operating system so that computers could more easily “talk” together – a good thing; but it also forced everybody to use Microsoft software for other uses such as “Office”, and it drove out competing firms in fields such as word processing – a bad thing. Wal-Mart delivers an abundance of low-priced goods, but it also acts as the vendor for China in America, and it drives out local “Mom-and-Pop” operations. We all value the family farm, but, to keep it going, we have built a huge system of subsidies that artificially raises the price of all land and that leads us to farm “against nature” in many ways. Unemployment and poverty never go away, and the bad from them outweighs the good.

Bad deviations do not lead to progress, and they do not tend to return the system toward the static ideal. They create lingering problems.

Some bad deviations are tolerable if the extent of the bad deviation is not too great, such as having only one company that supplies our electricity. Some bad deviations we have to tolerate because the cure is worse than the harm, such as cheap foreign labor because protection against cheap foreign labor causes more harm than the cheap foreign labor.

If we cannot avoid bad deviations in real life, then we might as well respond to bad deviations in good ways. Rather than try to sue every cigarette smoker for the cancer caused by secondhand smoke, we can ban smoking in public places. Sometimes doing nothing is the best response. Farming is unusually uncertain and difficult. Yet to give farmers greater certainty and a better living, we have to pay a high cost in farm subsidies. Instead of giving farmers subsidies, we all, including the farmers, are better off to

let farmers live with uncertainty. Despite MS Windows' flaws, it is better to have one major computer operating system even if we have to put up with Microsoft. We can always hope that Windows becomes better with each version, and more "open source" with each version.

**Excuses.** The real problem is that often we cannot tell the difference between good dynamic deviations versus bad deviations. We do not know what to do, and so we are vulnerable to ideology, manipulation, and excuses for intervention. Any deviation might fall into one of the categories below, and we cannot always tell which.

(1) Normal random fluctuations such as a new invention or a hurricane. These might be good or bad, or something that we just have to adjust to.

(2) Good deviations such as the development of microchips or solar power, or the discovery of a new oil field.

(3) Bad deviations which are tolerable such as cheap labor in poor nations, a single operating system for computers, and the depletion of oil.

(4) Bad deviations for which the cure is worse than the disease such as poor profits in family farming, cured by subsidies; the collapse of the Savings and Loan industry, cured by a massive bailout; or the housing crisis that began in 2006, also cured by massive bailouts.

(5) Bad lingering deviations from the static ideal or dynamic ideal which cause serious problems such as chronic unemployment, poverty, lack of health insurance, and some kinds of unfair competition. These deviations are not the result of any deliberate strategy but arise out of the normal operation of the economy.

(6) Bad lingering deviations from the static ideal or dynamic ideal which cause serious problems. These deviations do result from deliberate strategy focused on a problem. They include some kinds of unfair competition, intrusions into the political process to gain favors, and state intrusion into the economy such as to protect business.

Focus on the computer motherboard industry. Suppose that the labor in another country is paid less than the labor in the United States. The overseas workers use similar technology, they are well treated, and the level of pay is generous by standards there. We are pretty sure that the level of pay eventually has to rise to American standards, but that rise might take decades. In the meantime, the American motherboard assembly industry is wiped out. Taiwan did this to America in the 1990s, and now China is doing it to Taiwan. Is this a good dynamic fluctuation that brings benefit to most, or is it unfairness that hurt American workers and then hurt Taiwanese workers?

*Responses.* There is no magic policy by which we can sort good deviations from bad, and always respond in the best way. When faced with hard decisions about these issues, people tend to take one of these major positions about state intervention:

(1) Do nothing. Never intervene. Let the market handle everything. Tolerate problems in the short run

because we say everything works out in the long run.

(2) Intervene all the time.

(3) Always intervene to help me. Do not intervene otherwise.

(4) Always intervene to help me. I do not care about other people and other interventions. If I can make a deal so that I get my intervention while somebody else gets his/her intervention too, that solution is fine with me. This is normal politics.

(5) Develop objective guidelines about when to intervene, especially for problems that derive from underlying flaws. In case of indecision, always intervene.

(6) Develop objective guidelines about when to intervene, especially for problems that derive from underlying flaws. In case of indecision, never intervene.

I favor position six.

Of course, in real life, the positions get thoroughly mixed up.

*Comments on the Positions.* Some Conservatives argue we should never expect the economy to come close to the static ideal. They say the only bad deviations about which we can do anything are those that come from the state, and the cure is to remove state interference, such as aid to the poor or aid to business. All other deviations and problems are temporary. The loss of doing something always outweighs the gains of doing nothing. The cure is always worse than the disease. Despite problems, the dynamic ideal always leads to a better life for everyone in the long run. We should trust in the dynamic ideal regardless of any temporary deviations or problems. I have a lot of sympathy for their position because it rests on love of freedom and distrust of the state; but I cannot accept their position.

Some economists and state officials accept that bad deviations exist, and offer solutions for the deviations, without realizing the extent to which their solutions distort the system and cause further problems. Usually they have good hearts but misjudge human nature or the workings of the economy. This happened with the social programs of the 1960s and 1970s such as public housing and food stamps, and with de-regulation that led to financial abuse and the housing crisis of 2006 and afterwards.

Some economists and state officials argue as if bad deviations did not really exist. They write as if the real system were always just on the verge of achieving the static ideal: The next recovery from this temporary downturn will definitely forever solve all unemployment problems. The use of solar power or hydrogen fuel cells will forever solve all energy shortages, pollution problems, and poverty. "Drill baby drill" will forever supply us with enough oil from domestic sources only. They explain away all problems, primarily because some of the problems actually help their clients, such as "big oil".

Some economists and state officials accept that bad deviations exist but they offer solutions that do not really address the problems. Instead the solutions help them and their clients, such as urban development projects, poorly conceived public health insurance plans, unrestrained cutting of reserved

forests, or freezing interest rates for house buyers.

This book provides guidelines but it cannot give absolute rules. If we cannot tell for sure, usually it is better to do nothing until we know for sure that our proposed cure is not worse than the disease. This is why we need to understand the basic static ideal; the dynamic ways by which the static ideal improves; and the bad deviations that cause a reduction in public welfare.

**Flaws.** Mostly, flaws are bad deviations from the static ideal. They undermine good competition. They undermine the benefits of the static ideal, and keep the dynamic ideal from moving toward the static ideal. Some flaws have been mentioned above, but they need to be assembled here in one place.

*Imperfect Competition.* Imperfect competition thwarts good competition. It includes unfair competition but it is wider than that. Imperfect competition also includes any case in which goods do not receive their proper value, too few goods are produced, choice is restricted, price is higher than it might have been, or markets do not clear properly. When too few rental units exist in a good neighborhood, we have to pay too high a price. Sometimes a large chain supermarket can drive out a farmers' market or a local "organic" food store by lowering prices below cost for a while.

*Intervention.* State intervention impedes beneficial competition. State intervention usually thwarts good competition. State intervention usually does not nullify imperfect competition so as to restore good competition. State intervention has helped to promote imperfect competition, such as with protection for the sugar industry and with mortgage subsidies. State interventions forcibly move resources around, set prices, set interest rates, or set the amount of goods provided. Usually the state acts for some client group, such as steel producers, steel workers, old people, teachers, ranchers, car makers, Blacks, Whites, or defenders of the environment. When we think about state intervention, we have to think about who benefits, who has to pay, and how resources are moved about.

Not all intervention is necessarily bad. If the state intervenes to correct an obvious flaw, then the intervention can actually help the poor, or the environment, and the intervention can encourage the good dynamic ideal. The problems are: (A) we often do not always know how to intervene properly, (B) even good interventions tend to go beyond their target and to last too long, and (C) good interventions open the door to bad interventions.

*Uncertainty.* Ebb and flow in the real world cuts both ways. In a good way, it opens the door to opportunity and to creative people. In a bad way, it invites imperfect competition and state intervention. Exactly how it invites imperfect competition is the subject of later chapters but we can get a feel for the process here. For example, to reduce confusion over food, we tend to rely heavily on a few name brands, such as Campbell's. This kind of reliance tends to thwart the normal good competition between firms. For safety, we have the state certify doctors, dentists, and other medical people. In using the state to certify medical professionals for us, we artificially limit the number of medical care professionals and so raise the cost of medical care. We have the state supervise the stock market or else we know that the cheating of some people would create havoc. The state interferes in farming to stabilize prices for food and to make sure that we have abundant food but that interference creates a class of farmers that depend on the state.

*The Business Cycle and Getting Stuck.* The typical business cycle lasts for about ten years, during which

time it goes through a boom phase of too much prosperity and then a bust phase of unemployment and bad sales. Sometimes the down phase can last for much longer than a few years, and can be quite severe, as in the Great Depression of the 1930s. The economy can get stuck at levels below its natural capacity and at levels well below best resource use and maximum welfare. These cases also invite state intervention. Everybody would like the economy to run at an even keel most of the time, and to run at high capacity, but nobody is quite sure what full capacity might be, how to avoid getting stuck, and how to keep the economy on even keel. Some recent state institutions such as unemployment insurance have smoothed out the bumps and have kept us from getting severely stuck.

*Out of the System.* In the static ideal, the costs for producing everything are all within the system, so we can assess the impact of producing any good and can respond to changes well. For example, the costs of producing a small wooden boat are entirely in the cost of growing the wood, processing the wood, cleaning up, and labor. If any of these costs change, as for example elm wood undergoes a plague and we have to switch to maple, then we can pretty much understand all the adjustments that we need to make.

Some costs lie outside the system, and so it is hard to assess their impact and to assess what effects changes might have. The technical term for most of these cases is “externality”, reflecting the idea of “external to the system”. The clearest example is pollution. Suppose that the boat factory does not spend the money and labor to turn all its wood chips into mulch to sell but instead just dumps all of its waste products in the local creek. Instead of the boat maker paying for all the hardships for boat production, now all the local fishermen, children, farmers, and residents pay the hardships through reduced ability to use the creek and through increased disease. We cannot even assign a money cost to the effects now as we could before when the boat maker had to clean up his/her own wastes. We are not sure what would happen if we tried to force the boat factory to clean up or if we tried to organize the community to clean up. Some costs of boat production now lie out of the system, with unpredictable results.

*Unfairness.* See above too. Although the static ideal always increases total welfare, and almost always increases the welfare of all participants, the results are not always fair in ways that we can easily live with. A rich family and a single mother both pay the same price for a loaf of bread. That is how a public price system works. But the loaf of bread means much more to the poor family, and sometimes they cannot afford the loaf of bread because they have no skills sufficient to trade for the loaf of bread. This is not fair. Yet any interference to correct the problem is likely to cause more harm than good. Later chapters show how these cases arise and speculate on what to do in these cases.

**Problems.** The flaws cause inevitable problems. Some of the problems we met above in the description of the flaws. Other problems include:

Imperfect competition causes poor use of resources. When gangsters controlled alcohol in the 1920s, alcohol was not produced in the most efficient way to the highest standards. The price of alcohol was much higher than it should have been. Much of the price went into corrupting state officials.

We find it hard to cure pollution because we cannot assess how bad the effects really are, and we cannot make the polluters pay. Who knows how many cases of cancer are caused each year by car exhaust,

and who knows how to make car drivers pay for the sickness?

The most important case of resource misuse is unemployment, which is poor use of the resource of labor. Imperfect competition creates an inevitable minimum of unemployment. This unemployment cannot be cured once-and-for-all by causing the economy to grow through any jobs programs or through any aid. No matter how big the economy grows, the "pie" of the economy still has the same pieces; and it always has one piece missing that represents unemployment. Aid can keep the poor from leading bad lives, but usually it cannot lead them to find jobs and to support themselves.

Not only does imperfect competition create unemployment, it also promotes bad employment where some people can get jobs that are only barely enough to live on, without any health benefits or retirement benefits.

Bad employment causes other problems in turn, such as poverty, family disintegration, and discrimination by race, sex, age, and religion. It feeds class conflict in which people with decent jobs fear the poor and act against the poor. People that fear the poor prevent the poor from getting the help that the poor need such as by making welfare difficult; and people that fear the poor pass laws that make life harder for the poor such as against soft drug use. Class conflict feeds political polarization and feeds dependency on ideologies instead of supporting the use of reason.

Problems with unemployment and jobs lead politicians to promote economic expansion as a cure. Natural growth through the implementation of innovation is quite good but artificial growth through state programs almost always causes more harm than good. Yet it is hard to resist the programs because poverty will not go away.

More often than not, the growth programs are not really aimed at helping the poor but at helping clients: business firms such as the construction industry or special interest groups such as urban Blacks or suburban Whites. It is hard to assess the real impact of the programs and who the real target beneficiaries are.

We understand that we need to do something about pollution and that we need to maintain the environment such as by preserving species and habitat. But we find it hard to keep people from exploiting the environment because we mistakenly think that helping the environment denies people jobs. We incorrectly think that exploiting the environment can make more jobs and reduce poverty.

We are never sure if we as a nation can afford decent health care for people that cannot afford it themselves, can afford decent education for all children, or can afford decent retirement for all people. We feel that people should be responsible for themselves in these matters, but we know that they are not, and we do not know what to do.

When any industry, such as garment making, wishes protection against competition, it can claim that helping the industry is necessary to maintain jobs, even though this is usually not true. Congress finds it very hard to deny any particular help that is supposed to preserve jobs or create jobs.

**Key Question.** When we see a problem, we want to do something directly about it. We are tempted to

“throw money” at problems, a tactic satirized in an IBM TV ad mimicking King Arthur and his Round Table. Sometimes doing something directly actually works, even throwing money. Yet limited success can be more of a problem in its own way than consistent failure because it fools us into thinking that intervention is a good tactic in general. The real question is not “does this particular solution seem to work?” but about the unintended results of good will. Sometimes the unintended results of good will can be worse than the original problem: “The Road to Hell (sometimes) is paved with Good Intentions”. We need to ask more deeply:

(1) Is this solution liable to cause other problems, some of which are even worse than the original problem? Is the cure worse than the disease? The classic example is welfare. We do need to help people, but we cannot do so in a way that tempts other people off work entirely and that empties the pocketbooks of hard working honest people. When foreign competition gets the jump on an American industry through innovation, as it did with steel, then it makes sense to help out the American industry for a while until it gets back on its feet or until it collapses and the workers can find jobs elsewhere. The trouble is that the helping never stops, the industry never gets back on its feet, and the workers never find jobs elsewhere. Helping becomes welfare to corporations and to well-paid union workers.

(2) Even if a solution works, and does not cause other severe problems in its immediate vicinity, is this solution liable to set a bad example for abuse in other ways and in other places? Even if helping an industry does succeed sometimes, as it did with Chrysler in the late 1970s and early 1980s, helping sets a bad example, as with the later Savings and Loan debacle and as with helping out house buyers in 2008. Other industries ask for help, including protection from competition, and then they never get better. The textile industry is the classic example. The textile industry first began to receive protection in the early 1800s, and has received protection continually ever since. Another example is tax breaks for various special interest groups of ordinary people. It makes sense to give old people a tax break on their home or to give sick people a medical deduction, but tax breaks of one kind lead to a never ending chain of tax breaks for everything. Intervention in one area opens the door to other unrelated areas. State aid to education seems like a good idea but now the federal government has the right to control the direction of much research and it has the right to insist that military recruiters be allowed on any campus that receives federal aid even if military policies on homosexuals are not acceptable to the people on that campus. It is hard to tell if interventions outside the primary problem work or not, and so we wind up with many instances of bad protectionism and bad welfare.

It is very hard not to do something about a problem, do less than we might do, or do other than we wish; but we have to work hard to think things through. If a solution is liable to cause other problems, set a bad example, or open the door to state officials and their clients, then we might have to do nothing, or we might have to find other solutions. This conclusion hurts me but I have been forced to this conclusion through abuses I have seen. Much of this book is about seeing links so that we can assess the likely full impacts of proposed solutions to urgent problems.

**Systems Ideas and Terms.** To think clearly, it helps to have some ideas from systems theory. Many readers know the ideas intuitively from experience, so here it is only necessary to give the ideas a name.

*Reductionism and Holism.* The logic of economics works from the inside out, from the bottom up, or from the part to the whole, rather than from the top down, or from the whole to the part. Economics explains in



terms of the strategies and interactions of people and business firms. Economics assumes that all features of a group ultimately can be explained in terms of actions by individuals and firms. Economics assumes that no group features can dominate individuals so much that individuals cannot “break free” to do what they want, at least in the long run.

Economics does not assume that people never make mistakes, or that they are not susceptible to pressures such as advertising. It just assumes that individual action is more important in the long run.

To understand individual strategies and interactions, we have to assume that individuals are primarily self-interested rather than altruistic. We also have to assume some typical human goals such as the desire for a family. These topics are the subjects of later chapters.

In contrast to reductionism, “holism” assumes that the whole is greater than the sum of the parts, and that the whole can mold the parts so that the parts can better serve the whole. A strong version of social holism is the Borg on “Star Trek TNG”. More reasonable examples might be members of a Parent Teacher Association (PTA), the children on a YMCA soccer team, or the members of a church. Many people fear becoming a cog in a large mechanism, as when they first take a job in a large corporation or if they join a church that is very strict. Most social scientists other than economists think that holism is the norm in human life, and that the greater benefit comes through the whole rather than through individual action. Their examples of social wholes include cultures such as Western European culture or Chinese culture; societies such as Germany in the 1800s or India in the 1800s; nations such as modern England or France; tribal groups such as the Yanamamo in South America or the Nuer in Africa; or religious institutions such as churches, mosques, temples, and synagogues.

In their pure forms, holism and reductionism are not compatible. I am committed to reductionism, and most of economics is also committed to reductionism.

Reductionism does not overlook culture, society, institutions, or history; it just looks at them in terms of individual interaction. It does not assume that social life cannot guide individual action, or that social life cannot sometimes dominate individuals; it just assumes that people can work through social institutions to achieve their self-interests most of the time. It assumes that people make social institutions through interaction based on self-interest.

Reductionism seeks the institutions under which strategic self-interest can lead to the benefit of most individuals and to the benefit of the greater society at the same time. It seeks the social institutions that can be created and recreated through individual consent and that also guide individuals to serve the greater social good while they serve themselves. It takes the free market as a key example of such an institution.

*Self-Regulation.* This feature is really four closely related features that have always been mixed together. Self-regulation does not rule out change. It does not mean “completely stationary”. It is the ability to return to balance even after some changes. Thus it works well with both the static ideal and the dynamic ideal. I give both ecological and economic examples below to show that the logic is similar in both.

(1) The ability to return to a balance after minor changes. For a forest, this would be a return to balance after an unusually cold winter. In an economy, it would be a successful response to a cold winter or to a

change in taste from last year's fashions. This category includes the ability to respond to the ebb and flow of daily reality.

(2) The ability to return to balance after a major disruption such as a large forest fire, a war, a hurricane, or a housing bubble.

(3) The ability to adjust to long-term changes such as drying of the climate or the depletion of oil.

(4) The ability to return to balance after adopting an innovation, such as the introduction of horses to North America or the introduction of electricity to the modern world.

Economies self-regulate through: (A) consumer decisions to buy what gives them the most satisfaction, (B) people seeking the best jobs, (C) business firms seeking profit by offering goods, and (D) the flow of capital from ventures that make less profit to ventures that make more profit.

*Microeconomics and Macroeconomics.* Reductionism and self-regulation form the basis for what is called "microeconomics", or looking at the economy entirely from the point of view of individual people and business firms.

In contrast, "macroeconomics" is looking at features of the whole system at a time. Instead of thinking how the decisions of individual borrowers and lenders go to make up the interest rate, macroeconomics thinks about how the total amount of money might affect the interest rate.

If macroeconomics is done without any consideration of particular strategies, or if it is done by assuming that the economic whole determines the action of people and business firms, then it is "holism". Ideally, macroeconomists oppose holism. They believe that all large-scale patterns should be explainable in terms of small-scale actions but that sometimes it is much easier to work on the large scale without worrying about how the large scale depends on the small scale. When they are careless about how the large scale depends on the small scale, they sometimes slip into holism.

This book stresses microeconomics.

The following ideas are my way of providing a foundation for macroeconomics. They are a useful version of macroeconomics. In using these ideas, I am careful to think about the whole in terms of the parts. These ideas occur all through the book. In addition, I include two chapters on macroeconomic topics toward the end of the book. This effort balances my inclination toward microeconomics, and provides readers with the ideas about macroeconomics that they need.

*Circularity.* "What goes round comes round". "Everything depends on everything else". "Everything affects everything else". "What A does affects B, and what B does affects A". "The whole world is a circle". In a forest, plants provide the food for animals, which provide the fertilizer for plants, and so on. In an economy, power from oil allows people to mine iron ore; with the iron ore, people make tools with which they drill for oil. People make all the goods in an economy; they have to buy all the goods that they make with the salaries that they get for making the goods. Business firms make all the goods in an economy; they have to be able to buy all the parts and goods from the revenue that they make from

selling all the goods that they make.

*Closure.* This is the idea that everything that affects the system, or is affected by the system, is in the system. Complete closure only happens at the level of the universe, so we have to think in terms of degrees. Even so, most ecosystems, such as a forest or the oceans, are fairly closed; and most modern economies are fairly closed. Foxes live out their lives according to what they can hunt in the forest, and, when they die, they give their bodies back entirely to the forest. In the modern world, the very vast majority of people can only make their living at a job in a firm that makes products that other working people have to buy. Firms can only sell their goods to people that work for firms.

Externalities, such as pollution, can be exceptions to closure depending on the scale of inclusion (whole earth versus economy) and the point of view (particular business firm versus community).

*Self-Reproduction.* A system has to be able to make itself. A complete system is not like a car that gets made by a factory, or even like a deer that gets made indirectly with the help of the whole forest. A complete system is like the whole forest in which the parts make themselves with the help of each other, and then remake each other. Deer indirectly make trees, and trees indirectly make deer. In a modern economy, the factories have to make not only the goods that final consumers buy but also have to make the tools that make the factories. When consumers buy final goods, such as cars, they also indirectly buy the tools that make the factories that make the cars. Workers have to get paid not just enough to eat everyday but enough so that they can live well enough to be reliable workers, so that they can raise their children all the time that their children cannot work, and so that they can educate their children to be workers too someday.

Self-reproduction does not imply holism. Self-reproductive systems can be fully understood in terms of the parts looking out for themselves and in terms of the parts interacting to recreate the relations between them, as with the plants and animals in a forest. Plants make animals and animals make plants; we do not need any higher level to understand what is going on.

Together the ideas of circularity, closure, and self-reproduction help us to get a better idea of what will happen to  $x$  if we do something to  $y$ . If we shoot all the rabbits, what happens to the foxes? If we shoot all the wolves, what happens to the deer? If the steel industry goes overseas, what happens to the steel workers, to the other people in the American economy that depend on steel, and to prosperity in general?

*Directionality.* Systems do not only remake themselves, they also change over time, sometimes in response to major changes such as a change in climate. Changes sometimes have a direction. A pine forest becomes an oak forest over time, especially if the climate changes. Red squirrels replaced gray squirrels all over the United States in the last hundred years. The car replaced the horse, and thereby changed sex habits and vacation habits all over the world.

*Progress.* Not every change is for the better. Most changes just happen. Some changes are for the worse. The large majority of directed changes work out for the better in the long run because people make them that way, such as TV - but not all changes. We have yet to see if nuclear energy will work out for the best for the world, even though it certainly has caused many changes in particular directions.

People tend to evaluate all change according to their outlook on the world and according to their ideology about capitalism. If they are optimistic and they trust capitalism, then they tend to trust change, and vice versa. We need to relax with change to see if it is really worthwhile. We have to accept that a change will happen if it is valuable to a large minority even if it is something the majority does not want now and often regardless if we think that it is good. Such is likely to be the case with stem cells and other biotechnology. Many people still fear computers. I do not like cell phones, but I am learning to live with cell phones, and I can even see how they are useful when on the road a long way from home.

*Spontaneous Unplanned Persistent Order.* People tend to think that a beneficial arrangement such as the static ideal or dynamic ideal can arise only if it is well planned. In particular, people that advocate state intervention think only state intervention can establish and keep a benevolent order. They are wrong. Often good order arises by itself, and keeps itself, through the spontaneous action of the parts. In that case, it is beneficial "spontaneous unplanned persistent order".

Nobody can create forests deliberately unless we give that credit to God or the Dharma. The planned forests of today are not nearly as interesting and stable as the natural forests they replaced. All ecosystems arise naturally from the action and evolution of their various species, and they persist in the same way. Only when people intervene to disturb them do we then have to keep going back to fix the problems that we caused.

Many of the best games arose spontaneously, such as golf, baseball, and American football. Nobody planned them exactly. They developed out of an accumulation of small changes from a lot of individuals and groups. Once they reached a level of "perfection" and interdependence, they tended to stabilize and to remain stable.

Economists see capitalism as a benevolent spontaneous unplanned persistent order. The economy arises spontaneously out of the actions of individuals and business firms, and the economy self-regulates in the same way to maintain itself. Nobody has to institute the economy or has to guide the economy to keep it going. Even when the economy changes over time, and even when it makes progress, an economy does so on its own without any need of external planning by the state or by clients of the state.

Some economists argue that a spontaneous order is always beneficial, and tends toward the maximum practically available welfare. The only condition is that individuals and business firms are free to participate to the extent that they want and only to that extent. The freer they are, the more likely the economy is to be spontaneous and beneficial.

Their argument would probably be true if there were no flaws or problems in the economy, but there always are, and so it is not the case that a benevolent order always arises by itself when the possibility is there, and it is not always the case that every order is benevolent. Sometimes orders do not arise for reasons that have to do with system dynamics and are too complicated to get into here. Sometimes orders do not arise because people, interest groups, or the state prevents it. Sometimes bad orders arise, particularly as a result of flaws. Sometimes flaws, or interference by state officials on behalf of clients, turn a good order bad.

When we have a bad order, we have to be careful about interfering because bad orders are tricky. It is very hard to get out of a bad order once we are in a bad order.

*Capture.* An order can be “captured” by a subgroup that cares more about its own welfare than about the welfare of the group as a whole, and that is willing to act unfairly.

Sometimes an order is captured by imperfect competition even when business firms act fairly – it can just turn out that way. Microsoft sold Windows mostly in accord with the rules of fairness but managed to capture the market anyway.

Special interest groups try to capture a portion of the market when they seek protection against foreign competition. Political groups try to capture a portion of the political market, as for example the Religious Right or activists that promote homosexual marriage.

Ordinarily in a beneficial spontaneous unplanned order, particular individuals and business firms are not powerful enough to capture the order. Even most normal coalitions of individuals and business firms are not powerful enough.

In one of the charming paradoxes of the static and dynamic ideals, the pursuit of self-interest actually makes the benevolent order of the ideals stronger. Individual people and business firms usually do not have to altruistically give up their self-interest to the whole to preserve the benefits of the whole. They just have to act fairly.

Most people are familiar with a particular firm gaining control of an industry as Intel once controlled the market for central processing units (CPU); an urban gang taking over a neighborhood; a political party taking over a country; a special interest group such as the Left or Big Business taking over a political party; or a special interest group such as the Religious Right taking over a political party and a country.

Subgroups that capture an order often think their own benefit coincides with the benefit of the group as a whole, and so they do not always understand that what they wish is not necessarily for the benefit of the group as a whole. They always know what is best. What is best for them is best for everybody. This attitude is typical of fundamentalists of the Left and Right. This is why we have to de-centralize and defuse power when we can.

### **More Terms and Ideas.**

*The Market.* In economics, “the market” usually does not refer to a particular physical location such as a flea market, a farmer’s market, or a local auction for cattle. It refers to all the buying and selling for a particular good, regardless of where the action takes place. The market for oranges is all the buying and selling of oranges whether in California, Texas, Florida, China, or Thailand. Energetic traders carry out the market for Google stock through computers on an abstract stock market. Sometimes the idea can be more specific, as “the real estate market in Auburn, Alabama” but usually people qualify the term when they mean it that way.

*Free Market.* Originally a free market meant a market not encumbered by many of the traditional

interferences that were practiced by agricultural states before about 1900: tariffs, travel fees, monopolies, special grants and privileges, fixed prices, fixed production targets, etc. Originally a free market meant a market in which the owners of wealth were able to invest their wealth any way they wished.

Now the term “free market” is politically charged, and discussion is confused because proponents and opponents of the free market do not mean the same thing as before. Some people, generally Liberals, argue that the market ought to be restricted so wealthy people cannot use the market to perpetuate an advantage. They deny that the market is ever truly free, and they see the “free market” primarily as an ideology that lets rich people do what rich people want. Liberals use the argument against a free market as a tactic to gain power for their clients such as Hispanics or workers worried about losing their jobs to overseas cheap labor. Conservatives publicly argue against any interference in the market yet privately they really want interference. They use the ideology of the free market to deny help to the needy or to competitors. They promote state interference that is beneficial to them such as protectionism, subsidies, and tax breaks. They use the argument for a free market as a tactic to get the kind of interference that they want and to block the kind of interference that they do not want.

When this book says “free market” it means a free market in the original sense, with as few obstacles as possible and where people can use their wealth any way they wish as long as they do not hurt other people. It does not use the term as an ideological cover to favor the rich. It does assume that a market can be free, and that a free market does not necessarily hurt the poor.

*Property Rights.* People have never been able to do whatever they wished with their property, especially if their actions hurt other people. At the very least, people have called on the state to enforce contracts; and laws against pollution far predate capitalism.

Yet even modest restrictions on private property tend to seriously undermine the static or dynamic ideals, and lead to serious reductions in welfare. People need to feel secure in their property, and in gains from their property, for people to undertake the ventures that lead to general benefit. People cannot live in fear that a state official, or a gangster, can seize their property. People need to trust that regulations really are for the public good, and that regulations impact all business and all special interest groups as equally as possible. People need to feel that they can use their property as they wish, and that taxes will not take away too much of what they make.

People also need to feel that great wealth does not give great political power. People need to feel free from fear that they will get hurt when other people use property, as from pollution. People need to feel that wealth will not turn private citizens into state-sponsored gangsters.

This book cannot settle abstract questions of property rights, and so for the most part will not address questions of how property rights can be limited in the public interest without hurting the normal operation of the economy and thus hurting the real public interest.

“*Laissez faire*” is a French term that means “let it be”, “leave it alone”, “let it make (itself)”, or “let it happen (by itself)”. (It is pronounced “leh-zay fair”.) People who originally advocated a free market in the early 1800s used *laissez faire* as their slogan. It captured the idea that a free economy makes itself and self-regulates, and that a free economy achieves the best practically available welfare for everybody. Now

the phrase is politically charged because people use it as a code to mean, "Do not interfere with business or with the wealthy. Allow them to do as they wish, even if it hurts the poor. Interfere with the poor if you wish. Interfere in the market if that helps particular business interests". This book uses "laissez faire" as originally: "allow a truly free market".

*Free Enterprise.* An "enterprise" is any business venture, such as growing apples, making shoes, practicing medicine, car repair, or putting money into a mutual fund. "Free enterprise" means being able to go into ventures at will, limited only by the normal modest restrictions on property rights that apply to all people and all kinds of property. "Free enterprise" means that investors are not subject to any special taxes on wealth or profits, and are not limited in the kinds of ventures they can undertake as long as ventures do not hurt other people.

People have the same mixed attitudes about free enterprise as they do about other ideas in this section. Sometimes "free enterprise" is seen as a slogan that allows the rich to do as they wish, and that justifies the intrusion of Western business firms into the affairs of other nations. I will not argue this issue.

An "enterprise" is a particular business venture but it is also the vehicle by which business fulfills its role in the ideals. By carrying out enterprises, business serves the consumer and the nation. "Free" enterprise is the conditions under which business fulfills this role best.

This view of free enterprise as the instrument of public welfare is a romantic image of business. This view of free enterprise often goes along with the use of "free enterprise" as a slogan not to leave people alone but instead to justify interference in the affairs of others. It is no accident that all the flagships of the Star Trek sagas have been named "Enterprise" and all have interfered in the affairs of other people despite the Prime Directive of non-interference.

*Free Trade.* "Free trade" means pretty much the same as free enterprise or laissez faire but usually the term applies to international exchange rather than to domestic enterprise. It can apply to both international and domestic markets. In this book, it is not restricted to international exchange.

*Trade.* "Exchange", "trade", and "reciprocity" mean pretty much the same thing in this book unless differentiated on purpose. I do not use "reciprocity" very much, and I use "exchange" and "trade" as synonyms, mostly for variety.