Making Known The Capitalist Ideal (Book Review)

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Capitalism, by George Reisman, Ottawa, Illinois: Jameson Books, 1996. 1046 pages.

When, in 1966, Ayn Rand brought together a small collection of Objectivist articles on politics and economics, she called the book Capitalism: The Unknown Ideal. Thirty years later, in a 1046-page treatise also bearing the title Capitalism, Pepperdine University economist George Reisman has made known in definitive fashion just what capitalism is and why it is the political-economic ideal. The essence of Reisman's economics can be stated in a few plain sentences: Wealth consists of material goods made by people, and the need for wealth is limitless. Fortunately, wealth can be increased by the application of increased labor. Unfortunately, labor is inherently scarce.

On this foundation, the fundamental economic need of rational beings emerges as the overcoming of the limitations [on] production imposed by the scarcity of labor... There is only one solution to this problem. And that is continuously to raise the productivity of labor... The problem of precisely how continuously to raise the productivity of labor ... is what I call the economic problem... The remainder of this book can be summarized as demonstrating a single proposition: in every possible way, with no valid objection, the solution for the economic problem is capitalism (pp. 60-61).

Obviously, this is not the place to evaluate Reisman's sweeping claim. Nor is it the place to evaluate such recondite matters as his net-consumption/net-investment theory of profit and interest. Professional journals of economics will, or at least should, take up those matters in the years ahead. Here, a reviewer can discuss only Capitalism's treatment of some widely understood economic and philosophic issues.

Environmentalism

Immediately after setting down the basic premises stated above, Reisman launches an all-out assault on what he sees as the anti-rational, anti-individualist ecology movement. Why does this topic appear so early? Reisman would probably agree that the greatest threat to capitalism in the twentieth century has been socialism. But the socialism of the twentieth century, he points out, was communism, which Karl Marx tried to base on science and reason. The unraveling of communism in the last few decades means "that socialism should be expected to revert to its irrationalist origins, which is precisely what it is doing in the rise of the environmental movement" (p. 102). That is why Reisman gives such prominence to environmentalists: he sees them as the greatest threat to capitalism today. He writes, "The green movement is the red movement no longer in its boisterous, arrogant youth, but in its demented old age" (Ibid.).

Is Reisman right that environmentalism is the greatest postcommunist threat to capitalism? He makes a decent case for the proposition. But an even greater threat can be found in Walter Olson's latest book on employment law (The Excuse Factory: How Employment Law Is Paralyzing the American Workplace, Free Press). No matter how employers now deal with employees, they can be sued for it. Given the central importance of the employer-employee relationship in a division-of-labor economy, laws that make employers afraid to hire, and afraid to fire for even the best of reasons, are surely candidates for the label of capitalism's enemy number one.

But whether environmentalism is currently capitalism's greatest enemy or only its second-greatest enemy, Reisman has deftly revealed the pathology of much of the environmentalist movement. He quotes a Los Angeles Times article in which David M. Graber, a National Park Service biologist, denies that people are part of nature, claims that humans are a cancer on the earth, and hopes for "the right virus to come along" (p. 81). Anticipating the objection that such environmentalists are a small minority in the movement, Reisman points out that the founder of the Sierra Club, John Muir (1838-1914), expressed similar sentiments and that mainstream environmentalists have never disowned Graber's anti-human convictions.

To counter environmentalist rhetoric, Reisman shows that the environment has improved dramatically with the advance of capitalism. He notes, for example, that the safest drinking water in the world is found in those places where modern purification plants add chemicals to the water. He also reminds readers that before capitalism, a city's open streets served as sewers; and that before automobiles, horses in cities caused horrible pollution. These facts may seem obvious, but it is striking how rarely anyone brings them up anymore.

If Reisman's section on environmentalism is a triumph by virtue of its content, it is doubly so by virtue of its wit and pungency. Everyone knows that most environmentalists are skeptics concerning reason, science, and technology. And everyone has heard their dire forecasts of global warming. But has anyone pointed out the inherent contradiction as amusingly as this: "The one thing, the environmental movement holds, that science and technology can do so well that we are entitled to have unlimited confidence in them is forecast the weather — for the next hundred years!" (p. 88). Likewise, Reisman highlights the hostility to human intelligence involved in something as commonly accepted as "natural foods." Environmentalists, he writes, "turn to 'natural' foods, as though millions of years of blind evolution in the selection of food were to be trusted, but the application of science and human intelligence to the improvement of food were not" (p. 79). Of that punchy formulation, Ayn Rand herself might have been proud. Lastly, in what may be the book's best line, Reisman writes that one should not dismiss the false claims of environmentalists as those of a boy crying wolf. "They are a case of the wolf crying again and again about alleged dangers to the little boy. The only real danger, of course, is to listen to the wolf" (p. 87).

While this section on environmentalism is among Capitalism's greatest strengths, it is marred by Reisman's unfortunate lumping together of all environmentalists. He writes again and again about "the environmentalists" as if there are no major differences among them, and he fails to acknowledge the economically literate environmentalists at the Political Economy Research Center in Montana and at the Competitive Enterprise Institute in Washington, D.C. Those environmentalists see government as the major cause of environmental problems, and freedom as the natural solution to such problems.

Price Controls

Many of the topics that Capitalism covers will be familiar to those who have read Henry Hazlitt's Economics in One Lesson, Milton Friedman's Capitalism and Freedom, or my Fortune Encyclopedia of Economics. But even when writing about the familiar, Reisman offers a fresh outlook. Take his analysis of the effects of price controls. Economically literate readers know that price controls often create shortages, by holding prices below free-market levels. But Reisman goes beyond the obvious and presents several insights about the specific harm done by price controls.

He first examines the apparently arbitrary distribution of gasoline brought about by Nixon's price controls in the early 1970s and the Ford/Carter controls of the late 1970s. In some parts of the country people lined up for blocks to get gasoline, while in other regions lines were much shorter. In a free market, a relative scarcity in Connecticut would have brought a higher price there, inducing profit-seeking oil companies to send more gasoline. But price controls severed the link between price and supply. Why should a company bother sending more gasoline to Connecticut if the company gets the same price in Texas? As Reisman explains: "It largely ceased to matter to the oil companies how their gasoline was distributed" (p. 244). He fails to mention that the federal government also imposed strict allocation controls that led to severe shortages in some areas and moderate shortages in others. But he indirectly demonstrates that the severity of the shortages in various regions would have been random even absent federal allocation.

Secondly, Reisman shows how controls drive prices to exorbitant levels in uncontrolled sectors of the economy. Consider housing in New York City, where many apartments are under rent control while many are not. Assume that without rent control there would be one million apartments. These apartments would be rented to the one million people willing to pay the most for them. But now assume that the government regulates the rents of half the apartments. Then some of the people renting at the lower, controlled rent will displace people who would otherwise have paid the higher, free-market rent. What happens to the displaced renters? Some of them will shift to the uncontrolled market, competing with the half million people already renting in that market. The net result is higher rents in the uncontrolled sector. And the greater the percent of apartments subject to rent control, the higher the rent will be in the uncontrolled sector. That is one reason why New York City, which has the largest proportion of rent-controlled housing of any major U.S. city, has the highest open-market rents in the nation. (Reisman says it is the reason, but surely the value of New York land for commercial use is an important factor.)

Reisman's third fresh insight is that, in creating shortages, price controls also change the psychology of the relationship between buyer and seller. The buyer (who because of the shortage is at the mercy of the seller) "views the seller as an omnipotent tyrant whom he must beg for favors or threaten with reprisals" (p. 240). The seller, because he no longer needs any individual buyer, "views the buyer as a hysterical petty chiseler seeking values without payment." (Ibid.). Reisman illustrates the harsh attitudes shortages can breed with a story from the days of gas lines. At the time, one could buy gasoline only on alternate days, determined by whether one's license plate ended in an even number or an odd number. A gas station wishing to help its customers would simply have posted a reminder far down the line. But the day after the rules went into effect, the following remark from a gas station attendant in New Jersey was The New York Times's "Quotation of the Day": "If he's that stupid, he waits in line an hour and doesn't know the rules, I let him get to the pump — and then I break his heart" (Ibid.).

The Gold Standard

Apart from his epilogue, "Toward the Establishment of Laissez-Faire Capitalism," the final section of Reisman's book is a 72-page chapter entitled "Gold versus Inflation." In it, Reisman advocates a gold standard and lays out the details of how such a standard would be implemented, drawing on the work of the late Murray Rothbard. Like Rothbard, Reisman advocates a 100 percent reserve gold standard: all paper money would be issued by private banks and backed in full by gold. Government would not be involved in the money supply.

Although elsewhere in the book Reisman aligns himself with those who believe such a system could come about through free-market processes rather than government mandate, he also claims that a bank issuing paper money backed only by fractional reserves would be committing fraud. But his argument is not convincing. Clearly, it would not be fraud against the depositors, for they would know in advance the terms on which their notes were issued. Reisman replies: No. It would not be fraud against the depositors, but it would be fraud by the bank and the depositors against anyone who accepted the depositors' banknotes as money. But, again, why would this be fraud? Surely some retailers would knowingly accept fractionally backed banknotes as money, and, if so, there would be no fraud involved.

Four Other Notions

The topics discussed above as discrete items — environmentalism, price controls, and the gold standard — are illuminated in Reisman's work by virtue of the larger, integrated context. And the same is even more true of the topics that, for convenience, are discussed individually below: wartime prosperity, perfect competition, exploitation theory, and opportunity costs.

Wartime Prosperity

The conventional wisdom holds that individual economic well-being was much higher in World War II than in the years immediately preceding the war because the wartime gross national product (GNP) was much higher, on a per capita basis. Reisman, however, argues convincingly that the real standard of living of the American people during World War II fell to a level far below the worst years of the depression. The explanation is this: Even during the worst depression years, three-fourths of the labor force was employed and people could buy anything they wanted commensurate with their earnings. But during World War II no one could buy a new car, new house, or new major appliance because the government banned production of those items. So GNP per capita overstated economic well-being in two ways: (1) close to one-half of GNP was devoted to the war effort, and (2) price controls reduced the quality of many goods and made it impossible for people to buy as much as they wanted.

Perfect Competition

Another high point in Capitalism is Reisman's devastatingly witty critique of the perfectly competitive model that economics professors teach to undergraduates but themselves ignore when they try to analyze competition in the real world. Reisman's technique is to offer a concrete example of what the perfectly competitive model would mean by imagining a movie theater with five hundred seats, only fifty of which are about to be filled by people paying the going price. Perfect competition dictates that, because almost all of the movie theater's costs are sunk costs, the theater should drop its price to whatever level fills the seats, even if the theater company will lose money by doing so. If that sounds absurd, then Reisman has made his point. (Incidentally, an economist acquaintance once

told this reviewer that he snuck into movie theaters when he was a kid and even at the time had the economist's insight to justify to himself: that the seat would have gone empty anyway, so he was just making efficient use of "society's" resources.)

Exploitation

Reisman also sets about refuting the Marxist notion that employers exploit employees. Most economists no longer believe that, but because Karl Marx took some of his ideas about the capitalist/worker relationship from David Ricardo, who, in turn, got some of his ideas from Adam Smith, modern economists have unfortunately tended to throw out the Smith/Ricardo baby with the Marxist bath water. Reisman rectifies that mistake, salvaging some basic insights from Adam Smith and correcting some key Smith errors.

Marx believed that the capitalists' profits are deducted from what is rightly owned by laborers. That view originated in what Reisman calls Adam Smith's "primacy-of-wages" doctrine-the idea that the laborer came first and the capitalist followed, with the latter wanting to take a cut of the proceeds. Reisman comes up with a clever reformulation: the capitalist and profits came first and wages are a (justified) cut of profits. He reasons as follows. If someone is his own boss, he does not earn a wage; instead, he makes a profit equal to the difference between his revenues and the cost of his inputs. In a world where everyone is his own boss, therefore, there are no wages, only profits. In this sense, profits are primary. As some people choose to hire workers, they pay wages. Wages are, therefore, secondary. There is no exploitation of the workers because they voluntarily take the jobs, which means they consider themselves better off being employees than being employers or self-employed. That is a straightforward application of one of the simplest and most powerful tenets in economics — that no one engages in an exchange unless he expects to gain by it.

Opportunity Cost

On the way to refuting Marx and salvaging Smith, Reisman rejects the modern economics concept of "opportunity cost." This idea holds that one incurs a cost simply by not earning potential income. The "opportunity cost" attached to a course of action is the value attached to the best available alternative action. While the notion of opportunity costs is second nature to many economists,

Reisman makes a somewhat persuasive case against it. Imagine a person could spend $1 million buying stock A or stock B at $10 a share, and he decides to buy 100,000 shares of A. Next, stock A's price rises to $20 and stock B's to $30. If that person were not informed about opportunity costs, he would think he had made $1 million. But, writes Reisman, "If one believes the opportunity-cost doctrine, this is grounds for leaping from the nearest skyscraper — one has lost a million dollars" (p. 461).

The main case that many economists would make for the concept of opportunity costs is that it serves as a conceptual string on the finger, a reminder always to consider the best alternative use of a good. Reisman would counter that the injunction to compare all relevant options for using a good accomplishes the same end. That is true. Yet people steeped in the notion of opportunity costs seem to remember better to compare options.

Quantifying the Economy

When he comes to economic measurement, Reisman appears to share the disdain that characterizes many members of the Austrian school of economics. For example, after correctly showing that price indexes can never be perfect, he discards entirely the idea of measuring real GNP: "It is difficult to see how the use of price indexes — and thus measures of real GNP — provides any greater actual precision than such qualitative judgments as: there is no perceptible change, there is a slight change, there is a significant change, there is a large, very large, or enormous change" (p. 674). But if an economist says there has been a "very large" change, how does anyone know what the economist's conception of "very large" is? Even imperfect price indexes are more precise, allowing people to conclude that GNP last year rose by somewhere between 2 and 5 percent.

Economics and Economists

"Procapitalist economic thought and economic thought as such are essentially synonymous" (p. 1), Reisman says truly in his book's introduction. And among the more or less procapitalist thinkers he points to are the classical economists, including Smith and Ricardo; the Austrian economists, including Mises, Hayek, and Rothbard; and the Chicago school economists, including Milton Friedman. But there are numerous other examples. Even much of the writing of Keynesians like Paul Samuelson and James Tobin (among the older contemporary

generation), and Paul Krugman and Alan Blinder (among the middle-aged), is procapitalist. It was Samuelson's textbook, no less, that provided this reviewer with the thrill of understanding the wonderful function of futures markets and speculation. And Alan Blinder's contribution to the Fortune Encyclopedia of Economics is among the most cogent articles ever written in favor of free trade. Clearly, the community of economists who believe in important elements of capitalism is far larger than the one Reisman mentions — it includes most economists. Indeed, that follows from Reisman's own dictum: If procapitalist thought is essentially synonymous with economic thought, then anyone producing good economic thought is producing procapitalist thought.

In defense of this outlook, I would offer a personal anecdote from the summer of 1973, when I started my first tour of duty at the Council of Economic Advisers (CEA) and assumed that I was a hopelessly isolated procapitalist within the federal government. Wanting to know what the CEA's outer limits might be for free-market thinking, I decided to read over earlier, internal CEA memos from the Nixon administration and also from the administration of Lyndon Johnson. What I found stunned me. Liberal economist Kenneth Arrow had written in favor of deregulating natural gas, and the MIT Keynesian Robert Solow had penned another free-market paper. And these were not exceptions. Most of what CEA economists wrote, whether under Nixon or Johnson, criticized the statist programs and proposals they were analyzing and supported free markets, implicitly or explicitly.

Which brings up the most fundamental flaw in Reisman's book — he writes as though isolated from much of the economics profession. Although his introduction names various contemporary economists as allies, his later mentions of them are almost always negative. For example, Reisman mentions Armen Alchian as an ally, but nowhere in this large book can a reader find any discussion of Alchian's ground-breaking work on the economics of property rights. Alchian's name comes up only when Reisman faults his textbook.

Reisman's isolation is even more apparent when he notes the strong similarities between his theory of investment (first arrived at in 1959) and that propounded a few years earlier by the left-wing economist Joan Robinson, who had in turn learned the doctrine from the Polish Marxist Michael Kalecki. "They are advocates of socialism," writes Reisman, "while I, of course, am an advocate of laissez-faire capitalism. Because of this, I could never conceive of cooperating with them in any manner, and thus I never attempted to contact Mrs. Robinson, who continued to be prominent in the economics profession for many years after I became aware of her theory of profit" (p. 803). Could never conceive of cooperating? Does Reisman think he could have learned nothing from Robinson because she fundamentally disagreed with him, or that she could have learned nothing from him? Does this advocate of reason think that reason is impotent?

Reisman's likely answer is that one should not sanction those who advocate the initiation of force against humans and that engaging in a civil discussion with Robinson would be to sanction her views. But a pleasant conversation with an ideological adversary does not constitute sanction per se. If it does, then the cause of freedom is doomed. The advocates of initiating force substantially outnumber the advocates of freedom, and if freedom lovers start to believe they should never talk to their opponents, the result (besides resembling something out of a Monty Python skit) would be the victory of force. Take an extreme case: If an advocate of freedom had had a chance to talk to Stalin before he murdered millions of kulaks, should the freedom lover have turned down the opportunity, or should he have taken his shot at preventing mass murder? Granted, a literal shot in the back of Stalin's head would have been a surer thing, but, assuming the presence of bodyguards had prevented that from being an option, should not the hypothetical freedom lover have done his utmost to spread the word?

Economics, the late George Stigler once wrote, is a social science. Economists who want to influence how other economists think must talk to their peers and write in places where peers will see their work. They must also try out their ideas on economists with contrary views. Attempting to sway someone with a radically different outlook will often fail, but sometimes it will succeed. In any event, one is almost bound to improve one's own persuasive skills. And besides, persuasion is rarely all or nothing. An argument with a socialist might not make a capitalist of him, but it might make him a less plausible socialist the next time he talks about exploitation of the working class.

Capitalism is a book with many virtues. Had Reisman been more in touch with other economists, it would have had many more.