Free Buffalo

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Economics in Five Lessons

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Power and Market Don't Mix

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Introduction. The decline of the Western New York economy over the last 45 years is best explained by economics. Only when the people of this area understand the basic economic principles and political dynamics that explain our decline, will they support the policy changes necessary to revive that economy. This essay will outline the five lessons of economics that we believe are most important for understanding our plight and how to get out of it.

The laws of economics cannot be evaded or avoided any more than the laws of physics can be ignored. Human beings are free to engage in any action that is physically possible. Neither physics nor economics says otherwise. People are free to jump out of airplanes without parachutes, and people are free to enact minimum wage laws. We are, however, absolutely *unfree* when it comes to avoiding the consequences of our actions as dictated by physical or economic law. The jumper will be crushed to death by a collision with the ground which unleashes an amount of energy strictly determined by his mass and speed and the density of the ground. The minimum wage law will cause all those perceived by employers to be unable to produce sufficient gross revenue to justify their wages, not to be hired, or, worse, to be fired. It *will* cause unemployment. Our only options with respect to natural laws are to ignore them at our peril or study them so we can adjust our behavior accordingly and be happy.

Here's lesson No. 1:

1. *All economic resources are scarce.*

The resources we use to produce the goods and services we want are land, labor and capital. We could also add ideas and knowledge as the product of our past labors. All those resources are scarce compared to our virtually unlimited human wants. Our human imagination, which is virtually infinite, can always conjure up new needs and wants when prior needs and wants have been satisfied.

Resources used for one purpose are thereby rendered unavailable for other purposes at the same time. In economics, this is known as *opportunity cost. Cost* is not the same as *price*, though they are closely related concepts. The monetary price of a loaf of bread may be two dollars, leading some to think that cost is an objective, calculable thing. That would cheer the hearts of central planners everywhere. On the contrary, cost is purely *subjective*. The cost of that loaf of bread is not two dollars, but the subjectively-felt loss of the good or service we cannot buy because we bought the bread instead.

The point is that cost is not objective, mathematically calculable, or comparable between or among persons. Rather, it is entirely subjective, not subject to mathematical calculation, and not comparable between or among individuals. There is no rational way a politician, central planner or bureaucrat can conclude that the cost of taxing John Doe $100 is *less* than the value of giving John Smith that same money through some government program.

As with many other economic principles and concepts, the concepts of opportunity cost and the subjectivity of value have been entirely ignored by policymakers in Western New York for 45 years. The results of that indifference are readily apparent.

Since all resources are scarce, no economic system can fulfill all needs and wants at the same time. Thus, it is not a fair criticism of any economic system that it fails to do so. Rather, the question is, which system is the best or better than the others at meeting human needs and wants?

Our choices are limited, though this is obscured by the apparent availability of a variety of different economic and political systems. All such systems can be boiled down to whether they use choice or force in allocating scarce resources. They may use force or choice in varying degrees for different purposes, but it is the decision to use choice or force in various amounts which ultimately determines the kind of economic system a given society has.

For example, Tiger Woods possesses a valuable economic resource: the ability to golf better than anyone in the world over a five year period. Other people desire this service and will pay for it. How do we allocate this scarce resource. Choice or force? We can either let Tiger and those who wish to see him play decide whether he will play, where and for how much, or, we can point a gun at him and make him play and dictate the terms to him.

Which do we do? Surprisingly, we do *both*. We allow Tiger to decide whether or not to play and where and for whom and for how much. We do not force anyone to watch him play or pay him for playing. However, after the golf tournament is over, and money has changed hands, people do go in at gunpoint and make Tiger and the other participants fork over large sums of money by force. If the people who take those profits by force did so without the sanction of the law, we would call them criminals. Since they do it with the sanction of the law, we call them government agents or the taxman.

So, let's call a system based on choice *the market*. Let's call a system based mainly on force, *socialism*. And let's call a mixture of the two pure types of systems, *a mixed economy*. In the United States, we have a mixed economy because we sometimes rely on choice, *the market*, but other times we rely on force, or *socialism*.

For example, the computer industry—hardware, software, and the internet—is relatively unregulated and not heavily subsidized. It is therefore the most dynamic area of the economy featuring an endless supply of new products often less expensive than the ones they replaced. Consumer satisfaction is high. In sharp contrast, the primary and secondary education industry is highly regulated and heavily subsidized. It features a high degree of consumer dissatisfaction. Its products and services change little from year to year while costs increase continually. The main difference between these two industries is that *consumer choice* dominates in computers while *government force* predominates in education.

In summary, since all economic resources are scarce, we must decide whether to allocate them on the basis of force or choice, or some mixture of force and choice.

While lesson number one may seem perfectly obvious to all, its truth is often ignored in political debate. Politicians who propose an endless series of new spending programs to fulfill unmet needs are implicitly denying the truth that economic resources are scarce and that not all human needs and wants can be satisfied.

Whenever you hear a politician propose a new spending program, you are really hearing someone deny that all resources are scarce. They rarely talk about the cost of these new programs, the real costs to real people they know nothing about who will lose their hard-earned dollars and have to give up their personal dreams so that some politician can buy votes with their money.

2. *The market increases wealth by providing incentives to invest in capital.*

Other than working longer or harder, the only way wealth can be increased is by investment in land, labor or capital. We invest when we take resources we could consume *now* and use them to increase productivity in the *future*. In an economy based on free choice, there is a strong incentive to invest in capital and labor because the owner can then reap the rewards of increased productivity. No one can come in later when the business is making a profit and force the owner to turn over profits to them.

In the market, all relationships are voluntary and therefore no trade occurs unless both parties expect to benefit. The market is therefore the means by which individuals can pursue their goals in harmony with others.

Entrepreneurs are essential to the proper functioning of the market system. Their role is to perceive needs and wants not yet satisfied in the market. They then gather together the factors of production necessary to provide such needed goods and services, produce them, market them and distribute them to consumers. Shrewd entrepreneurs who make good decisions tend to accumulate more and more capital that allows them to bring to market ever greater numbers and kinds of desirable goods and services. However, the judgment of the market is unforgiving and if they begin to make poor decisions, they will not only fail to earn profits but may lose their entire investment. The market rewards success and punishes failure but today's failures can be tomorrow's successes.

It is because of entrepreneurs that the market is self-correcting. If there are inadequacies in existing goods and services or companies, clever entrepreneurs seeking profits will conjure up other goods and services that better meet those needs or in fact correct defects in existing products. For example, if network newscasts are perceived to be slanted toward one political viewpoint, talk radio entrepreneurs will offer a different product. If talk radio hosts play fast and loose with the facts, blogging entrepreneurs will start websites that track and monitor their shows to keep them in line.

3. *Socialist and mixed economies decrease wealth by reducing incentives to invest in capital.*

In an economy based on force, people will be less likely to invest in the future because of the likelihood that force will be used to siphon off the wealth so produced. Using force to take wealth from some so that it can be invested by others does not increase the total amount of investment. It merely redirects capital from one area of the economy—the market sector—to another area—the socialist sector. Nor is this a zero-sum game since capital is shifted from the productive sector of the economy to the far less productive sector.

The problem of scarce resources cannot be solved by government spending. Government expenditures must be paid for by the opportunities lost to those who have paid the taxes that made those expenditures possible. For example, when the government subsidizes one business with tax money, those funds are thereby unavailable to the taxpayers for investment, savings or expenditures in the market. Those losses are almost never considered or discussed when such corporate welfare schemes are being proposed. It doesn't help that those losses are invisible since they represent projects that do not exist because the government pilfered the necessary funds.

To put it another way, every time government tries to solve a problem by new spending, it creates a new problem by taking resources from people that they had been applying to meeting their most urgent needs and wants.

In deciding whether to use force or choice to allocate resources, we need to consider the issue of *incentives*. The type of system we have will affect the incentives people have to produce or not produce wealth. In a system based on choice, if people wish to improve their economic condition, their incentive will be to produce goods and services that other people will want and will choose to pay for in the market.

In a system based on force, people will generally be motivated to *produce force*, or to be part of organizations that use force to allocate economic resources. That way, they can use that force to direct economic resources to themselves. Conversely, in a system based on force, there will be a disincentive to produce goods and services because you do not have control over their distribution and cannot receive what you perceive to be their full value in any transaction. Rather, the goods and services you produce will tend to be taken from you by force in exchange for little or no compensation. Thus, *economies based on force reduce the incentive of all to produce wealth and increase the incentive to produce force*. Since productive work is not fully rewarded, there is an increased incentive to remain idle, since leisure is not taxed. There will also be thriving black markets as people try to produce goods and services outside the reach of regulatory and tax regimes.

If we look at the peak years of Soviet Communism, a system based almost entirely on brute force, we see that the Soviets maintained an enormous and powerful army, a large and ruthless secret police force, and a huge and horrendous prison system. The Soviets invested in force because force was the coin of the realm.

In democratic mixed economies, there is still a large investment in force. Many people believe that democratic governments don't use force because the people consent by participating in elections. This is nonsense. We can see why by asking: what are the people voting *for*? They are voting to get their party into *power* so they can wield the levers of government *force* on their behalf. That's why we have *three million people* in the military or law enforcement. George Washington famously recognized that "government is force." Democratic force is mediated through constitutions, voting, and court decisions, but that doesn't make it any less real. If people don't obey the government's edicts and laws, they will be forced to do so at gunpoint.

If you look hard, you can see the enormous investments that people have made in ensuring access to the levers of force in our mixed economy: hordes of lobbyists and lawyers and pressure groups crowding our capitals and political machines totaling millions of people operating in every county and state and nationally. With government force controlling such a large portion of our economy, we have invested billions of dollars and untold human energies and time to influence the use of that force, resources that in a market economy would be freed up for much more productive pursuits.

What the *entrepreneur* is to the market, the *politician* is to the mixed economy or socialism. Let's compare the two. Both entrepreneurs and politicians purport to be problem-solvers. There is no doubt that entrepreneurs deserve that title. Just think of what Edison, Ford, and Bill

Gates have done for the world. In contrast, our most famous politicians are known for presiding over wars. That's a subject beyond our scope today, but let's consider the role of the politician further.

It is hard to think of a politician who got elected in the last 100 years by promising to protect life, liberty and property, which are, after the true purposes of law and government. Rather, they often get elected by promising to take some people's money and give it to others. Greedy voters are taken in by the dream that they will be in the receiving line, not the giving line. Knowing nothing about the people whose money he is seizing, the politician just knows that his use for their money is more urgent than theirs. Opportunity cost is a concept he does not consider. As far as he is concerned, the money he seized grew on a tree. While an entrepreneur must raise his capital by persuading investors to contribute, the politicians just order the taxman to go out and grab the needed funds at gunpoint if necessary.

This approach to problem-solving creates more problems that it solves. It destroys capital, disrupts millions of lives, reduces the incentive to produce and increases the incentive to consume without producing, which impoverishes society and eventually hurts all of us. The politician's grand schemes usually backfire because of the law of unintended consequences: government interventions into the market often result in the exact opposite of what the politicians intend. Rent control reduces the supply of apartments; urban renewal makes neighborhoods less livable; the minimum wage hurts poor workers and so on. The lesson is never learned however, so one failed program is "rescued" by another, which then fails and is "rescued" by a third in an endless chain of failure extending for decades. While the market is *self-correcting*; problems caused by the government tend to be *self-replicating*.

Note that, unlike entrepreneurs, politicians and bureaucrats do not own the *capital* value of government property. Also, as Murray Rothbard argued, they merely temporarily control the government's *income*. These facts explain much.

- In Buffalo, vast tracks of waterfront property have lain fallow for decades. They are owned by a government agency, the Niagara Frontier Transportation Authority (NFTA). The

NFTA's managers had no personal incentive to maximize the capital value of that land.

- Politicians and bureaucrats saddle government with debt to fund spending sprees. They get the immediate benefits without incurring any personal liability for the debts since they don't own the capital value of the enterprise.

- Government systematically fails to invest in infrastructure. Why invest in an asset when you don't own its capital value and you won't be around when it crumbles? For example, it was recently reported that the water pipes in Buffalo are leaking, wasting large quantities of clean water. At the same time, various forms of *income* are fully and generously funded including wages and employee benefits.

In contrast to the harmony seen in market relations, economic relationships in socialist and mixed economies are characterized by a high degree of conflict. Whereas market transactions are voluntary and mutually beneficial, when force is used to compel transactions, the interactions become *unilaterally* beneficial. Indeed, it is precisely because one party does not wish to engage in a given transaction, that they must be compelled to do so. Because large numbers of persons are compelled to participate in various government programs such as government schools, those programs are usually fraught with conflict and dissatisfaction. Taxpayers, parents and students regularly attend meetings to express their dissatisfaction with the goings on in government schools. Similar meetings of protest are unheard of with respect to the computer, software or internet industries.

Why the difference? It's simply because the computer business is based on the free choice of all involved and people can use their freedom of choice to produce and purchase precisely those goods and services they desire, whereas such choice is largely absent in government schools. There, *force* is the predominant mode of decision making—through taxation and coercive laws and regulations. (Most regulations are taxes on non-monetary wealth.) A system based on force necessarily creates conflict as those against whom the force is used accurately perceive themselves as victims of the decision makers or as being exploited by them.

4. Market prices are the only rational way to allocate resources.

Market prices are the central nervous system of the economy. The price system is the means by which information about the scarcity of and the demand for resources—which information is scattered throughout the economy and otherwise not possessed by any one person—is encapsulated in one simple number: the price of a good or service. Prices fluctuate as various buyers and sellers make purchases or sales of certain goods and services and resources or abstain from making them. Prices tend toward that level which will insure that supply and demand are in balance. At that price, all those who wish to buy will have a supply of the good or service available. Thus, prices convey information about conditions in the world by means of a simple, easy to grasp number—the price of a good or service.

Economic value is subjective. Only individuals can truly know their values and needs and wants. Individual preferences are ranked ordinally, not cardinally. In other words, "1st, 2nd, 3rd, etc., not 1, 2, 3. That being the case, there is no way to mathematically compare one person's preferences with another's. *Central planners and politicians do not and cannot know them.* However, through freely chosen market transactions, individuals make their values *objectively* known to others, alter supply and demand and affect prices. Prices in turn then reflect the sum total of all human knowledge about the scarcity and value of economic resources. High prices lead us to conserve scarce resources while low prices tell us that the good or service is plentiful and need not be so carefully conserved. Lower-priced resources are then used to create more valuable products and commodities. Without market prices, the process of converting lower-priced goods into more valuable ones would be impossible.

When an economy is run by force, the wishes and values of all people are not considered or even known. Prices no longer reflect actual scarcities and preferences of people; rather, *they reflect the preferences of those with the power to force their preferences on others*. When force is used to directly control prices, disaster ensues. Prices then no longer reflect the relative scarcity and value of goods and services. Scarce goods priced artificially low will tend to disappear and shortages will inevitably result. When prices are set artificially high, the good or service may be available but there will be a shortage of willing and able buyers.

Just as prices allow the free market to rationally and efficiently allocate resources, the general absence of market prices in government "enterprises" and for government property prevents government from doing likewise. For example, the complex Bass Pro project in downtown Buffalo calls for a government entity, the Empire State Development Corporation to take title to the old Memorial Auditorium as a tax dodge. Thus, a government entity, whose managers do not own the capital value of their property, will, over time, have no incentive to determine if a sporting goods store is the highest and best use of the building.

With respect to government programs generally, Murray Rothbard explains:

> "[T]here is no way that the government, even if it wanted to, could allocate its services to the most important uses and to the most eager buyers. All buyers, all uses, are artificially kept on the same plane. As a result, the most important uses will be slighted. The government is faced with insuperable allocation problems, which it cannot solve *even to its own satisfaction.* Thus, the government will be confronted with the problem: Should we build a road in Place A or place B? There is no rational way whatever by which it can make this decision. It cannot aid the private consumers of this road in the best way. It can decide only according to the whim of the ruling government official, i.e., only if the *government officials* do the "consuming," and not the public. If the government wishes to do what is best for the public, it is faced with an impossible task."[1]

Thus, when the government officials on the newly-created Erie Canal Harbor Development Corporation choose plans for how to spend government money and how to utilize government land on the Buffalo waterfront, they are in effect choosing based on *their personal preferences and values*, not having any possible way of knowing what the public's priorities are. (Asking the public's opinion on a survey or at a public meeting tells us *nothing* about what costs those persons would be willing to pay *out of their own pockets* for the projects they prefer. Thus, such

[1] Man, Economy and State, p. 820. Online at http://www.mises.org/rothbard/mes/chap12d.asp#9D._Fallacy_Government_Business_Basis

commonly used approaches do not remotely replicate the efficiency of market choices.)

5. Taxes will rarely be spent the way you want.

When you have a dollar in your pocket, you are the absolute master of that dollar. Unless it slips through a hole in your pocket, you *will* spend it on a good or service that you believe will improve your life in some small way. What happens when the taxman reaches into your pocket and takes that dollar from you by force, by threatening you with jail unless you pay up? We often complain about how our tax money is spent, but such complaints really miss the point of taxation. *The point of taxation is to take your funds because you would not spend them the way the authorities want them spent.* They take your money to spend it on programs, projects and policies that differ from your own priorities. If they did not differ, they wouldn't have to tax you.

So, *the essence of taxation is to take your money and spend it on things you oppose*. Once you understand that simple but elusive and painful truth, you will no longer be mystified by the so-called waste of your tax dollars. They may be wasted from your point of view, but they are not wasted from the point of view of those who spend your tax dollars: the bureaucrats and politicians and their infinite list of clients. Just as you will spend your funds on your highest and most urgent needs and wants, they too are now spending *your* tax dollars on *their own* needs and wants. You may moan and groan about the Defense Department paying $1,000 for a toilet seat, but the manufacturer of that toilet seat was laughing all the way to the bank.

In sum, money in your pocket will be spent on your most urgent wants and needs. Once the taxman grabs it, kiss it goodbye. You could spend lots of time and money trying to influence how it is spent by lobbying your legislators and so on. However, you will then be expending further valuable economic resources: your time, energy, and money, in a largely futile effort to recapture your lost control over your own money. You will almost always be wasting your time.

Summary. Economic resources are scarce. They are best allocated by their owners in freely chosen transactions in a free market. That system provides the greatest incentive to invest in the resources—land, labor and capital—needed to produce the various goods and services we call wealth.

Allocating resources based on force will *reduce the total amount of wealth in society and will only benefit a minority who are clever enough to gain control over the levers of power.* In that system, people invest not in wealth but in force so they can confiscate the wealth of others.

The market creates wealth. Socialism and our own mixed economy destroy it. The empirical evidence for this is overwhelming. West Germany was far wealthier than East Germany; Hong Kong was and is far wealthier than the rest of China. The most socialist economy on earth—North Korea's—is the poorest in Asia. The United States was far wealthier than the Soviet Union. America's freer economy is far ahead of Mexico's more socialist regime. The more socialist areas of the United States—mainly in the Rust Belt—have been falling behind economically for decades. When Buffalo's economy was market-based, it was world class. As it became more socialized, it steadily declined.

The political ramifications of all this are clear. Government should be reduced to a few minimal functions that the market would have difficulty providing such as courts, police and prisons. Taxes must be kept to an absolute minimum and replaced by user fees wherever possible. Political power should be decentralized so that governments compete with each other in keeping taxes low and so that people can easily vote with their feet if their local governments become oppressive.

That is, of course, the Free Buffalo plan[2], our best hope for reversing our 45-year-long decline and making Buffalo great and good again.

[2] http://www.freebuffalo.org/mission_statement.htm

Bibliography/Recommended Readings

This essay is written from what is called the Austro-libertarian point of view. (No originality as to the basic ideas and principles is claimed. Copyright is claimed only as to the expression and explication of those ideas.) That perspective combines insights from the Austrian School of Economics with libertarian political analysis. The following books would be helpful to those wishing to pursue these lines of thought in greater detail. Free Buffalo does not necessarily endorse all the views expressed in these works.

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The most comprehensive source for information about the Austro-libertarian tradition is http://mises.org, the website of the Ludwig von Mises Institute.

Free Buffalo's philosophy and plan contain elements drawn from populism, libertarianism, and New England-style town meeting democracy. In a word: Jeffersonian. To support Free Buffalo's efforts to restore Western New York's economy, see http://freebuffalo.org or call (716) 566-7720.