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ALMOST EVERYONE says he's in favor of free enterprise but hardly anyone really is. Slogans like "Make free enterprise work" or "Preserve capitalism" are the usual rallying cries of all kinds of programs to impair freedom of enterprise. A lot of this is disingenuous.

These disingenuous slogans of the false friends of free enterprise don't bother me nearly as much as the fact that many real friends of free enterprise have hazy notions about how such a system is supposed to work. Even they fail to understand that most so-called "welfare" objectives can be achieved better by free enterprise than by collectivism. In debate they are too often easy pushovers for the collectivists.

I am continually impressed by the fact that most individualists and most collectivists are surprisingly close together in their gen-

eral objectives of social welfare — elimination of poverty, reduction of inequality, and provision for hardship. The differences between the individualists and the collectivists are differences not in values but in technical analysis of the means of attaining these values.

For this reason, I shall make an attempt to picture in very broad strokes the basic mechanism of a free enterprise economy — to describe the way it should — and mostly does — work.

170 Million Individuals

Here in the United States is an area of about three million square miles containing 170 million people. Suppose you were asked how to organize these people to utilize the resources available to them for their material satisfactions. You can imagine you have a fairly detailed inventory of the natural resources of the country, of the peo-

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ple and their knowledge, energies, and abilities, and of their wants. Imagine that all these resources are as unorganized as a set of chessmen just poured out of their box and awaiting organization on the chessboard. Your problem is to organize the resources so that wants will be filled as well as possible.

Organization Problems

If you can get your head working at all in the face of so staggering a prospect, it will occur to you that one of the first things you are going to need is some way of establishing goals and measuring achievement. Which of the many things wanted are going to be produced, in what quantities, and with what priorities?

And after you establish these goals and priorities, you will need a method of assigning the various pieces of capital, the various natural resources, and the various people to particular activities. Each will have several alternative uses; you will need a method of coordinating the resources assigned to cooperate in each task.

Then, third, you will have to have some system for dividing the product among the people; who gets how much of what, and when?

Fourth, you will probably realize that for one reason or another your system will not work per-

fectly but will sometimes have overproduced some things and underproduced others. You will need some system of adjustment to these temporary shortages and abundances, until your method of measuring achievement and your method of allocating resources can get the basic situation corrected.

A fifth kind of problem you may worry about is that of providing for the expansion and improvement of your capital equipment and technological knowledge.

These five functions have to be provided for when you establish any organization, even a small and relatively simple one. When we consider the large and complex organization of an entire economy, what are some of the alternative ways of arranging for them?

Alternative Systems

The most obvious way to arrange things is the way an army does. You set up a commander or a general staff. They decide on goals, they decide who shall do what to attain them, they decide how to apportion the product, and they issue orders accordingly. Another method is that used in beehives and ant colonies in which caste and custom determine who does what. Things go on in the same way, generation after generation.

A third way is to introduce

money and let each person decide which he will perform of the activities that others will pay for, and what he will buy of the things that others offer for money.

Under this system, goals are set by the money offers of individuals for goods and services. Resources are allocated to one activity or another by the desires of their owners for money income. Goods are distributed to individuals according to their willingness and ability to pay the prices. Thus prices become the crucial organizing element in such an economy. Indeed, this system is often called the "price system."

Efficient and Voluntary

The price system has two outstanding features. First, it is by all odds the most efficient system of social organization ever conceived. It makes it possible for huge multitudes to cooperate effectively, multitudes who may hardly know of each other's existence, or whose personal attitudes toward one another may be indifference or hostility. Second, it affords a maximum of individual freedom and a minimum of coercion. And since people can cooperate effectively in production even when their attitudes on other issues are hostile, there is no need for unity and conformity in religion, politics, recreation, and

language — or even in patriotism and good will except in the very broadest sense.

Although one of the big features of the price system that commends it is the voluntary nature of individual actions, the system nevertheless exerts powerful inducements and even compulsions.

Guides to Action

A consumer who has it in mind to use up a lot of a scarce commodity highly prized by others is forced to forego consuming other commodities to an extent judged by others to be equivalent. A producer who tries to get more income than his services are judged by others to be worth is prevented from doing so by the freedom of buyers to buy elsewhere and of other sellers to underprice him. A business manager who tries to waste labor, capital, and raw materials is prevented from doing so because he will find himself taking in less money than he pays out. As long as he can make good the deficit, by giving up his own right to consume, this can continue; but when he can no longer make good — that is when he can no longer pay for the labor, capital, and raw materials — he is forced to stop wasting them just as firmly as if a cease and desist order were issued by a Federal Bureau of Efficiency. Maybe more firmly, for his con-

gressman may be more influential with the federal bureau than with his creditors.

The freedom of the system produces inducements or compulsions for individuals to act efficiently in the general interest. It is not by any means true that each enterprise is free to do what it pleases. It is restricted by the freedom of consumers to buy elsewhere; of the owners of labor, capital, and raw materials to sell elsewhere; and of business managers to enter the same business in competition with it.

Price Communications

This freedom of others to compete for advantages is effective in checking individual self-aggrandizement because economic information is effectively disseminated by prices. Prices represent one of the most efficient communication devices ever invented.

Indeed, we might look on the problem of organization as hinging on communication. The problem is to bring to bear on each decision two very different kinds of information. On one hand, any decision depends on general, over-all economic data; for example, how much a certain product is wanted, and how abundant the resources are from which it could be made. On the other hand, it depends on minute special knowledge; for ex-

ample, knowledge of peculiar abilities, of unused resources, of possible changes in ways of doing things.

Centralize or Disperse?

Now the problem is whether to transmit the detailed knowledge of special circumstances to a central agency, or to transmit the general information to the individuals who have the detailed knowledge. The detailed knowledge is too voluminous and nebulous for transmittal or for assimilation, and no one could know what parts should be selected. The general information, however, is summarized in prices.

Just that part of the general data that is relevant to an individual's decision is summarized in prices. If a price goes up, that tells him everything he needs to know to guide his action; he does not need to know why the price went up; the fact that it did go up tells him to try to use a little less or it tells him to produce more of the commodity, and how far to go in his efforts.

Not only do prices convey information on how an individual *should* act, but they provide at the same time a powerful inducement for him to do so.

An understanding of the theory of a price system is essential to any efforts to improve our economic organization or to any com-

parison of alternative modes of economic organization. To me, the most depressing thing about the prospects for a free society is not the hydrogen bomb, or international politics, or communist agitation; it is the fact that so very few have any understanding of economics. • • •

For a superb explanation of the fundamental role of prices in a free economy, uncluttered by technical details, I recommend highly the following two references which are, in fact, the source of my own remarks above:

1. Frank H. Knight. *The Economic*

Organization. New York: Augustus M. Kelley, Inc., 1951. This small book was written in the late 1920's, but until the early 1950's was available only in limited editions, which were used extensively in teaching economics at the University of Chicago, and occasionally at a few other colleges and universities. The framework which Knight introduced here has influenced writers of several widely-used textbooks in economics.

2. F. A. Hayek. "The Use of Knowledge in Society." *American Economic Review* 35:519-530. September 1945. Though written for a more technical audience than was the author's famous book of about the same date (*The Road to Serfdom*), this short article is equally lucid and important.

Capital and Initiative

WHAT, THEN, IS RESPONSIBLE for our economic supremacy? Two things, more than anything else. The first is capital. Both sides of American industry—management and labor—have more machinery and other equipment to work with than is available in any other nation in the world. The second is the ability and willingness to make the kind of effort required for economic growth. American history has been characterized by a value system which encourages a spirit of adventure, a desire for higher living standards, and a will to economize resources. Economic institutions like property, profits, and other individual "rights" have tended to assure that the rewards for productive effort will be received by those who earn them. Some other nations have had one or the other of these factors to a high degree, but in the United States they have been uniquely combined and together they go far toward explaining our unprecedented industrial achievement.

WALTER S. BUCKINGHAM, JR. From the *Atlantic Economic Review*, January 1957

Shall the Needy

INHERIT

OUR

COLLEGES

F. A. HARPER

A FRIEND who is unusually talented and devoted to the cause of liberty has asked for advice on specifications for some college scholarships he wants to finance. He has tentatively included "financial need" as a requirement for a grant, along with character scholarship, and the like. I have suggested that he delete "need" as a requisite for a grant.

Most scholarship awards in the United States now specify need as a condition of any grant. The practice has become so prevalent that any suggestion to omit it calls for some explanation; otherwise the suggestion is likely to be discarded without even a thought. These are my reasons.

From Childhood to Self-Reliance

In order to bring the question into focus, let us start with the birth of the child.

A child at birth is wholly dependent on grants of aid as a matter of survival. His food and the like are not what he himself has

produced, or what has been obtained in exchange for what he has produced. Ascribing to his own endeavors the genesis of his own creation is stretching the biological point a bit too far.

So parents, ordinarily, assume the responsibility of caring for the newborn, according to his need. If any aspect of merit is to be ascribed to it at all, it is the hope and expectation that he will grow and later develop the latent talents of self-reliance which he is presumed to possess at birth.

In order for this hope to become a reality, it is important that the child develop as rapidly as possible from an object of need to one whose existence rests on reward for his own attainment. This attainment should more and more take the form of economic production to supplement his other satisfactions.

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