IDEAS ON LIBERTY
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The Bias Favoring Governments over Markets

The thrust of my columns could be summarized as follows: We would be better off increasing our reliance on the voluntary cooperation of the marketplace and reducing our reliance on government commands. This is not an idle assertion reflecting blind ideology or religious zeal, as some would claim. It is based on an impressive foundation of theory and evidence. For over 225 years, dating back at least to Adam Smith's *The Wealth of Nations*, economic theory has explained how markets coordinate the actions of countless people, even when each is motivated by narrowly defined self-interest, to serve the public interest far more effectively than government action, no matter how well intended.

And the evidence is clear that individual freedom disciplined by market incentives is closely connected to widespread wealth. Markets and the freedom they allow are far more important to the prosperity of nations than natural resources. Many countries rich in natural resources have been impoverished by the substitution of government compulsion for market freedom (consider Argentina, Russia, India, China, and any number of African countries). There are also many countries poor in natural resources that have prospered by relying primarily on market forces (Japan, Hong Kong, Switzerland, and Singapore).

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But if the market is so superior to government, why do people respond to almost every problem, real or imaginary, by demanding a government solution? Why have governments relentlessly taken ever more responsibility for their citizens' welfare, and ever more of their paychecks, in unsuccessful attempts to make everyone better off at the expense of everyone else? No complete answer to these questions can be given in a short column. But at the heart of any answer is an irony—markets are criticized for the very reason that they create wealth, and governments are applauded for the very reason that they destroy wealth.

Markets work their wonders by creating in each of us an intense interest in taking actions that increase the welfare of others. Few of us give much thought to the well-being of more than a few of the hundreds of millions of people who in various and indirect ways benefit from our work and investments. But we are vitally concerned with the salaries we are paid and the profits we receive, and in markets our salaries and profits rise or fall with the value of our contributions to others. So by adjusting our efforts and investments to improve our conditions, we also improve the conditions of countless others.

The well-known implication of this is, as Adam Smith pointed out in 1776, that though each person "intends only his own gain, . . . he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention." But immediately before this famous statement,

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Smith made another, less celebrated, observation that each individual "neither intends to promote the public interest, *nor knows how much he is promoting it*" (emphasis added). Because the benefits from our efforts are so dispersed over so many people in so many ways, we can never know how much we benefit others, even if we cared. And because the benefits we realize from others are similarly spread over so many, none of us notice, or can identify, the particular contributions others are making to our welfare. The benefits generated through markets are largely unappreciated because they are distributed so broadly and impersonally. And even when these benefits are appreciated, people seldom understand that they are made possible only by the cooperation created by market incentives.

Little Credit Given

While the market receives little credit, or appreciation, for the benefits it provides, it is constantly attacked for the very thing that makes those benefits possible. The inevitable consequence of the market's rewarding those who do the most to benefit others is that it imposes losses on those who don't. Firms suffer losses and bankruptcy when they fall behind the competition in catering to consumers, releasing scarce resources to those making better use of them. Similarly, those who invest in, and work for, firms that aren't continually giving consumers better products at lower costs find their portfolios shrinking and their jobs disappearing, again shifting resources (including labor) to more productive activities. Although everyone, including those who suffer these costs, is better off living in an economy that imposes them unrelentingly, the pain that results is undeniable. And because the pain is concentrated it is easily seen, readily associated with the market forces that caused it, and invariably criticized as a market failure that calls for corrective government action.

So the success of markets is easily overlooked, or taken for granted, while the discipline that makes that success possible is easily depicted as an unnecessary and unacceptable cost. We have all seen the nightly news lamenting the horrible disruption people suffer when the major employer in their communities goes out of business. But how many have seen a follow-up on the millions who are a few dollars a year better off because the bankruptcy freed up resources to produce more valuable goods and services elsewhere in the economy? We have become wealthy because these adjustments create more benefits than costs. But because the benefits are dispersed and the costs are concentrated, the market is seldom given credit for the former, but constantly blamed for the latter.

On the other hand, government programs destroy wealth because their benefits are typically concentrated, and therefore easily noticed, while their costs are widely dispersed and easily ignored. The political benefit-cost ratios of these programs are greater than their social benefit-cost ratios, so they are invariably expanded far beyond the point where their marginal value covers their marginal cost. Obviously, the group receiving most of the benefits from a program will appreciate it, know which politicians support it, and reward them for expanding it. Even taxpayers who pick up the tab for wasteful special-interest programs commonly favor them because the benefits are so apparent and easily connected to the particular program that provides them, and the cost of any one program to any one taxpayer is typically too small to notice.

Finally, political authorities like providing government benefits even when doing so destroys far greater benefits in the market. Politicians and bureaucrats are in the business of taking credit for things, and they cannot take credit for the benefits generated through the market, and receive little if any blame when programs reduce those benefits.

We shouldn't laugh at the dog that bites the hand that feeds it. When expanding government programs that distort and discard market incentives, we are not only biting the hand that feeds us, we are also feeding the hand that bites us. □

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A Tale of Two Tariffs

by Larry Schweikart

Although it doesn't happen often, especially with modern "econometric" tools and the application of computers, sometimes there are questions in recent economic history where those who embrace free markets *know* something is right but just can't prove it. We can argue theory endlessly, but some people are never convinced until you show them a little empirical proof.

Such is the case of the tariff in American history, particularly two key episodes: the early "protective tariff" established in George Washington's day and the Smoot-Hawley Tariff, whose role in sparking the Great Depression has been asserted but never proved. Until quite recently, free-market advocates have had to rely on theory to advance the position that those tariffs were at best unnecessary and at worst destructive. But scholars continue to look for new topics, and better ways of investigating the topics they have. The result is a series of new studies that shed light on these two critical chapters in American tariff history.

First, the basics: a tariff is a tax on imports. Since the United States of America has a government, even the most minimalist "Jeffersonian" government needs money to carry out its functions, and it must come from some source. In the early Republic, where the Founders despised direct taxes, George Washington's administration, led by Secretary of the Treasury Alexander Hamilton and Secretary of State Thomas Jefferson, settled on two main sources to avoid direct taxation: a tariff and land sales. Hamilton's argument on the tariff was that it would raise revenue and "protect" infant American industries against the more established competition from Great Britain. Thus it was known as a "protective" tariff.

Although the dean of tariff historians, Frank Taussig (1931), contended that this tariff ceased to protect after the 1830s, he lacked the computing tools and masses of data now available to back up his claims.[1] Nor could he say much about the early period, when he, like most other economists and historians, agreed that the tariff had indeed "protected" American manufacturers. Over the next 60 years the so-called liberal drift of academe tended to gently repudiate Taussig. Then in 1984 Mark Bils and C. Knick Harley wrote articles in the *Journal of Economic History* arguing that the tariff was absolutely necessary even after the 1830s for the survival of American manufacturing.[2]

Fortunately, that was not the last word. Douglas Irwin and Peter Temin detected a major flaw in previous analyses of the supposed benefits of tariffs in the early Republic, namely: the analysts always assumed that American producers would make the same things as their British competitors. This, of course, was a complaint by free marketeers for some time, but on a slightly higher level.

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