

CAPITALISM  
DEFINED AND DEFENDED

CLEMSON INSTITUTE  
FOR THE  
STUDY OF CAPITALISM

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**PART I**

**CAPITALISM  
DEFINED**

# WHAT IS CAPITALISM?

**The social system that separates  
economy and state completely.**

Capitalism is the socio-economic system where all property is privately owned, where freely formed contracts form the basis of economic interaction, and where the government does not engage in regulation, supervision, or direction of market processes. In short, it is a government policy of non-interference with the economic lives of its citizens; it is the system of *laissez-faire*. The proper implementation of a program of *laissez-faire* capitalism, however, requires an appropriate political system at its base.

*Laissez-faire* capitalism means the systematic implementation of the principle underlying the separation of economy and state—freedom. To be fully free, men must have the ability to guide and direct their actions according to their own best judgment. Men must also have the ability and freedom to act on those conclusions and the ability to acquire the means to do so. These freedoms recognize a man's right to life—that is, his right to take the actions required for the survival of a rational being.

To protect these freedoms for all citizens and to make it possible for them to act according to their own judgment, the government must protect men from the initiation of physical force. By outlawing the initiation of force, both by other citizens and by the government itself, the government guarantees each individual's freedom of action in a social context. In practice, this means protecting individual rights, including the right to property. To do this, a government must be constitutionally restricted to use force only in retaliation against those who initiate its use. The government in a capitalist system is thus limited to providing an internal police, a court system, and a military for national defense.

Keeping this context in mind, it is possible to state the definition of capitalism in its most essential terms:

*Capitalism is the social system based on the recognition and protection of individual rights.*

# MORAL FOUNDATIONS

## Self Interest & Egoism

Capitalism begins with the individual as the primary unit of political, social, and economic life. It recognizes that each individual has moral sovereignty over his own life. Each man must choose his own course of action—whether he becomes a CEO or a day laborer—according to some moral code. In a capitalist system, it is morally proper for individuals in general, and businessmen in particular, to pursue their own self-interest. Underlying the system of capitalism is a morality of egoism.

The inventor who designs a new factory tool to save human labor power to the financier who devises a new method for allocating capital to worthy ventures, those who produce material goods—the lifeblood of capitalism—do so because it serves their own interests. These producers produce not because it serves others or helps the poor; they do so because they have a deep selfish motive for doing so—it advances their own well-being. Each individual faces the same basic choice, he must either act to produce or labor for the values he needs to survive and, ultimately, to flourish, or he faces poverty, sickness, and, ultimately, death. Each must choose to produce the material values necessary for his survival. From the primitive tools used for hunting to advanced factories that create

computers, human beings have had to produce in order to survive. Man's needs—winter coats, MRI machines, apartment homes, televisions, etc.—are not provided by nature, they must be created.

All of these goods came about because some individuals acted in their own interest in pursuing their own survival. Every great producer, from Thomas Edison to Henry Ford to Sam Walton, has been driven by what most satisfies and fulfills his own life. Although each of these men has greatly benefited humanity by providing it with light bulbs, cheap automobiles, or cheap consumer retailing, his motive in working toward these ends must be his own satisfaction and fulfillment. Each of these men, and the millions of producers throughout history, have enjoyed a personal and selfish reward in the act of production itself. The uncountable hours of labor, mental energy, and effort that each put into the act of production could only have been possible if the work itself was personally rewarding. It was for their own lives, first and foremost, that they acted, not for the social consequences of their work. The act of pursuing one's goals does not come automatically; these goals must be discovered and chosen. Likewise, the means of pursuing those goals is not built into human nature; they, too, must

be discovered. Scientists, businessmen, inventors, and other creative individuals throughout history have had to confront their circumstances and figure out what things are good for human life and what things harm it. They have ascertained, for example, that some foods provide optimal nutrition and others cause disease or even death. They have learned that building homes with good airflow and light promote human life whereas

dank and dark hovels do not. At a deeper level, though, their process of establishing these basic requirements for survival points to a deeper truth—that certain methods of making one's choices and pursuing one's values leads to success and happiness and that other methods lead to pain, suffering, and death. The method that leads to human flourishing is the method of reason.

## Rationality & Morality

All of the goods that man uses in his life have come to him by a process of thought, i.e., through reason. Consider what it required to build one's home. Those who built the home, the architects and engineers, had to acquire a knowledge of how material objects act in relation to each other—they had to know everything from physics to mechanics to astronomy. They had to learn why only walls of a certain thickness can support a roof of a given size, or why windows facing south allow for more natural light. The suppliers who provided the materials for the house also had to observe reality and gain knowledge about it. They had to test and experiment with different woods to determine which one made the best framing. They had to discover why sheetrock makes a good wall surface for insulation and sound qualities, relying on the fields of thermodynamics and acoustics. The construction crew relied on reason to understand the tools that they use, from air-powered nail-guns to

simple levers and pulleys, to make them work correctly. Reason is necessary not only for building shelter, it underlies all of the values that man needs. Nothing is given to man in nature—he must look out at reality with his senses, put together what he sees with his reasoning mind, and come to a conscious conclusion about how he will shape it to serve his needs.

The contrast to using reason as a means of survival is to go by some other method—whether this is by wishing, by relying on faith in the powers of a deity, or by ignoring facts and hoping for the best. Whenever man deviates from using reason, the result is not productivity and flourishing, it is stagnation and death. Consider how successful someone like Thomas Edison would have been if he had resorted to feelings or instincts instead of reason. When he was confronted with the problem of designing the filament for his light bulb, would he have succeeded by insisting that corn straw was the best

material because he felt it to be true? In fact, he painstakingly investigated every substance he could find, applying the scientific method to each one until he had the results that he needed. Would Henry Ford have prospered if he had arranged his assembly line according to his instinct? Even more simply, would any human survive for long at any stage of economic development without using his mind to discover the facts and evaluate them according to how they affected his life?

To be moral, to pursue one's self-interest in the clearest possible way, to succeed at producing values, men have to hold an unwavering commitment to live according to the only means possible to them—their reason. This means holding rationality as a virtue. One must accept reason as an absolute, never faking reality or placing feelings and whims above logic, never suspending or abridging rational thought or allowing oneself to be controlled by anything else. This has always been the great virtue of the heroes of capitalism.

To hold rationality as a primary virtue implies a set of other virtues that men must follow, but the most important of these for a system of capitalism is the virtue of productiveness. The system of capitalism, by embracing the moral code of egoism and rationality, makes possible all of the splendor and comfort that is available in the world today. The producers have accepted that man's happiness on earth is his most moral purpose. They have engaged in

transforming the standard of living into what it is today. This productiveness, the selfish pursuit of profit and moneymaking, is only possible under capitalism, the system that frees men to pursue their own self-interest and their own ends.

The moral commitment to achieving happiness through productivity, though, does not mean that one can do whatever one wishes. As all of the great innovators and producers have realized, a human life is inherently long-range. An immediately beneficial action, say, selling a stock because its value has increased, may not be in his interest over the course of his entire life and that no choice, no matter how small, is irrelevant to his survival. Business and production aim to the highest levels of happiness and human flourishing. When Sam Walton developed the management ideas that have helped to make Wal-Mart one of the most successful companies in the world, he did not have in mind what would only benefit him today, next week, or next year. He knew that building a great company meant having a vision for the future, for its growth over time, and that careful thought and planning were necessary to this. The same is true of any human endeavor, from the individual to the largest business, acting long-range—which means acting on principle—is absolutely required for success.

The moral foundation of capitalism is the morality of egoism. By recognizing that, to be fully moral, men must act long-

range, in their own interest, according to their own conclusions, capitalism provides a context in which morality is

possible because it leaves men free to use their minds and pursue their happiness.

## The Initiation of Force

Capitalism protects men and makes it possible for them to be moral by removing the primary social evil, the means of stopping them from taking moral action, the initiation of physical force.

The initiation of physical force is evil because it halts the rational mind. A reasoning man cannot pursue a process of thought when he is being held at gunpoint, he cannot grasp reality and analyze facts according to the thug who threatens his life. Under physical compulsion, a man becomes something less than a man; his mind shuts down. He can be forced to act, his body can be compelled to hand over his wallet or work in a factory, but it is not by his choice and his process of reasoning. As the philosopher Leonard Peikoff eloquently explains, force “makes a man act against his judgment. The victim still sees what he sees, values what he values, knows what he knows.” When he hands over his wallet to the robber, the man does not suddenly believe that it rightfully belongs to the robber—he still knows it is his property. Force negates the mind, and thereby negates reality, preventing a man from acting in accord with a fully rational morality.

The initiation of force applies in the same way in the realm of business. For example, when the government prohibits Company ‘A’ and Company ‘B’ from merging because a Justice Department attorney believes it to be anti-competitive, the management of those companies does not suddenly believe that the merger is a bad idea. When the Internal Revenue Service demands payment of capital gains taxes, the taxpayer still knows that it was his effort—the effort of a long-range mind that calculated risks, allocated resources, and managed investments—that created the wealth and that it morally belongs to him, not the public. These are instances of the initiation of force as much as that of a petty thief. Through the voluntary consent of both parties, two companies wished to merge and become a new entity. Through a process of lawful trade and sale, a man wanted to earn money on his business activity. Their action involved no force, only mutual cooperation. Yet the government in this instance initiated force against them by compelling them (under threat of imprisonment) to halt their activity. In effect, the government has detached their rational conclusions from their action. They are no longer acting according to their own best judgment, but according to that of a government bureaucrat.



To pursue his life and his values, a man must be free to use his unique tool of survival—his mind—unhampered and unrestrained. Because force is the only means by which other men can prevent this pursuit, it represents the primary evil in a social context. To have a fully

free social system, a society must protect the ability of all men to exercise their own judgment, to make use of their own minds. The means of recognizing and protecting man's ability to live morally in society is the concept of individual rights.

# BASIC PRINCIPLES

## The Fundamental Right Is the Right to Life

Individual rights are the means by which every man can live morally in society with other men. The fundamental basis for individual rights is the recognition that each man is unique and must live a moral life, which means to live according to reason. When a society protects individual rights, it is ensuring that the society is one in which all individuals can be moral.

When men form a society, when they set down rules for living in an organized way, they must be guided by a principle of social interaction. This principle is the principle of rights. A right is, in Ayn Rand's words, "a moral principle defining and sanctioning a man's freedom of action in a social context." To create a moral society it is necessary to define the range of action that each man may take consistent with a proper moral code.

The fundamental right is the right to life. This means that each man has a right to preserve and protect his own life. As a basic requirement of a moral society, each man must be left free to take those actions required for his survival, including the right to think and the right to produce and keep the products of one's efforts. The right to life thus protects and sanctions an objective set of

actions—those that are, in fact, required by the survival of a rational being.

Individual rights focus on the moral authority to make choices and take actions. Although rights have often been designated by a list or inventory, they are not limited to a set of concrete actions. To have a right means to have the moral authority to engage in the choices and actions that are necessary for survival of a rational being. Man survives by the use of reason, and rights protect this. To say that a man has a right to think to further his own survival does not prescribe what he must think or limit him to thinking only about certain topics. Likewise, to say that a man has a right to produce does not dictate what he must produce. He must evaluate each choice according to his own survival needs. He is free to choose, for example, to eat foods that are unconventional in his society, but he cannot choose to eat poison. In judging the survival value of a man's choices and actions, reality is the arbiter.

There is no possible conflict between the rights of men; no individual can have a right to violate another's rights. The only way one man can stop another from acting to according to his objective survival needs—which means according

to the principles of his moral code—is to initiate force against him. In a free and just society, no man can claim a moral right to initiate force against another man because it is contrary to the survival requirements for a rational being. Human nature demands that each man be self-sustaining, which means that no man can claim by force the services or products of another man. To make

such a claim against another man's will necessarily involves the initiation of force. It cannot be claimed as a moral right by any man—to do so would be to give some men the authority over other men to replace the free exercise of their minds, which means to allow some men to dictate the conditions upon which other men live and think.

## Property Rights

The protection of property rights is one of the main foundations of a capitalist system. Property rights recognize the individual's moral claim to the products of his mind or his labor. The right to private property is a direct implication of each individual's right to life, which entails the right to take the actions necessary to sustain his life. Since human beings require material values for their well-being and survival, they must have a right to acquire, use, and dispose of those values. They must have a right to both the thought and work that goes into the process of creating those values.

The protection of property rights requires a stable system of laws, which recognizes both material ownership of land and possessions as well as ownership of intellectual property in the form of patents or copyrights. Politically, the right to property entails a system of

wholly private ownership. In capitalism, there can be no public property.

Property rights are crucial to a fully free society because they are the means of implementing the right to life and all its corollary rights. To sustain life, man must produce material values—from food and shelter to auditoriums and laboratories—that will enable human flourishing. To be moral, a man must be productive and he must have the right to engage in the production and consumption of material values. This right goes hand in hand with the other rights of individuals—rights are a unity. The right of property is what allows men to remain free to disagree in their political opinions, to express themselves in free speech, to practice their religion freely, to define the terms of their happiness according to their own judgment.

## Contract Rights

A system of capitalism must recognize and protect the rights of individuals to form and execute contracts. Because free individuals in a proper society do not have to deal with one another except by choice, a system of contract is essential. The justification for enforcement of contracts is the recognition that individuals have the capacity and right to bind themselves legally to perform some action or exchange some value. The proper basis for a system of contract law is the understanding that any disputes between rational men must be resolved by an impartial arbiter with an objective set of rules to define how such disputes will be resolved.

Under a proper government system, consenting adults may make any agreements they wish according to the best judgments of their own minds so long as those agreements are voluntary and do not implicate the initiation of force against any other party. Because breaches of contract involve the indirect use of physical force, it is vitally necessary

for the government to provide a system of civil courts whereby contractual disputes can be resolved. It is also necessary for the government to define the context in which some breaches of contract may constitute criminal violations.

As the primary means of using and exchanging property in a social context, contracts form an essential foundation of a free economic system. Contracts facilitate a division of labor whereby individuals can specialize and trade for the goods they need to survive. Thus, the objects of contracts can range from a few hours of labor to a piece of land to a complex scientific process.

A consequence of the protection of contract rights is the ability of individuals to take coordinated action across large spans of time and geography. Through the creation of partnerships, corporations, trusts, or holding companies, individuals can contractually achieve economic results that are otherwise unavailable to them.

# NATURE OF GOVERNMENT

## Government's Proper Purpose

The government in a capitalist system is the agency by which the citizens of a country protect their rights. To banish the initiation of force from human relationships, a society must create an institution with the power and authority to stop anyone who uses force against other individuals. To accomplish this end, the government is the sole possessor of the right to use retaliatory force against those who initiate force. It holds a monopoly on that power. In a rational society, all individuals agree to delegate to the government their right of self-defense, that is, their right to ward off and defend against those who initiate force against them. This delegation of the power of self-defense is the way that citizens can ensure that the use of retaliatory force is made objective. The use of retaliatory force cannot be left to the discretion of individual men who may disagree about its use in particular circumstances. By delegating this power to their agency, the government, the citizens can ensure that objective rules in the form of objective laws to guide its use.

To protect the rights of its citizens, a government must protect them from the initiation of force both by other citizens and by the government itself. The means to accomplish this is to limit the government, via a written constitution, to its proper functions. These include the provision of a domestic police force, the provision of a military force, and the provision of a court system to adjudicate disputes between citizens. By properly limiting government to its essential functions, a constitution places the retaliatory use of force under objective control. It delimits and strictly defines what powers are permitted to government officials and agents. It restricts their actions to only that which has been granted by the citizenry, leaving the citizens free to take any action that does not violate another's rights. The laws in a capitalist society have only one purpose, to prohibit those actions that involve the initiation of force by one citizen against another. Under such a system, men can enjoy the rule of law rather than the rule of men.

## Objective Law

The government in a capitalist system embodies the rule of law, not the rule of men. This means that the government must

operate in accordance with objective laws.

Objective laws, as philosopher Harry

Binswanger explains, “must be objective in both their derivation and their form.” To be objective, a law must be based on the recognition and protection of individual rights. It must be strictly limited. The government in a capitalist system embodies the rule of law, not the rule of men. This means that the government must operate in accordance with objective laws.

Objective laws, as philosopher Harry Binswanger explains, “must be objective in both their derivation and their form.” To be objective, a law must be based on the recognition and protection of individual rights. It must be strictly limited to the prohibition of the initiation of physical force in some defined form.

Because individual rights are the only means for a society to recognize the objective requirements of man’s survival as a moral being, they are the only proper basis for a system of laws to regulate that behavior in society.

That the form of the law must be objective means that it must be clear, knowable, and consistent in its language. Citizens must be informed of the laws, their justification, and the clear, objective punishments that accrue for violations prior to taking action. A government cannot rightfully engage in retroactive lawmaking (a principle enshrined in the Constitution’s “*ex post facto*” clause).

The contrast to a non-objective law illustrates the difference between the rule

of law and the rule of men. In a proper, objective system, a government would clearly define and prohibit murder. A non-objective law would be a law that prohibited “doing things that are mean” to other people. Whereas in the first example, the individual’s right to life is protected against the initiation of physical force (gunshots, stabbings, poison, etc.), in the latter example, no man could know what would be enforced as “mean.” Such a law would waver according to the judge or jury involved in the case.

Unfortunately, such non-objective laws have come to be commonplace in our system. The antitrust laws prohibit “unfair” competition, which has been interpreted by the courts to both prohibit and allow the same types of business practices depending on the situation. Some legislators want to pass laws that prohibit gasoline producers from selling at prices that are “unconscionably excessive.” This is the essence of a non-objective law—it is not based upon an instance of the initiation of physical force since buyers and sellers of gasoline come to the market freely of their own choice; and it is not clear or knowable ahead of time, since “unconscionable” may mean different things to different juries and judges. In the end, the enforcement of such a law would exist at the whim of the man or men who held governmental power. No man would be safe from the arbitrary exercise of the government’s power in such a situation—it would truly be the rule of men.

## Rights in Political Society

In a fully developed system of government, the basic philosophic rights to life, liberty, property, and the pursuit of happiness must be applied to the particular contexts that arise in such a society. These applications limit and make objective a political system and the government's institutions. They represent a recognition and protection of the underlying individual rights of all men in a political system.

Implementing the rights of citizens might include things like the freedom

of association, freedom of speech, and the freedom of thought. In designing a proper government, its founders may also develop a system of procedural and civil guarantees to protect individual rights against the infringement of government. Such freedoms would include things like the trial by jury, voting in elections, confronting one's accusers, etc. In all these cases, such freedoms and guarantees must be reducible to the basic right to life, liberty, property, or the pursuit of happiness.

# ECONOMICS OF CAPITALISM

## Introduction

In the realm of economics, capitalism applies the principle of individual rights to the production and exchange of goods and services. Viewed from the perspective of economics, capitalism is the system that completely separates economy and state. Under this arrangement, individuals are left free to produce, trade, and consume economic values, both material and spiritual, according to their own rational judgment. The government plays only the role of neutral umpire, providing a system of objective laws that protects property and contract, and that punishes the initiation of force and fraud in economic relationships. The question that remains is: how does such a system work?

Leaving individuals free to exercise their rights and pursue their economic self-interest is the basic requirement of a capitalist economic order. This principle, however, is not the only important aspect of a capitalist system. To understand capitalism, and to maintain and preserve it, it is not enough merely to state that the economy and state should be separate. It is important, as well, to comprehend how a capitalist economic system works. What are its basic features? Once individuals are left free, how are they likely to interact economically? What types of relationships will they form? By what arrangements

will they carry on their interactions?

Economics is the field that answers these questions. It is the science that studies the production and exchange of wealth. By studying the operation of free markets, economics identifies and explains the causal laws that govern these phenomena. For example, an economist might observe how a new product competes with existing products, describing how economic actors in the marketplace respond to the manufacture, pricing, and distribution of the new product. Another example might involve an economist explaining why wage rates in a particular industry have risen relative to other wage rates over the previous decade. Economics also explains the full material consequences of protecting (or failing to protect) individual rights. For example, an economist might illustrate that leaving individual producers free to set their own prices maximizes prosperity and trade whereas government-mandated wages and prices bring dislocations, unemployment, and economic stagnation.

The field of economics also provides unique insights into the role of material production in human life by considering and integrating the long-term consequences of various economic actions. Because the proper standard of



ethical conduct is man's life, lived long-term, economists show how the virtue of productiveness works out over the course of a whole life, the life of a single enterprise, or indeed, the life of a

nation. Economists, thus, help to illustrate how a capitalist system of rights protection is both the moral and the practical system for human life.

## Division of Labor

The division of labor describes the process by which individuals choose to divide among many men the tasks required to sustain and promote individual human survival. The result of a division of labor is an expansion of the productivity of labor through specialization. As each individual commits himself to a specialized task such as agriculture, he acquires a higher level of skill at that task and can soon outperform in eight hours, for example, what eight other men could collectively accomplish in one hour each. By avoiding having to gather grains for an hour each day, the other men would likewise raise their productivity in whatever tasks they chose for their specialized labor. Without such a division, it would be difficult if not impossible for long-range productive action to take place. No man in a primitive society would have the time to sew fishing nets, plant seeds, or build shelter if he had not yet reached a level of productivity beyond eating the fruit he found on the trees and the fish he caught each day. The products of each individuals' labor would then be available for trade with other individuals, thereby allowing each individual to reap all the benefits of specialization.

Even though human societies have practiced some form of the division of labor since ancient times, capitalism plays a special role in securing and promoting the benefits of such a division. In primitive societies, the division of labor might take the form of some individuals spending their productive energy gathering berries and fruits while others hunted for meat, and still others built and maintained shelters. In a complex, civilized society, it takes the form of some individuals specializing in radiation oncology while others spend their productive efforts making computers, and still others by producing works of philosophy. In both cases, all productive individuals benefit through trading the products of their specialized labor.

As an economy grows and becomes more complex, the division of labor plays a vital role in promoting higher and higher levels of productivity. As individuals join together in business firms, one of the key roles of an effective business manager is dividing, organizing, and coordinating the tasks undertaken by the firm in their production, a job that in earlier stages of economic development would have been

performed by each individual producer. Likewise, the task of dividing, organizing, and coordinating how to allocate capital among competing firms in a complex society is not performed by all businessmen, but is left instead to those whose specialized occupation is to be a capitalist—i.e., someone who manages and provides capital in the marketplace. The presence of entrepreneurs as a distinct category of occupation in an economic system also represents a highly specialized economic order.

The unique advantage of the division of labor can only flourish under a system of capitalism, with its protection of individual rights. Because the division of labor depends on individuals choosing to forego current diversified self-sufficient production in the expectation of future

trade for divided production, each individual must be certain that he will in fact be able to make that exchange. The system of property and contract rights instituted by capitalism is the means by which this long-range behavior is protected. In the absence of the rule of law and the protection of individual rights, the division of labor economy would collapse. If a man were not certain that his specialized production of computers, for example, would be safe from forced redistribution and that his daily needs for food could be purchased freely in the market instead of doled out by decree, he would never choose to specialize and agree to divide his labor. By protecting rights, capitalism allows the division of labor to flourish to its fullest extent, thereby benefiting all producers with higher standards of living and wealth.

## Competition

In a capitalist system, economic competition is the pursuit of economic values, whether dollars or resources or market share, by business firms or individuals. The economic use of the term is a more specific use of the idea of competition, which at root means the pursuit of values by different individuals when the achievement of the value excludes its attainment by others. Under capitalism, this rivalry for economic values benefits all productive individuals in a society because it represents productivity under a system of freedom and individual rights.

Competition, properly understood, means free competition, which means unrestrained by government interference in economic life.

In a capitalist economy, producers face competition from other producers, both existing and potential. Various individuals may compete to sell milk where there is a demand for twenty gallons of milk. If these individuals can each produce twenty gallons of milk, they will compete to sell their product to the purchasers of milk. Another example might be when a new college graduate

with specialized skills enters the job market and receives multiple offers from different companies. Each company competes for the services of the graduate and in turn the graduate competes against other graduates. If Joe succeeds in selling twenty gallons of his milk in the market, it necessarily means that Sally cannot sell hers. If Company X hires Betty to be their accountant, it means that Companies Y and Z cannot employ her at that time.

Unlike sporting competition or games, where there is necessarily a winner and a loser, economic competition has features that distinguish it and makes it mutually beneficial for individuals to compete economically. In economic competition, there is always one party that gains the value—the sale of a car to an individual car-buyer and its proceeds—that is therefore unavailable to other parties, but these other parties are not losers in the same sense as the team that loses the championship game. In economic life, there is a harmony of interests between rational economic actors. This is not true in the context of other types of competition. The reason lies in the nature of what it means to compete in each context.

In other competitions, the winner and loser compete to achieve some defined mutually exclusive objective—to score more points, to finish a marathon in less time, to achieve checkmate against an opponent. In these cases, the action or actions that enable one competitor to be

declared a winner have meaning only in the context of the contest. Running for 26.2 miles in under two hours and fifteen minutes, while certainly a feat of human athleticism and endurance, is not a value outside the context of running in (or training for) a marathon. The same holds true for other actions taken to compete in sports or games. Moving around small pieces of carved wood on a checkered board is not a value outside of doing so according to the rules of chess against an opponent in the context of a chess match.

In economic competition, the actions that various competitors take to “win” are different. In a capitalist system, individuals compete to be a more successful or more efficient producer of wealth. Whether in the form of earning a wage, inventing a new machine, manufacturing an electronic device, or hiring the best employee, competition in economic life always involves producing and offering values. When different individuals “compete” in the economic realm, they are each achieving a productive value—they each create wealth. Although one producer may exceed the others in success (he may sell more or earn more profits or hire better employees), the producers who have not “won” nevertheless have achieved something of value appropriate to their own productive efforts. They may hire some other employee or sell some milk or make some profit. This point has been concretized well by philosopher Harry Binswanger. He notes that “if

the New York Yankees could choose between winning by a score of 2 to 1 or losing by a score of 9 to 10, they would unhesitatingly choose winning, even though it means scoring fewer runs.” By contrast, “if a business had to choose between ‘winning’ (being the market-leader in sales) with profits of \$2 million or ‘losing’ (being second, third, or lower in earnings) with profits of \$9 million, they would unhesitatingly choose ‘losing.’”

Indeed, even when a particular seller of milk, for example, is “out-competed” in the marketplace and is unable to sell any milk, he benefits from the actions of the rival producer. His rival has achieved efficiency and productivity, has made it possible for others to be more productive and efficient, and in turn has created wealth. When the competitor was unable to make a sale, he failed to achieve a new value, but he did not “lose” the sale. It never “belonged” to him in the first place, though he was free to attempt to gain it. That each individual competitor has produced milk does not constitute a right or entitlement to sell it or to deserve customers. Each has entered the competition voluntarily with a full knowledge of the potential gains and risks. When the milk-seller who “loses” has seen his rival devise new ways of reducing the price of milk, he may be motivated to enact such cost-saving measures himself, he may be driven to new levels of productivity, or he may

discover that his talents are better suited to another profession (or even to going to work as an employee for his former rival). A final aspect of economic competition is worth highlighting. Consider again the rival producers of milk. Each of these producers is in competition not only with other producers of milk, but also with producers of substitute goods as well as any other goods. Some purchasers of milk may prefer instead to spend their money on soy milk, or on soda, or orange juice, or any other beverage. Beyond this, if their purchase of milk is done as an additional, luxury good, they may choose instead to spend their money on car wax or hot dogs, or they may even choose to invest the money at interest. In this wider context, milk producers compete not only with other milk producers, but also with other producers in the marketplace who might offer a more attractive substitute at a similar price. For this, it is clear that even a marketplace with only one producer of milk is still competitive because potential purchasers of milk can either choose not to do so or to spend their money on rival goods. Even when there is only a single producer or a handful, it is usually because they are the low-cost producers; they gain, not by “price gouging,” but by efficiencies and cost savings that yield higher rates of profit. Thus, even these single producers will themselves have to compete for capital and resources against other producers in other fields.

## Prices

In a capitalist system, a price is an exchange ratio that individuals freely place on any transaction. When any two men trade in an advanced economy, they set the terms of trade as the price of exchange. Prices exist in every economy, but only under capitalism, where individuals are free to set prices (both at which they will sell and buy economic values), does the price system achieve its fullest function.

Under capitalism, prices are crucial integrators and conveyors of information. In a fully free market system, prices act to allocate resources by indicating where they will be most effectively and efficiently used. Prices perform this function by bringing together information about the value of goods and services being produced and the exchange ratios that these goods and services have relative to each other. By amassing literally millions of points of information, a price is the distillation of this information into a convenient and graspable form. Prices reflect the balance between the supply and demand for resources (including raw materials, labor, information, and any other economic value). The law of supply and demand states, simply, that the producers of any good or service will increase their production if the price rises and that the demand for any good or service will increase as the price falls, with the inverse holding as well. What this means for an economy is that prices convey signals to

producers about the quantity of goods that they should produce. The production of goods represents an implicit demand for goods and services. In an advanced economy, when primitive production for immediate use has largely disappeared, production of one product constitutes a demand for other products by exchange.

The pricing system acts to integrate the activities of all the individuals in the marketplace, signaling the producers of goods about where the most efficient use of resources is. In our example, the new production of wheat by our dairy farmer creates a larger supply to the market. For the price of wheat before his entry into the marketplace, buyers of wheat had demanded a certain quantity. Now that the quantity of wheat has increased, some suppliers will be left with surpluses at the current price level. To get rid of these surpluses, the sellers respond by lowering their price on current stocks of wheat until it is sold. The new price signals that wheat is not as valuable relative to other production as it had been before. Now, producers of wheat may choose to dedicate some portion of their output to corn, which, relative to the same resources it would require in production as those used to produce wheat, is being sold for a higher price. As a dynamic market moves forward, these price signals act to bring equilibrium to the marketplace by allocating resources where individuals can use

them most efficiently and effectively.

The nature of the price system exists across the entire range of goods and services in a capitalist economy. The free functioning of the price system enables a capitalist system to allocate resources not only most efficiently but also consistent with individual freedom and justice. Individually, all members of society make decisions about the competing uses of their time, energy, and resources based on the prices of the marketplace. The price system does not, of course, protect individual producers against making incorrect decisions. They may produce a good or service that is not as valued on the marketplace as they thought (for literally hundreds of reasons, from a shifting supply to the introduction of better substitute goods to the mere changing taste of buyers). Nevertheless, even when individual producers must sell below cost, this information relays a crucial piece of information not only to that producer (stop using resources

in this way), but also to every other producer in the marketplace (resources will be better used elsewhere). Even a single individual's consumption of caviar sends important signals through the price system. At the current price, he is willing to buy caviar in a certain quantity but not if the price is any higher. That information indicates to producers and potential producers of caviar how to use their time and resources in productive activity. Overall, the information that is captured by prices facilitates the interaction of specialized producers in a division of labor economy and makes productivity possible. Further, it is only under a system of capitalism, where individuals' rights to property and contract are protected and enforced, that prices reflect each individual's free choices. In other system of prices (whether they are set by a central price office or are artificially set at maximum or minimum levels), the individual is forced to use his life, time, and resources in a manner inconsistent with his judgment.

## Money

Money in a capitalist economy is a commodity chosen by individuals to serve as a medium of exchange and a store of value. Money arises as a means of facilitating calculation and trade. In a society without money, individual producers who wish to trade must exchange the commodities or goods that they produce directly for other goods. Although money has existed since

ancient times, it can only perform all of its functions fully under a system of capitalism and its protection of individual rights. The existence of money is what makes a division of labor economy possible. Without money, the only means of trade would be direct exchange, for example, a wheat farmer trading his wheat for pigs or tools. The men who raise hogs and make tools would face

a similar situation. This barter system inhibits the division of labor because it makes calculation difficult—how many bushels of wheat count for one hog? How do you divide a living hog into fractions when wheat or tools are only needed in that amount? How do you price the exchange of pigs, which vary in quality even when they weigh the same, and hammers, where each additional hammer is indistinguishable? How long would the wheat stock have to remain on hand spoiling before the farmer could attain enough value to exchange for a tool or a pig? Individuals can solve this problem by executing their exchanges in terms of a third commodity, money.

Money is a means of solving the problems of complex exchange and trade. It acts as a medium of exchange, a unit of account, and as a store of value. Money serves as a tool of exchange, a commodity that producers agree to use as a medium of exchange for other commodities. It can be used to pay for goods or services. When all producers in an economy recognize the value of the exchange commodity, it can be used to store productive value. In other words, the wheat farmer can buy his ham from the hog farmer with money, which he has received

for his previous production of wheat.

Over time, individuals have used various commodities for money (including everything from shells to tulip bulbs to cigarettes and precious stones), but gradually settled on the use of precious metals, especially gold, as the best for use as money. The use of gold reflects the objective requirements for such a tool of exchange and saving. Money must be a material commodity that is rare, durable, homogenous, and relatively stable in its inherent value. This commodity acts like a yardstick of the unit of account—it is fixed in value.

In a capitalist economy, where the control of money is entirely free from governmental interference, money is a symbol of productivity. To the extent that men are productive and act long-range, their money will serve as a means of increasing their future productivity and their standard of living. To the extent that the government protects individual rights, especially the right to property in every commodity including money, an economy can benefit from the increased productivity and wealth that a stable medium of exchange can provide.

## Banking

In a capitalist economy, banks facilitate and foster economic activity. Like money, banks existed before

capitalism, but only perform their vital functions fully and best under a system of individual rights and capitalism.

A bank is simply a business that provides financial services for its clients. The earliest banks began as warehouses for gold deposits, which could be relied upon to store and protect an individual's assets. These warehouses issued receipts to depositors for their gold. Over time, these deposit receipts circulated as a stand-in for actual currency. Since the receipts—which in legal form were a contract for storage and disbursement of the gold—could be taken to the warehouse and exchanged for gold, they served as a convenient circulating currency.

As banking became more sophisticated, the gold warehouses undertook to make loans at interest from their gold deposits. In return for the risk incurred by the depositor as well as the inconvenience of not having immediate access to his gold on demand, the gold on deposit would earn interest. Banking thus served a specialized role in a division of labor economy.

Productive individuals with large capital reserves might wish to lend some of their money at interest, and entrepreneurial individuals with new ideas might require borrowing capital to start their businesses. The interaction of these parties might take place on an individual basis in a free economy to the extent that strangers might be able to gauge the risk of new ventures and to the extent that strangers can persuade others to offer them capital for untried ideas. The banking business serves as a

specialized actor in this regard, taking on the burden of making all the decisions about risk and cost, thereby leaving entrepreneurs and capitalists to remain specialized at their own occupations. By balancing the rates of interest and taking into account the other costs of operating a bank, the managers of a bank earn a return—a profit—by successfully operating their enterprise. In a capitalist economy, banks compete for customers just as any other business does, by offering the best products (credit products, stable and dependable currency, etc.).

Under a capitalist system, just as the supply and use of money would be determined by the market, so too would the size, complexity, and operations of the banking industry. In such a system, a central bank that directs interest rates and currency policy by legislative authority would be as strange to us as a central automotive agency that directed the production of automobiles by legally controlling how many auto makers could exist, what types of cars they made, what color they would be, and the prices they could charge. In a free banking system, which largely existed in the United States in the years prior to the Civil War, banks operated in the same manner as other businesses. To the extent that they offer economic value to those to whom they offer their products, they succeed. To the extent that they mismanage depositors' assets or overextend their loan portfolio, they fail.



# STUDY QUESTIONS FOR PART I

## MORAL FOUNDATIONS

### Self Interest & Egoism

1. Do you agree that producers and inventors act because it serves their own interests, or because it serves the interests of others? Explain.
2. In addition to Thomas Edison, Henry Ford, and Sam Walton, what are some examples of individuals acting in their own interest that ultimately benefitted humanity?

### Rationality & Morality

1. What do successful entrepreneurs like Sam Walton consider when making decisions?
2. What is the most important virtue for a capitalist system and why?
3. What are the moral foundations of capitalism?

### The Initiation of Force

1. How does the initiation of force halt the process of thought?
2. In what ways does the US government today initiate force in the marketplace?

## BASIC PRINCIPLES

### The Fundamental Right Is the Right to Life

1. How is the right to life conducive to a moral life?
2. What does the right to life protect against?

### Property Rights

1. Why are property rights essential to a capitalist system?

### Contract Rights

1. Why is a system of contracts essential in a capitalist society?
2. What must a government provide to resolve breaches of contract, and why?

## NATURE OF GOVERNMENT

### **Government's Proper Purpose**

1. What is the proper purpose of government?
2. What three functions are assigned to a proper government through a constitution?
3. Why must the power to use retaliatory physical force in non-emergency situations be delegated to the government in a free society?

### **Objective Law**

1. What is an example of an objective law? What about a non-objective law?
2. What is the fundamental problem with non-objective laws?

### **Rights in Political Society**

1. What two bodies must the government protect its people against?

## ECONOMICS OF CAPITALISM

### **Division of labor**

1. What is the division of labor?
2. Why is a capitalist system required for the division of labor to flourish?
3. How does the presence of entrepreneurs as a distinct category of occupation represent a highly specialized economic order?

### **Competition**

1. Why do economies not necessarily have “winners” and “losers”?
2. How does competition create a healthy, thriving marketplace?
3. How can a market with just one producer still be competitive?

### **Prices**

1. In a free-market system, what role do prices play?
2. If the price of a good rises, what should the producer of that good do?
3. How do prices reflect individual's free choices?

**Money**

1. How does the use of money as a medium of exchange make the division of labor possible?
2. Why is gold used as an objective tool of exchange and saving?

**Banking**

1. What is the motivation for an individual to store their capital in a bank?
2. How are banks actors in a division of labor economy?
3. How do banks earn a profit?

# SUGGESTED READINGS

## INTRODUCTORY WORKS ON CAPITALISM

1. Andrew Bernstein, *The Capitalist Manifesto*
2. Henry Hazlitt, *Economics in One Lesson*

## CLASSIC BOOKS ON CAPITALISM

1. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*
2. Ludwig von Mises, *Human Action: A Treatise on Economics*
3. Milton Friedman, *Capitalism and Freedom*
4. George Reisman, *Capitalism*

## CLASSIC ESSAYS ON CAPITALISM

1. Friedrich von Hayek, “The Use of Knowledge in Society”
2. Ayn Rand, “What Is Capitalism?” in *Capitalism: The Unkown Ideal*
3. Leonard Read, “I, Pencil”

## MORAL FOUNDATIONS

1. Deirdre McCloskey, *Bourgeois Virtues: Ethics for an Age of Commerce*
2. Ayn Rand, *Atlas Shrugged*

## LAISSEZ-FAIRE GOVERNMENT

1. Frederic Bastiat, *The Law*
2. Friedrich von Hayek, *The Constitution of Liberty*
3. Ayn Rand, “Man’s Rights” and “The Nature of Government” in *The Virtue of Selfishness*

## THE HISTORY OF CAPITALISM

1. Charles Adams, *For Good and Evil: The Impact of Taxes on the Course of Civilization*
2. Tom Bethell, *The Noblest Triumph: Property and Prosperity Through the Ages*
3. Burton Folsom, *The Myth of the Robber Barons*
4. Nathan Rosenberg and L.E. Birdzell, *How the West Grew Rich: The Economic Transformation of the Industrial World*

## **PART II**

# **CAPITALISM DEFENDED**

# CAPITALISM DEFENDED

## Socialism vs. Capitalism

Throughout history there have been two basic forms of social organization: collectivism and individualism. In the twentieth-century collectivism has taken many forms: socialism, fascism, nazism, welfare-statism and communism are its more notable variations. The only social system commensurate with individualism is laissez-faire capitalism.

The extraordinary level of material prosperity achieved by the capitalist system over the course of the last two-hundred years is a matter of historical record. But very few people are willing to defend capitalism as morally uplifting.

It is fashionable among college professors, journalists, and politicians these days to sneer at the free-enterprise system. They tell us that capitalism is base, callous, exploitative, dehumanizing, alienating, and ultimately enslaving.

The intellectuals' mantra runs something like this: In theory socialism is the morally superior social system despite its dismal record of failure in the real world. Capitalism, by contrast, is a morally bankrupt system despite the extraordinary prosperity it has created. In other words, capitalism, can only be defended on pragmatic grounds. We tolerate it because it works.

Under socialism a ruling class of intellectuals, bureaucrats, and social planners decide what people want or what is good for society and then use the coercive power of the State to regulate, tax, and redistribute the wealth of those who work for a living. In other words, socialism is a form of legalized theft.

The morality of socialism can be summed-up in two words: envy and self-sacrifice. Envy is the desire to not only possess another's wealth but also the desire to see another's wealth lowered to the level of one's own. Socialism's teaching on self-sacrifice was nicely summarized by two of its greatest defenders, Hermann Goering and Benito Mussolini. The highest principle of Nazism (National Socialism), said Goering, is: "Common good comes before private good." Fascism, said Mussolini, is "a life in which the individual, through the sacrifice of his own private interests... realizes that completely spiritual existence in which his value as a man lies."

Socialism is the social system which institutionalizes envy and self-sacrifice: It is the social system which uses compulsion and the organized violence of the State to expropriate wealth from the producer class for its redistribution to the parasitical class.

Despite the intellectuals' psychotic hatred of capitalism, it is the only moral and just social system.

Capitalism is the only moral system because it requires human beings to deal with one another as traders—that is, as free moral agents trading and selling goods and services on the basis of mutual consent.

Capitalism is the only just system because the sole criterion that determines the value of all goods and services exchanged is the free, voluntary, universal judgment of the consumer. Coercion and fraud are anathema to the free-market system.

Capitalism is both moral and just because the degree to which man rises or falls in society is determined by the degree to which he uses his mind. Capitalism is the only social system that rewards merit, ability and achievement, regardless of one's birth or station in life.

Yes, there are winners and losers in capitalism. The winners are those who are honest, industrious, thoughtful, prudent, frugal, responsible, disciplined, and efficient. The losers are those who are shiftless, lazy, imprudent, extravagant, negligent, impractical, and inefficient.

Capitalism is the only social system that rewards virtue and punishes vice. This applies to both the business executive and the carpenter, the lawyer and the factory worker. But how does the

entrepreneurial mind work?

Have you ever wondered about the mental processes of the men and women who invented penicillin, the internal combustion engine, the airplane, the radio, the electric light, canned food, air conditioning, washing machines, dishwashers, computers, etc.?

What are the characteristics of the entrepreneur? The entrepreneur is that man or woman with unlimited drive, initiative, insight, energy, daring creativity, optimism and ingenuity. The entrepreneur is the man who sees in every field a potential garden, in every seed an apple. Wealth starts with ideas in people's heads.

The entrepreneur is therefore above all else a man of the mind. The entrepreneur is the man who is constantly thinking of new ways to improve the material or spiritual lives of the greatest number of people.

And what are the social and political conditions that encourage or inhibit the entrepreneurial mind? The free-enterprise system is not possible without the sanctity of private property, the freedom of contract, free trade and the rule of law.

But the one thing that the entrepreneur prizes over all other values is freedom—the freedom to experiment, invent, and produce. The one thing that the entrepreneur dreads is government intervention. Government taxation

and regulation are the means by which social planners punish and restrict the man or woman of ideas.

Welfare, regulations, taxes, tariffs, minimum-wage laws are all immoral because they use the coercive power of the State to organize human choice and action; they're immoral because they inhibit or deny the freedom to choose how we live our lives; they're immoral because they deny our right to live as autonomous moral agents; and they're immoral because they deny our essential humanity. If you think this is hyperbole, stop paying your taxes for a year or two and see what happens.

The requirements for success in a free society demand that ordinary citizens order their lives in accordance with certain virtues--namely, rationality, independence, industriousness, prudence, frugality, etc.

In a free capitalist society individuals must choose for themselves how they will order their lives and the values they will pursue. Under socialism, most of life's decisions are made for you.

Both socialism and capitalism have incentive programs. Under socialism there are built-in incentives to shirk responsibility. There is no reason to work harder than anyone else because the rewards are shared and therefore minimal to the hard-working individual; indeed, the incentive is to work less than others

because the immediate loss is shared and therefore minimal to the slacker.

Under capitalism, the incentive is to work harder because each producer will receive the total value of his production or trade--the rewards are not shared. Simply put: socialism rewards sloth and penalizes hard work while capitalism rewards hard work and penalizes sloth.

According to socialist doctrine, there is a limited amount of wealth in the world that must be divided equally between all citizens. One person's gain under such a system is another's loss.

According to the capitalist teaching, wealth has an unlimited growth potential and the fruits of one's labor should be retained in whole by the producer. But unlike socialism, one person's gain is everybody's gain in the capitalist system. Wealth is distributed unequally but the ship of wealth rises for everyone.

Sadly, America is no longer a capitalist nation. We live under what is more properly called a mixed economy--that is, an economic system that permits private property, but only at the discretion of government planners. A little bit of capitalism and a little bit of socialism. When government redistributes wealth through taxation, when it attempts to control and regulate business production and trade, who are the winners and losers? Under this kind of economy the winners and losers are reversed: the winners



are those who scream the loudest for a handout and the losers are those quiet citizens who work hard and pay their taxes.

As a consequence of our 85-year experiment with a mixed economy and the welfare state, America has created two new classes of citizens. The first is a debased class of dependents whose means of survival is contingent upon the forced expropriation of wealth from working citizens by a professional class of government social planners.

The forgotten man and woman in all of this is the quiet, hardworking, law-abiding, taxpaying citizen who minds his or her own business but is forced to work for the government and their serfs.

The return of capitalism will not happen until there is a moral revolution in this country. We must rediscover and then teach our young the virtues associated with being free and independent citizens. Then and only then, will there be social justice in America.

## **Defending the Indefensible, Part 1**

In this essay and in the next, I propose to take up some of the more serious charges and to dispel what I believe are some of the most common fallacies about capitalism.

One of the least understood and most widely misrepresented aspects of the history of capitalism is the charge that during capitalism's supposed heyday—the period from roughly 1875-1925—the condition of the laboring classes were progressively deteriorating, that greedy, heartless businessmen exploited their workers, paying them abysmally low wages and forcing them to work in unsafe conditions in order to eke out ever greater profits.

This view of capitalism's history is unquestioned today. One cannot pick up an American history textbook without reading of the inhumanity and cruelty done to the laboring classes by the

so-called “Robber Barons” of the late nineteenth century. America was saved, we are told, by the heroic efforts of liberal reformers to improve the work-place and living conditions of the laboring classes.

Any discussion of laissez-faire capitalism, the Industrial Revolution and the factory system cannot begin until a certain context is kept in mind. It is inappropriate for late twentieth century Americans to look at pictures of nineteenth century working or living conditions from the perspective of the present. In societies governed by free economies, material conditions are revolutionized with the passing of almost every generation, thereby raising each generation's standards and lowering their toleration about what are and are not acceptable social conditions. It is also important to judge the social conditions of the late nineteenth century New York City, for instance, relative to

where many of the workers had come from. For many Irishmen, Italians, or east-European Jews, social conditions in America's industrialized urban areas were a great improvement relative to where they had come from. Tens of thousands if not millions of people escaped the disease, famine, discrimination, persecution and death that were regular features of life in the old country. Poverty in America meant something very different from the poverty of rural Ireland, Italy, or Poland.

Conditions may have been squalid for some, but then only for a short time. For most, however, America's system of unregulated capitalism offered a new hope and new opportunity that brought millions of immigrants to this country who were illiterate, who knew little or no English, and who had little capital or worldly possessions.

The existence of slum tenements, poor houses and overcrowding in late nineteenth-century America is easily explained. In the years following the end of the Civil War tens of millions of immigrants, many of whom were unskilled, illiterate, and who did not speak English, were pouring into the country. The population of the United States increased by an extraordinary 140 percent between 1860 and 1900. The population of New York City alone increased from one million in 1860 to just over three million in 1900.

The extraordinary population pressure

put on America's urban centers was often more than some cities could bear. But what is truly remarkable about this population explosion is that American business was able to absorb these newly arrived immigrants as easily as it did. No other civilization could have done it. Employment in manufacturing in the forty years between 1869 and 1909 rose astoundingly from 1.8 million to 6.3 million. What is truly remarkable is not how bad the conditions were for most. It is to the credit of America's capitalist system that it was able to absorb so many of the world's hungry, poor and tired.

What historians never tell you is that in almost all cases, these kinds of living conditions were temporary situations. The millions of people who came into this country with little or no possessions, not knowing English, and without a pre-established network of family or friends, found America's system of unregulated capitalism to be one where they could quickly prosper and achieve an extraordinary degree of upward social mobility.

A second barrier to a just understanding of the period known as "The Gilded Age" is the charge that the rising inequalities of wealth during this period resulted in declining standards of living for the working poor. The facts simply do not bear out the charge that businessmen got rich on the backs of the working poor.

In the years between the end of the Civil

War and the beginning of the First World War, the United States became the wealthiest nation in the world and had the highest per capita standard of living in history. The national wealth in 1860 was \$16 billion and grew at an amazing rate to \$88 billion in 1900. This kind of growth rate is nothing short of revolutionary.

The standard and quality of life for laborers also rose precipitously during this period: wages rose, prices declined, and the work day became shorter.

Per capita income in these days was doubling almost every thirty years. Between 1860 and 1900 per capita income rose from \$500 to \$1,100. Likewise, wages rose precipitously. In manufacturing, for instance, real wages rose 50 per cent in the years between 1860 and 1890 and by 40 per cent in the years between 1890 and 1914. All of this occurred in America before labor unions acquired any significant size or economic and political power.

As wages went up prices went down. In the years between 1866 and 1890 the wholesale price index fell from a high of 174 to a low of 82. Under the guidance of Andrew Carnegie's United States Steel Corporation, the price of steel plummeted from \$65 a ton in 1872 to \$20 in 1897. Likewise, John D. Rockefeller's Standard Oil lowered the price of kerosene from 26 to 8 cents per gallon between 1870 and 1885, and in the same time period the price of refined

oil dropped from 3 cents to 0.452 cents a barrel. The retail price of refined sugar in 1880 was 9 cents per pound but had dropped to 5.3 cents by 1895.

And as material conditions improved, workers also had more time to enjoy the fruits of their labors. The average work day in 1850 was 11.5 hours, in 1900 9.8 hours, and in 1920 8.5 hours. Increasing wages and the shortened work week were the result not of union demands or of labor legislation, but came about because self-interested employers found ever more effective ways to increase the productivity of their workforce through efficient cost-cutting measures and through technological innovations.

Given these revolutionary improvements in production and the quality of life, we might well ask: What was the cause of the improving workspace and living conditions and the rising standard of life for working people in this country? Was it regulation and redistribution? Or was it something else?

It is a common fallacy these days to say that labor unions and government legislation are responsible for the improved living conditions of the working class over the course of the last hundred years. This claim is false and dishonest. The sole cause of the ever-improving working and living conditions of the laboring classes in this century is due to the industrial and technological advances in the means of production that are

the consequence of freedom, voluntary exchange, and the entrepreneurial spirit.

The advances in work productivity have very little, if anything, to do with physical labor. In and of itself, the productive value of physical labor is extremely low. If physical labor were the standard of value and cause of ever increasing amounts of wealth and well being, one would expect India, China, or the nations of Africa to have the highest standards of living in the world. But such is not the case. None of these countries have politico-economic systems that protect the rights and freedoms of individuals, nor do they place high value on reason. A very simple question will demonstrate our point. Would the standard of living in India or Nigeria be increased by sending them a contingent of our best inventors and entrepreneurs?

Once you admit the necessity of regulations to control the safety of working conditions, there is simply no means by which to prevent more and more regulations. Any person who

advocates the regulation of one area of the workplace has knowingly or unknowingly opened a Pandora's box of regulations that can logically know no limits. There is simply no way to provide a set of criteria by which to regulate and not regulate.

The result is and has been throughout American history that administrative codes proliferate, with the general result that employers now have less capital and less incentive to improve working conditions. A further result is that such regulations create new production costs that force marginal companies into bankruptcy (those companies that have been barely able to compete), they force some companies to lay off workers, and they provide a disincentive to potential new companies, thereby conferring monopolistic privileges on existing firms.

What, then, are the causes and conditions necessary for the creation of wealth? In Part Two, I will conclude this essay by examining the new and improved moral relations that accompanied the rise of unregulated capitalism.

## **Defending the Indefensible, Part 2**

The extraordinary material prosperity and well-being generated by unregulated capitalism did not happen in a vacuum. Let's now examine how a revolution in moral and political philosophy provided the necessary precondition for the rise of capitalism and the peculiarly American culture of freedom and virtue.

Socialists and a certain kind of conservative have always found capitalism to be low and distasteful. One conservative philosopher has even described the capitalist world-view as a "joyless quest for joy." Left- and right-wing socialists like to speak of community and

some mystical notion of the public good. Both camps yearn for an older time.

In the centuries before the rise of capitalism, feudal or post-feudal society was structured by a fixed, unchanging hierarchy of status. Laborers were born as laborers and died as laborers. Everyone in this society was assigned his or her appointed and inherited role in life. Laborers were forced to work for others and they were bound to certain professions. This kind of feudal or post-feudal society (its remnants were felt in Europe well into the nineteenth century) was held together by legal and sentimental ties between baron and serf, master and servant, laborer and guild; it was held together by status, by class ranks, cartelized industries, guilds and various other organizations which kept men in permanent relations to one another. There was little if any social mobility.

Beginning in the late seventeenth century a new conception of liberty took hold in the Anglo-American world. Encouraged and supported by the development of John Locke's natural-rights philosophy, civil liberty was now defined as a social guarantee that all individuals, under the rule of law, would have the freedom to pursue, exchange, and keep property. As a corollary to the protection of private property, the inviolability of contracts was also guaranteed as a natural right. In other words, each man would now have complete self-governing authority and the exclusive employment of all

his physical and intellectual powers.

The rise of capitalism--that is to say, the rise of freedom--was a direct consequence of this revolution in political philosophy. But ideas in themselves are not enough; theory must be translated into practice. For new ideas to have any substantive affect on society, they must be institutionalized politically, socially and economically. The death-knell of the ancien regime came when America's founding statesmen institutionalized Locke's philosophy. They built a strong and durable constitutional edifice in which freedom might flourish.

The Founders' constitutionalism can be characterized as having established a negative conception of government--that is, the purpose of government was to protect the rights of individuals, but much beyond that it would not go. In America, this meant that government would not tax for its own purposes or redistribute for the benefit of others the profits of individual and private companies. Nor would government in the name of the elusive "public interest" regulate and control that which was fundamentally private.

The American Constitution laid the foundation for the development of laissez-faire capitalism by protecting private-property rights and the sanctity of contract, thereby providing individuals with security from the arbitrary powers of government. Such protection was seen

as absolutely necessary for the peaceful and productive activities of a growing and prosperous nation. The culture and mores of capitalism found fertile soil in this kind of constitutional environment.

This political revolution had cultural consequences as well. Traditional relations between individuals were bound to change. This new society would be based on the voluntary actions of freely laboring, freely associating, freely contracting and freely exchanging individuals. The old system of status, hierarchy, prescription and custom was dissolved and torn to pieces by a society that would guarantee to each individual the right to "life, liberty, and the pursuit of happiness." No longer was a man tied by sentimental or legal bonds to family, farm, guild or master. The static, unchanging world of feudal and post-feudal society would be replaced by a dynamic, ever-changing, progressing society.

In this new society, men and women would come together as free and independent parties for the purpose of exchanging goods and services that are of mutual advantage. The relationship between individuals in this new society was based on the premise that all individuals are self-governing, that they have a right to self-generated action, and that they are the best judges of their own prosperity and happiness. The relations between individuals in such a society are rational and voluntary rather than sentimental and coerced.

Freedom in this new social context did not mean anarchy or brutishness, however. Freedom and the necessity wrought of nature's niggardliness meant that individuals would be encouraged to develop certain virtues—virtues necessary to achieve prosperity and happiness. The new-model man of capitalism would be self-reliant, independent, industrious, enterprising, frugal, temperate, honest and rational. For those who chose to be idle, lazy, intemperate, extravagant, shiftless, imprudent, negligent, and impractical, freedom would mean bad luck and hard times. What, then, does it mean to exploit workers? How did the captains of industry actually exploit their workers?

In the first place, workers were not compelled or forced by businessmen to take jobs in factories. This point is important. For the first time in history, the laboring classes could, on the whole, choose the kind of work they wanted to do, they could choose where they wanted to work, and they could choose for whom they wanted to work. This new sense of liberation freed young men and women from either the drudgery of life on a farm or from a stratified society based on a fixed, unchanging hierarchy of status relations.

Under the system of unregulated *laissez-faire*, every individual had the right to sell his or her labor/skills in exchange for a fair wage. Unlike the feudal system, the worker was not restricted by family, by guild or by baron

as to whom or as to where he may seek employment. On the basis of a free and voluntary contract, the employer agreed to pay a wage salary in exchange for the employee's labor and know-how.

In this free-market environment, wages were determined by the law of supply and demand. Employers competed with one another for the services of workers. An employer who underpaid his workers would frequently lose them to those who paid a higher wage. The case of Henry Ford is illustrative. To attract the best possible workforce, Ford paid his workers five dollars a day at the very same time that his competitors were offering two and three dollars a day. It is a truly remarkable feat that as tens of millions of new immigrants poured into this country, wages continued to rise.

Unlike the defenders of socialism, the advocates of capitalism do not believe that human nature or human society is capable of perfection. Under any social system--including unregulated capitalism--there will be unscrupulous individuals who will lie, cheat, exploit, steal, and will use violence against other

people. Our system of justice has both criminal and civil remedies against such people and against such actions.

If capitalism improves the conditions of the vast majority of the laboring poor, one cannot condemn a whole system because a few may slip through the cracks or because a few individuals may be unscrupulous or dishonest. The question under consideration is what social system will best promote the virtues of human nature and which will best prevent the vices of human nature?

Both conservative and socialist defenders of regulations believe that ordinary people are incapable of making rational decisions that affect their self-interest. They believe that government is necessary to make those decisions for them.

We stand with capitalism because it is the most just social system, because it is the system that best fosters virtue, and because it is the system that brings the greatest happiness and prosperity to the greatest number of people. If as Americans, we are unable to defend capitalism, we are also unable to defend America.

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