SEEING THE 'INVISIBLE HAND': ASSESSING MILTON FRIEDMAN'S FAITH IN THE MARKET.

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Abstract:

This thesis assesses the theories of Milton Friedman, arguably the most influential economist of the 20th and 21st centuries. His core argument – that an economy populated by profit maximising businesses and largely unregulated by government will be driven by market forces to maximise the over all wellbeing of society – has been highly influential, both in government regulatory and economic policy and in management theory and practice. These arguments depend in large part on Friedman's own particular conception of Adam Smith's 'Invisible Hand' – whereby individuals acting only in their own self interest incidentally benefit others by way of an exchange economy, and thus maximise the overall good of society as well as the level of individuals' personal 'freedom'.

The influence of Friedman's ideas has largely endured since its rise to prominence in the 1970s, despite the proliferation of what many would deem to be corporate malfeasance – the production of unsafe products, the creation of unsafe or oppressive labour practices, deleterious pollution which threatens the very support system upon which human society relies – as well as systemic instability as shown spectacularly with the recent financial crisis. Friedman's work has not been without criticism, and indeed there is in many ways a comprehensive body of literature which provides convincing arguments against elements of his theory. However, while Friedman provided a broad, comprehensive meta-theory informed by these elements, the counters to the elements of his work remain atomistic, often indirect, and in many ways isolated from one another; obscuring the whole.

This thesis aims to synthesise and expose the impacts that the heedless and unregulated pursuit of profit produce and then draw a holistic picture complemented by an alternative vision of a thriving system. The thesis draws together economic theory and its practice in management and suggests a different model to follow. This thesis aims to fill a gap in the discernment and the literature – to 'see' the true nature of the 'Invisible Hand'.
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PART I. INTRODUCTORY.
1 Concepts and the Problem: Friedman's Invisible Hand

1.1 Overview of Friedman and his theories

In 2004, management guru Peter Drucker described Milton Friedman “our greatest living economist” (cited in Bakan, 2004, p 35). Stilwell (2006, p. 303) asserts that Friedman “can claim to have rivaled J.K. Galbraith as the most popular interpreter of economic affairs in the late twentieth century”; Klein (2007) calls him “the most influential economist of the past half century”. The position taken in this thesis is such that his status as a 'great' economist (in terms of being one whose theories about how the economy works are accurate) should be called into question, but at the same time what makes addressing Friedman’s arguments on a number of issues so worthwhile is the fact that he has been, at the very least, an important and influential figure whose theoretical arguments have, for better or worse, effected real-world results in a way that few can claim to have done. While, certainly, there has not been universal adoption of all of Friedman's ideas; elements of his arguments regarding the role of the state in regulating business behaviour, as well as the role of corporations and their managers in society, including his faith in the ability of the 'Invisible Hand' of the free market to direct self-interested behaviour toward the maximal social good, have both profoundly influenced and been reflected in economic theory, government policy, and management practice, particularly in the United States.

Friedman's (2002) Capitalism and Freedom was first published in 1962, followed by Friedman's (1970/2002) The Responsibility of Business is to Increase Its Profits in 1970, and Free to Choose in 1980 (Friedman & Friedman, 1990). In these Friedman sets out a particular world view in which government intervention in the economy is generally seen as suppressive of personal freedom and economic development. The premises of this are as follows: Firstly, freedom of the individual to make choices about what they do with their own resources and property (regardless of what those resources and property might be) – without interference from government - is taken as the “ultimate goal in judging social arrangements” (Friedman, 2002, p. 12). Society is not conceived of as anything other than the sum of the individuals which compose it (Friedman, 2002).

Another premise is perhaps best illustrated with a quote:

"Fundamentally, there are only two ways of coordinating the economic actions of millions. One is central direction involving the use of coercion - the technique of the army and of the modern totalitarian state. The other is voluntary cooperation of individuals - the technique of the market place. The possibility of coordination through voluntary cooperation rests on the elementary - yet frequently denied - proposition that both parties to an economic transaction benefit from it, provided the transaction is bi-laterally voluntary and informed. Exchange can therefore bring about coordination without coercion. A working model of a society organised through voluntary exchange is a free private enterprise exchange economy - what we have been calling competitive
capitalism” (Friedman, 2002, p. 13)

In other words, market transactions devoid of government 'coercion' allow people to make their own informed choices about what they buy and do. The marketplace also provides the incentives for people to voluntarily come together to meet each other’s needs. Consumers want products and will offer an amount of money for them in accordance with their interests, businesses in turn desire peoples’ money and will therefore seek to produce products that consumers want at a price which they can afford. Similarly, workers desire money and will offer a given amount and quality of their labour depending on how much money they want, while businesses need labour for production and sale and so will offer said workers money for them. In each case, in the interests of spending their resources in the best possible way, both parties will have the incentive to seek sufficient information about the other so that the exchange becomes informed. Each will negotiate to the best of their ability, and neither will accept an exchange unless it is of benefit to them – therefore each party, while seeking to satisfy only their interests, in doing so benefits the other. In the words of Adam Smith - the Scottish philosopher credited with being the founder of classical economic thought and oft quoted by Friedman (& Friedman, 1990, Friedman, 2002, 1970/2002) – each party, while benefiting the other:

“intends only his own gain, and 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. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it.” (Smith, 1776/1952, p. 194)

Regulation of these transactions to protect either party – in terms of such things as minimum wages, price controls, and even safety regulations – are largely seen as inefficient infringements upon the freedom of individuals to make their own choices and the cause of economic ills, and much of both Capitalism and Freedom and Free to Choose is spent refuting the need for and benefit of such regulation (Friedman & Friedman, 1990, Friedman, 2002) – instead the 'Invisible Hand' should be allowed to work its ‘magic’ for the benefit of all. Only coercion and fraud should be regulated by government – and these concepts are given little scope or definition in Friedman's work. As a general rule, markets, not the government, are seen as the solution. Furthermore, attempts by managers of corporations to think about and act upon their moral obligations to stakeholders other than shareholders – their 'social responsibilities’ - are criticised as being subversive of a system whereby the self-interest of everyone serves to maximise the greatest overall good. These managers will best serve the interests of society, it is argued, precisely by focusing single mindedly on increasing profits and allowing the 'Invisible Hand' to guide them to the benefit of consumers, workers and others (ibid).
1.2 Friedman's Role in Discourses on Social Responsibility

Friedman's particular conception of the role of the corporation and his ideas on corporate social responsibility are widely cited in the literature – indeed, it seems scarcely possible to discuss corporate social responsibility without discussing Friedman's ideas on it (see for instance Arce, 2004; Arnold, 2003; Bartlett & Preston, 2000; Bakan, 2004; Banerjee, 2007; Bird, 1996; Bishop, 1995; Carroll, 1999; Coates, 2007; Cross & Winslett, 1987; Dobson, 1999; DesJardins, 1998; Galbreath, 2006; Graafland, 2002; Grit, 2004; Hanson & Chen, 2004; Henry, 2008; Kinard, Smith & Kinard, 2003; Lantos, 2001; Lehman, 2006; Longstaff, 1999; Malehi & Wood, 2003; Nash, 1990; Newton, 1986; Ostas, 2001; Primeaux & Steiber, 1986; Robbins et al, 2006; Roe, 2000; Schaefer, 2007; Shaw, 2005; Walker, 1992; Wulfson, 2001). According to Roe (2000, p. 554) “Although aggressive when it first appeared, Friedman's perspective is now mainstream in American business circles”. Arnold (2003, p. 156) argues that “The most influential defender of a libertarian conception of the corporation is Milton Friedman, whose stockholder theory of the corporation remains influential despite having been subjected to significant criticism”. Lantos (2001, p. 603) states that “the best known argument for a purely profit-based position on CSR was laid out by neoclassical economist Milton Friedman of the conservative Chicago School of Economics”. Robbins et al (2006, p. 161) describe Friedman as “the most outspoken advocate” of what they describe as the “classical view” of the role of corporations.

Hanson & Chen (2004) also discuss their reasons for emphasising Friedman's 'shareholder primacy script' when discussing the social responsibilities of corporations in regard to corporate law. They argue that, despite some refinement, Friedman's views are the basis of the “now-dominant view of corporate law” (ibid, p. 42) and that his articulation of the case for shareholder primacy was “a seminal turning point in corporate legal theory” (ibid). They further allege that “Friedman's basic insight that all stakeholders are better off, on net, if profit is the sole corporate goal is now the conventional wisdom among prominent legal scholars” (ibid, p. 66). Bakan (2004) also discusses the primacy of profit-making in corporate law, and draws linkages between this shareholder primacy and the defence of it given by Friedman. Bakan (2004) attributes much of the corporate malfeasance which occurs to the fact that Friedman's shareholder primacy is enshrined in law.

No allegation will here be made that Friedman has been the sole cause of all of the corporate malfeasance discussed in this thesis. As early as the 1870s, railroad magnate Billy Vanderbilt was quoted as saying “the public be damned, I am working for my stockholders” (quoted in Josephson, 1934, p. 187). Chronicles of corporate crime and malfeasance have dated back to fairly early in their inception – long before the publication of Friedman's Capitalism and Freedom in 1962 - and continued fairly uninterrupted through to the present day (see for instance Bakan, 2004;
Braithwaite, 1984; Clinard & Yeager, 1980; Frank & Lynch, 1992; Josephson, 1934; Korten, 1995; Lux, 1990; McKenna, 1996; Nace, 2003; Nader, 1991; Perrow, 2002; Shaw, 2005; as well as later chapters of this thesis).

What Friedman has done, however – which others before him have done less successfully - is to provide a comprehensive and influential moral and practical defence for the unbridled pursuit of profits, and an argument that many of the 'crimes' perpetrated by corporations have been 'crimes' only because of regulations which should not have been put in place in the first place, thus undermining not only the argument for managers to consider the needs of stakeholders other than shareholders (beyond their role in the corporation's profits) but also the basis of regulations designed to protect stakeholders from wrongdoing by heedlessly profit-seeking corporations and which seek to put into place extra market costs for such wrongdoing. As Nash (1990, p. 58) suggests, “Friedman's position is important to understand, for its basic suggestion that pursuit of profit is the most socially beneficial act a corporation can engage in has in large part seduced many managers into thinking that the effective pursuit of profit – as long as it is legal – is in itself an assurance of high moral standards” (emphasis in original).

The idea of the 'Invisible Hand' of the market turning self-interested actions into ones which are good for society – originating in the thoughts of Adam Smith but generally interpreted and disseminated through Friedman's filter (see Coates, 2007; Cross & Winslett, 1987; Krugman, 2007; Lantos, 2001; Werhane, 2000) in a way that most likely defiles Smith's original ideas1 - is reflected in the attitudes of business and political leaders and theorists who defend the unbridled pursuit of profits on such grounds (see Bartlett & Preston, 2000; Bishop, 1995; Chirayth, Eslinger & De Zolt, 2002; Coates, 2007; Cross & Winslett, 1987; Dobson, 1999; Hanson & Chen, 2004; Heath, 2007; Primeaux & Steiber, 1986; Stovall, Neill & Perkins, 2004) – and it is frequently this defence – that the free market is ultimately responsible for providing people what they want – that pervades discourse on discussions of socially irresponsible behaviour. This form of moral apologia for what many would regard as corporate malfeasance - provided by Friedman - is one of the prime targets for assessment by this thesis.

1.3 Friedman and the ascendance of Neoliberalism.

In addition to his influence on the discourse surrounding the role of corporations and the obligations of their managers, Friedman and his perpetuation of the idea of an 'Invisible Hand' leading the behaviour of self-interested actors in a free market setting to the greatest possible good, have also been influential in the ascendance of a broader set of political, economic and ideological positions

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1 See Chapter 3 of this thesis for a discussion of Smith's writings and their reinterpretation and bastardisation by Friedman
commonly called 'Neoliberalism'\(^2\) (Gabbard & Aitkinson, 2007; Giroux, 2005; Hanson & Chen, 2004; Henry, 2008; Peck, 2008; Stilwell, 2006) – indeed Stilwell (2006, p. 303) asserts that Friedman is the “the best known of the right-wing economists responsible for the ascendancy of neoliberalism in economic analysis and policy”, Gabbard & Aitkinson (2007, p. 95) call Friedman “perhaps the leading American figure in the history of neoliberal economic theory” and Hanson & Chen (2004, p. 14) assert that Friedman has emerged as “America's, and perhaps the world's, best-known free marketer”. According to Krugman (2007, p. 27) “A number of economists played important roles in the great revival of classical economics (i.e. neoliberalism) between 1950 and 2000, but none was as influential as Milton Friedman.....Friedman's followers have acted as a sort of disciplined army of the faithful, spearheading a broad, but incomplete, rollback of Keynesian heresy.”

From shortly after The Great Depression until around the 1970s, the prevailing orthodoxy through much of the world had been the Keynesian\(^3\) ideal of a middle way between the free market and socialism; with government taking on a large role in managing and regulating the economy while still maintaining a basically capitalist system (Jones, 2008; Klein, 2007; Stilwell, 2006 – see also Part V on Friedman's macroeconomics for further discussion). The advocates of this system argued that the Great Depression had shown that a free market left to its own devices would ultimately result in massive instability. However, from fairly early on there was already a movement among some intellectuals (including Friedman) to undermine this system and facilitate a return to the rule of the market. 1944 saw the publication of Friedrich von Hayek's\(^4\) (1944/2007)\(^5\) *Road to Serfdom* which laid out much of the initial ideological groundwork for neoliberalism, and in 1947 the Mont

\(^2\) Though now a term perhaps more often used by critics than by advocates, “the project was regularly self-styled as neoliberalism from the late 1930s through the early 1950s, after which it was prosecuted through a more euphemistic lexicon” (Peck, 2008, p.6). In *Capitalism and Freedom*, Friedman (2002) uses the term “liberalism”, but explicitly distinguishes his idea of 'liberal' from the more left-wing political ideas now associated with the term, and instead attempts to (dubiously) associate it with the liberalism of 18\(^{th}\) and 19\(^{th}\) century philosophers. 'Libertarianism' is another term used and the underlying ideology is also associated with terms such as 'economic rationalism' as well as the Neoclassical school of economic thought (Brinkman, 2004; Brockway, 2001; Korten, 1995; Mair & Miller, 1991; Stilwell, 2002; Varoufakis, 1998). Lux (1990) simply uses the term 'economics' to describe much the same phenomenon, reflecting the ascendancy of the Neoliberal position and Neoclassical economics to orthodoxy in economic and political thought, and Keen (2001) similarly argues that one can generally speak of 'economics' and mean the neoclassical school due to it's orthodoxy. Korten (1995) also cites 'market liberalism' and 'market capitalism' as terms used but prefers the term 'corporate libertarianism' because it directly links the ideology with the interests it serves.

\(^3\) The 'Keynesianism' of this period was indeed a moderation of the previous neoclassical orthodoxy but left out some important aspects of Keynes' theory and was modified to remain within an essentially neoclassical framework. See Keen (2001) for further meditation on this issue.

\(^4\) Hayek is probably the only one to rival Friedman as the most important figure in the proliferation of Neoliberalism in political and economic discourse, and they are frequently cited as ideological allies. His works therefore can be seen as complimentary to Friedman's in their establishment of a basic worldview. (see for instance Hanson & Chen, 2004)

\(^5\) The book, though it sold well, cannot be seen to have had an immediate impact, and indeed Hayek was for many years shunned for his ideas (Peck, 2008)
Pelerin Society⁶, of which both Friedman and Hayek were members, was established as a think tank to push this agenda. (Henry, 2008, Peck, 2008).

A vigorous political campaign would now be undertaken to push the virtues of the free market and the evils of regulation (Gabbard & Aitkinson, 2007; Hanson & Chen, 2004; Henry, 2008; Peck, 2008). In addition to the Mont Pelerin Society, a number of other organisations – including among others the American Enterprise Institute; Cato Institute; Centre for Policy Studies; Heritage Institute; and the Institute of Economic Affairs - were established in advocacy of the Neoliberal agenda, and influential people recruited to serve on them (Hanson & Chen, 2004; Henry, 2008). Led by Friedman, from the 1950s the Chicago School of Economics (Chicago University) would become the most influential faction of the neoliberal agenda and “the first recognized counterrevolution against Keynesianism” (Formaini, 2002, p. 2; cited in Peck, 2008, p. 18).

While it must have seemed for some time an uphill struggle, in the 1970s the time came for Friedman and the Neoliberal agenda to begin to ascend into orthodoxy. In the United States and elsewhere, economies began to experience a phenomenon which Keynesian economics (or, rather, the version of it which prevailed at the time) seemed unable to come to terms with: the simultaneous occurrence of rising inflation and high unemployment caused by economic stagnation – dubbed 'stagflation'. The Neoliberals were well positioned to propose an alternative to Keynesian theory, and, far from merely allowing the (purported) logic of their ideas to speak for themselves, actively promoted their perspective – aligning themselves with the financial community and business organisations as well as their think tanks (Peck, 2008). In this they were led in particular by Friedman – who engaged wholeheartedly with the popular press, having been a contributing editor of Newsweek since 1966 and making several appearances on mainstream television in the 1970s (Peck, 2008). Hayek and Friedman would both win Nobel prizes for economics in this decade⁸ (Hanson & Chen, 2004).

The newly elected governments of Margaret Thatcher and Ronald Reagan would tout the benefits of deregulation and free markets, and based their policies on the theories and ideologies of Friedman and Hayek⁹. Indeed, Friedman acted directly as an adviser to Reagan at this time, and Reagan

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⁶ The ultimate influence of the Mont Pelerin Society – and the interests it served – should not be underestimated. According to Peck (2008, p. 14) “members of this highly selective free-market club would go on to run three countries (West Germany, Italy and the Czech Republic), while occupying ministerial positions in numerous others (including Chile, New Zealand, the UK and the USA)”

⁷ See Chapter 19 for further discussion on stagflation.

⁸ Nobel prizes awarded to economists associated with the Chicago School now number nineteen (Hanson & Chen, 2004)

⁹ Hanson & Chen (2004, p. 11) say of Reagan and Thatcher: “they were not peddling their own ideas. Rather, their success resulted from their effectiveness as de facto spokespeople for the scholars generating the ideas on which the meta script was based”. Thatcher, when confronting a member of her party's research department who had made the mistake of extolling the virtues of a middle way between free markets and government regulation and paternalism, is
listened (Friedman & Friedman, 1998; Hanson & Chen, 2004; Klein, 2007; Rayack, 1987). The general Neoliberal bent toward reduction of regulations protecting consumers and workers, of deregulation of trade, and of the reduction of the public sphere in favour of private enterprise has largely continued to prevail as orthodoxy ever since (Hanson & Chen, 2004; Klein, 2007). In a 2002 address, George W. Bush took time to sing the praises of Friedman directly, saying that “the rest of the world is finally catching up to Milton Friedman” (cited in Hanson & Chen, 2004, p. 19). Most recently, Friedman made the case that Hurricane Katrina provided an opportunity to remake New Orleans’ public school system into a broadly privatised one – this advice was followed, with the number of public schools since reduced from 123 before Katrina to a mere 4 afterwards; while the number of private schools grew from 7 to 31 (Klein, 2007).

As hinted by Bush in the aforementioned address, however, Friedman's influence is far from being restricted to Western democracies, and indeed many of the places where his influence has most been felt have not been democracies at all (Barber, 1995; Barrett, 2000; Cypher, 2004; Klein, 2007). Though Pinochet's coup in Chile is the most well documented case (Barber, 1995; Barrett, 2000; Cypher, 2004; Klein, 2007), the influence of Friedman and his Chicago School acolytes (who also have a very strong presence in the International Monetary Fund) has been felt in much of Latin America and Asia (including China in particular) as well as Poland, Russia, South Africa and even Iraq (Klein, 2007).

### 1.4 A brief on Market Failures

The following will provide some brief illustrative historical data demonstrating some of the empirical costs of the corporations’ unbridled pursuit of profits. These are given more detailed attention in later chapters.

Perhaps the most serious example of destructive behaviour by corporations is the issue of ‘corporate violence’. Monahan, Novaco, and Geis (1979, p. 118; cited in Clinard & Yeager, 1980, p. 9) define ‘corporate violence’ as “behaviour producing an unreasonable risk of physical harm to consumers, employees, or other persons as a result of deliberate decision-making by corporate executives or culpable negligence on their part”. Frank & Lynch (1992, p. 17) further propose five conditions for corporate violence that the behaviour must:

1) be socially injurious
2) be blameworthy
3) cause physical harm

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said to have held up a copy of Hayek's *The Constitution of Liberty* and remarked “This is what we believe” (Yergin & Stanislaw, p. 107, cited in Hanson & Chen, 2004, p. 13, emphasis added)
4) be committed by corporations

5) be meant to benefit the corporation as a whole, rather than specific individuals within the corporation.

The extent of this problem is both well known and widely documented (Punch, 2000), and the examples are numerous. The U.S. automobile industry, led by Ford and General Motors in particular, has a long history of this type of behaviour; beginning with profiting from involvement in the Nazi war effort, through a consistent number of product defects (such as the Chevrolet Corvair, Ford Pinto, and Ford Explorer debacles\textsuperscript{10}), as well as oppositions to safety regulations at every turn (Bakan, 2004; Billstein, Fings, Kugler & Levis, 2000, cited in White, 2002; Clinard & Yeager; 1980; Dowie, 1977; Ettore, 1999; Ferrell, Fraedrich & Ferrell, 2005; Frank & Lynch, 1992; Gioia, 1992; Hartley, 2004; Helms & Hutchins, 1992; Jennings, 2006; Lee, 1998; Luger, 2001; cited in Parks, 2001; Nader, 1991; Mokhiber, 1998a; Mokhiber, 1998b; Moll, 2003; Newton & Schmidt, 2004; Shaw, 2005; Smith, 1990; Svensson & Wood, 2003).

Braithwaite (1984) chronicles an epidemic of negligent and fraudulent testing procedures in the pharmaceutical industry; such that drugs (many of which treat ailments which are not life threatening – thalidomide, for instance, was used as a sleeping aide) go on the market touted as safe, only to go on to cause a host of health problems, including death. Corporations are also known to dump pharmaceuticals deemed unsafe in the U.S. on unregulated and uninformed foreign markets, primarily third world countries (Braithwaite, 1984; Cross & Winslett, 1987; Shaw, 2005). Similar cases occur in other manufactures (e.g. pacifiers with a choking hazard exported overseas); and the problem is particularly prevalent in the chemical industry with regard to unsafe pesticides (Cross & Winslett, 1987; Shaw, 2005). The latter problem ultimately comes back to the U.S. in the form of tainted imports of food (Cross & Winslett, 1987; Shaw, 2005).

Again, in the case of chemicals; the problem is by no means restricted to overseas exports. Lynch & Stretesky (2001, p. 154) claim that in the U.S. alone, “pesticide exposure kills 10,400 people each year”; and cite dioxins and the dumping of hazardous wastes as other areas where the desire for profits have usurped concern for human health. Companies avoid regulation (and keep the public uninformed) by manipulating data and using lobbying power to reduce the perceived risk (see below) (Bohme, Zorbedian & Egilman, 2005; Egilman & Billings, 2005; Egilman & Bohme, 2005; Lynch & Stretesky, 2001; Spitzer, 2005).

A more notorious case is that of asbestos manufacturers such as Johns-Manville, James Hardie and CSR, who had known of the dangers of asbestosis since as early as the 1930s and at least since the

\textsuperscript{10} See chapter 10 for further discussion of automobile safety.
1960s but chose to deny and suppress these facts rather than protect workers and consumers alike from the disease and death that followed (Hills, 2005; McKenna, 1996; Punch, 1998; Shaw, 2005; Wishloff, 2003). Writing in 1995, Punch (1995, p. 95) stated that “over the next 30 years; 240,000 people....will die from asbestos related cancer”.

The tobacco industry, moreover, led by giant Phillip Morris, denied for years the ill health effects of tobacco and the addictiveness of nicotine, while at the same time possessing substantial evidence contradicting both assertions, even manipulating nicotine to maximise the addictivity of its cigarettes (Bero, 2003; Hartley, 2004; Harwood, 1996; Newton & Schmidt, 2004).

The suffering also spreads to employees of the companies. In the United States alone; 6000 people die on the job each year, and 1 million suffer “lost-time injuries” – worldwide, the figure is 2 million fatalities, and for each of these 1,200 accidents resulting in three or more days off from work (Brown, 2002, p. 12). However, these figures from accidents would seem to pale in comparison to the deaths from industrial diseases; including respiratory illnesses caused by exposure to coal dust, asbestos and other pollutants; as well as other cancers and illnesses caused by contact with chemicals (Egilman & Bohme, 2005; Kovarik, 2005; Rai, 2006) – estimated to be between 55,000 (Egilman & Bohme, 2005) and 100,000 (Brown, 2002; Wishloff, 2003) per year in the United States.

In addition to this type of violence, the use of sweatshop labour from people paid barely enough to prevent them starving, the pollution of the biosphere which, in addition to more immediate 'violence' effects is contributing to the warming of the earth and the potential bleak future which accompanies that, and the heedless pursuit of high profit leading to a broad ranging economic and human crisis, are discussed further in the chapters of this thesis. Unfortunately, it is these sorts of consequences – clear failures of the free market – which Friedman's logic defends on the grounds that both perpetrators and victims are exercising their 'freedom'. Further, efforts to regulate these things are undermined by the prevalence of Friedman's ideas. It is thus imperative that these ideas be considered, and their logical and empirical flaws exposed.

1.5 A brief review of previous critiques

Many of the broad ranging critiques of neoliberalism have targeted the consequences of neoliberal policies and ideas empirically with little or no consideration given to the theories on which they are based. Bakan (2004) and Korten (1995), for instance, are both primarily concerned with the destructive actions of corporations. Both concern the increase of corporate power and the destructive effect this has on society, and address social issues of progressive environmental degradation, widening of the gap between rich and poor, use of sweatshop labour, and increasing political power of corporations commanding enormous resources. Both go further to make
recommendations to remedy this situation. Bakan (2004), in arguing that their legal profit mandate causes corporations to act, insofar as they are legal ‘persons’, as if they are clinical psychopaths; shows extensive historical evidence to support the idea that uncontrollable profit seeking produces dire consequences. The author does little, however, to address theoretically the argument on which the profit motive is based; i.e. Friedman's ‘Invisible Hand’ concept and the idea of market demand. Korten (1995) does make some effort to directly counter what he calls ‘the corporate libertarians’, but again this is theoretically far from comprehensive, and no direct mention of Friedman is made. Lux (1990) traces historically the progression of economics as a discipline and its effects on the world; exposing its theoretical bases in layman’s terms and demonstrating the failure of economics to produce its proposed economic theory is covered in more depth here; but unlike Bakan (2004) and Korten (1995), who propose (as has been done here) that modern economists like Friedman have misinterpreted and misused Adam Smith, Lux (1990) blames Smith for having “invented economics and ended morality”. Further, little explanation as to why the ‘Invisible Hand’ does not work is given here; the author seems largely content to show its effects and provide counter theory for a better society, rather than delving more deeply into the constraints which prevent it from working in the proposed manner.

Klein's (2007) work is one of the more direct critiques of Friedman. In The Shock Doctrine (2007), Klein traces the history of the ascendancy of Friedman's ideas into orthodoxy and, with exceptional factual rigour, demonstrates how Friedman and his powerful Chicago School acolytes have exploited (and, in some cases, precipitated) crises throughout the world, for the institution of sweeping, sudden (and often devastating) economic deregulation - essentially remaking the world in their own image. While some of the broad economic consequences of this are exposed, however, little is done to directly address the content of Friedman's theories.

Likewise, Rayack (1987) attempts to put Friedman's theories in a context of reality, concentrating principally on his relationship with the Reagan administration. As with Klein, some historical data is made use of to show that many of Friedman's factual assertions are falsifiable by a careful consideration of the facts. Again, however, the work lacks a grounding in a careful examination of the theories themselves and thus is left open to a reinterpretation of those facts (as is done with, for instance, corporate violence) through the Friedman theoretical lens.

On what might be described as the other end of the spectrum, Keen (2001) focuses more on the theories embedded in economics, particularly the 'neoclassical' school whose revival to the status of orthodoxy Friedman helped to facilitate. Keen (2001) effectively counters the current economic orthodoxy in general on its own terms, using the conventions of mathematical modelling and abstract theories about human behaviour which neoclassical economics has claimed as its own to
expose as a fallacy neoclassical economics’ claim to rationality and scientific and mathematical rigour, instead showing it to be essentially an ideology which uses highly flawed assumptions about human behaviour. Keen’s (2001) work explains in layman’s terms the extremely counterintuitive claims which economics makes about the causes and effects of human behaviour, and offsets attempts by neoclassical economics to bamboozle non economists into believing that these assumptions have somehow been scientifically and rationally determined by showing that even within the presumptions of economics, these predictions about effects largely do not hold true. Keen's (2001) intense focus on these abstract theories means, however, that the use of historical data to illustrate theory is necessarily scarce.

1.6 Seeing Friedman's Invisible Hand

Clearly, Friedman's influence is both widespread and ongoing. As Henry (2008, p. 215) notes, however, “the current ascendancy of laissez faire theory in modern economic thinking is not the outcome of superior theory”. In the preface to the 1982 edition of *Capitalism and Freedom*, Friedman similarly admits that his ascendancy was not due to his theories being any more convincing than they were in 1962, but due to changes in circumstances:

“Only a crisis-actual or perceived-produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes politically inevitable” (Friedman, 2002, p. xiv).

Nor is 'political freedom' (i.e. democracy) deemed a necessary condition for the 'economic freedom' on which Friedman places so much value – indeed Friedman admits that political freedom in many cases will 'inhibit' the development of 'economic freedom' (Friedman, 2002). Indeed, as Klein (2007) extensively documents, in strong developed democracies the extent of adoption of Friedman's policies has been tempered by public sentiment - where Friedman's policies have most vehemently been embraced this has been precipitated either by violent revolution or in areas where parties have reneged on promises made in election due to crisis and the need to bow to the demands of the powerful interests (most prominently the International Monetary Fund or IMF) who demand the adoption of Chicago School policies. Far from merely 'lying around', Friedman's ideas have been strongly pushed on the rest of the world.

While it is evident that the prevalence of Friedman's ideas has not been solely (or perhaps even primarily) due to the rigour of the theories themselves, a direct and reasonably comprehensive counter to them is needed, if only as a starting point. It is this gap in the literature which this thesis aims to address. This thesis seeks to critically analyse Friedman's positions and his faith in the 'Invisible Hand' of the market to direct actions ungoverned by either regulation or personal ethics
toward the greater good; and, through empirical, historical and theoretical analysis, to uncover the actual action of the 'Invisible Hand'. Furthermore, it aims to put forward possible alternatives to the Friedman dogma, and reinvigorate the development of the 'third way' between socialism and raw capitalism, the feasibility of which Friedman and his ilk have denied.
2 Design, Methods and Limitations of the Research

2.1 The Origins and Evolution of this Thesis

This research was originally conceived as a furthering of understanding and elucidation of concepts studied for the preceding Honours Thesis. The Honours thesis, entitled *The Value of Human Life: The Ethical Precursors to Corporate Violence*, had initially been inspired by concepts explored in the film *The Corporation* (Achbar, Abbott & Bakan, 2004) and the corresponding book *The Corporation: The Pathological Pursuit of Profit and Power* (Bakan, 2004). Of particular interest was the concept that incidences of corporate malfeasance were not the result of actions by a few 'bad apples' but were endemic among corporations, and the result of systemic issues. However, while accepting this premise, the researcher found the explanation given in these works – that the corporations were merely legally structured in such a way that they would necessarily pursue profits single mindedly in a manner characteristic of a 'psychopath', and that it was this legal structure that could be apportioned blame for the malfeasant actions of corporations – to be incomplete, and indeed unsatisfactory; particularly given that the legal structure specified the pursuit of profits within the bounds of the law and that many of the actions could be considered illegal.

Taking inspiration from Bakan's (2004) work on *The Corporation*, the Honours thesis was premised on the fact that 'corporate violence' is not the result of 'deviant' behaviour by a few rogue corporations or managers (as previous literature has emphasised) but is indeed endemic, persistent, and the result of systemic issues; occurring in entire industries over long periods of time and throughout changes in management. Incorporating the Critical Management theory of 'Management' with Jones' (1991) Issue Contingent Model of Ethical Decision Making in Organisations and the idea of 'Public Morality' explored in Cohen (2004), and using case histories of U.S. automakers Ford and General Motors over periods from the 1940s to the present day, the thesis looked at why human agents (managers) within corporations so frequently made, or failed to alter, decisions which they knew to place human life in danger. The case histories presented a persistent pattern of corporate violence in these companies over an extended period of time; and, combining and expanding upon the aforementioned theoretical constructs, the thesis presented a modified version of the Jones (1991) model which was deemed a 'Management-Biased Model of Ethical Decision Making by Corporate Agents'.

In this it was proposed that, in addition to situational factors, and beyond mere 'organisational culture'; an overarching, inter-institutional 'Management' ideology, which limited the consideration of decisions to matters of profit and loss, biased decision making in such a way as to limit both the
perceived and actual 'moral intensity' (as defined by Jones (1991) of ethical issues and hindered agents at every stage of the ethical decision making process (again in Jones, 1991), from recognition of moral issues to engagement in moral behaviour. The questions remained, however: why is 'Management' like this? How does it defend its emphasis on profit maximisation above all else? How can 'Management' thus be changed to be less destructive?

It was from these latter questions that this thesis was initially conceived. Time and again, the concept of 'The Invisible Hand' was brought up in the literature; as were the ideas of Milton Friedman, and in particular, in the Corporate Social Responsibility literature at least, his seminal essay 'The Responsibility of Business is to Increase its Profits' (Friedman, 1970/2002) which seemed in any case to be in large part premised on the 'Invisible Hand' concept. The profit maximisation ethic of 'Management' appeared to be premised on the idea that profit maximisation also maximised individual choice and the welfare of society – that in their uncompromising and relentless pursuit of profits corporations would be led by an 'Invisible Hand' to unintentionally benefit those from whom they hoped to profit. If 'Management' was to be prepared for change, this concept in particular would need to be addressed.

Interestingly, it did not seem that the concept of the Invisible Hand had been taken on directly and comprehensively in a management context, looking broadly at the behaviour of corporations and the application of the theories. Seminal works discussing the destructive actions of corporations, such as The Corporation (Bakan, 2004); Korten's (1995) When Corporations Rule the World, and Naomi Klein's (2000) No Logo; discussed the effects of corporate malfeasance and ways to potentially combat it while giving little attention to the theories which were an important part of the cause. Many works have also demonstrated the folly of individual theories of Friedman's; but there had been no synthesis of these arguments. There was no direct counter to, for instance, Friedman's Capitalism and Freedom (Friedman, 2002) or Free to Choose (Friedman & Friedman, 1990). This thesis hoped to fill that gap in the literature – to critically analyse the various tenets of the 'Invisible Hand' theory, expose their flaws and show why the 'Invisible Hand' did not guide society toward the best outcome as theorised; and ultimately to propose alternative theory, both descriptive of the real world and prescriptive on how to improve upon it.

The thesis went through various phases in terms of conceiving of exactly what 'the Invisible Hand' meant and who had defined it for 'Management'. At first a critique of Adam Smith had been anticipated, but, as is shown in this thesis, actual reading of Smith shows the modern 'Invisible Hand' concept to be, at best, a mere caricature of Smith's much more complex philosophy and political economy. A proposal and early literature review described the school of thought as Neoclassical Economics and Libertarian philosophy (at first wary of using the term 'Neoliberalism') – the schools of economic and philosophical thought to which Friedman belonged; but this was
found to be a potential disservice to the complexity and heterogeneity of at least the early Neoclassical economists such as Leon Walras and William Stanley Jevons. While Friedman and his ideas had always been the most cited in the Management literature and had in the researcher's mind always both best explained and been the basis for the modern conception of the 'Invisible Hand'; and had the most influence on Management discourses and theories; it was not until later that the question was asked whether Friedman's ideas specifically could become the focus of the study, whether he as a figure was sufficiently important and influential. As explained in the above, and as Naomi Klein has chronicled extensively in *The Shock Doctrine* (2007), Friedman's ideas were indeed sufficiently important and influential on both government policy and Management discourse – and as will be explained below, largely devoid of the complexity of his predecessors; egging on the profit maximisation at all costs mantra of Management.

Finally, a note on the changing context in which the thesis is situated and its influence on the evolution of the thesis. Firstly, this thesis began life as a critique of a prevailing discourse which exercised hegemonic control over much of the policy and behaviour at the time. Initially, the focus of the thesis was to be the corporation, its application of the 'Invisible Hand' theory (through profit maximisation) and the application of said theory upon it (through deregulation, or conversely through regulation); as well as the ethics of managers and the need for people to be protected from corporate malfeasance. Microeconomic considerations were to be emphasised while macroeconomic theories were to be addressed only to the extent that they affected microeconomic issues (for instance, the emphasis of the wage/unemployment dichotomy used to justify removing minimum wages). The nature and causes of economic depression and recession were largely to be left alone or at best skimmed over.

Both of these things have changed. The circumstances of the recent economic turmoil have, it seems, knocked Friedman's theories – at least those about the running of the broader economy – from their perch of hegemony; such that even staunch Friedmanite Alan Greenspan has admitted some folly in the free market system. They have also brought concerns macroeconomic (though with their origins in no small part in microeconomic mismanagement via the deregulation and faith in the market that Friedman so vehemently advocated) to the fore; such that they cannot be pushed to the side in a thesis of this kind. What began as a basically management-oriented study is now situated firmly in the realms of political economy.

2.2 Research Questions

- Does the 'Invisible Hand', as theorised by Friedman, actually guide business toward beneficial action in the way that Friedman theorises, without any need for ethical considerations or social responsibility, and severely limited need for prohibitive regulation?
Joseph McIvor ‘Seeing the ‘Invisible Hand’

How do the theorised and actual actions of the ‘Invisible Hand’ compare with one another?

- If not, why not? Why might self-interested action by market players (consumers, employees, business) not produce the greatest good for society? What prevents it from doing so?
- What has, and is likely to be, the result (generally) of allowing (and indeed compelling) business in particular to single mindedly pursue profits, free of regulation? How does this compare with Friedman's espoused views on this?
- How do the actions and power of market players theorised by Friedman compare with their actual actions in real life? What (differing) levels of influence do these market players have over one another? To what extent are market players ‘free to choose’?
- To what extent does the economy in general behave in a way that is different from that which Friedman theorises? Why?
- To what extent does government have a role to play in the economy, particularly in the regulation of business? How can the past and current regulatory framework be approved upon?

2.3 Research Objectives

*To synthesise and analyse data and arguments, and propose others; combining direct address of theory with placement of that theory in an empirical and historical context of reality; which demonstrate the flaws in Friedman's most important and influential theories and their historical or empirical bases; particularly his general faith in market forces and the 'Invisible Hand' over the more visible hand of government and his protestations against the acceptance of a 'social responsibility' by business.

* To propose alternatives to Friedman's prescriptions as well as current government policy, particularly in regard to the regulation of corporations.

2.4 The Structure of the Thesis

Friedman's most important and populist works were *Capitalism and Freedom* (2002; originally published 1962) and *Free to Choose* (1990, originally published in 1980), the latter accompanying a television series of the same name. President Ronald Reagan carried a copy of *Capitalism and Freedom* with him on the campaign trail (Klein, 2007). When asked about his favourite of his own books, Friedman was torn between the two, arguing that while *Capitalism and Freedom* was “more succinct, scholarly and abstract”, *Free to Choose* was “more popular, less abstract, more concrete.....present a fuller development of the philosophy that permeates both books; it has more nuts and bolts, less theoretical framework” (Friedman, 2002b, p. 2).

Together both books have acted as Friedman's own manifesto; outlining his views on political
economy and philosophy and his recommendations for economic policy. He advocates a society based on the idea of personal freedom of choice as its ultimate goal and with government playing a minimal role while self-interested actors are left free to pursue these interests; with the confidence that in doing so they will be led by an 'Invisible Hand' to unintentionally maximise the freedom and welfare of society.

Perhaps more importantly, however, both books argue the folly of attempts to curb this pursuit of self interest; and provide counterarguments to claims that government must protect its citizenry from the excesses of the free market and that business executives should be concerned with a 'social responsibility' other than that to maximise shareholder profits. Friedman revises interpretations of history. He alleges that the perception of early capitalism as a brutal regime of oppression is misguided and that people of the time, while poor, saw improvements in their lot as a result of the free market which might not have been seen had regulation been enacted. He trumpets the efficiency of the 19th century railroads of the U.S. He characterises the Great Depression as being the result, not of untrammelled and heedlessly self interested free market action, but of the folly of the Federal Reserve system. He writes off pollution as little more than a cosmetic concern; and the furor over product defects such as that of the Corvair as much ado about nothing. The corporate violence of companies such as that which produced thalidomide, he argues, is not in the self-interest of companies because of the effect on reputation; and thus will always be very much the exception rather than the rule. The power of the consumer and the worker to choose the products they buy and the companies they work for; and the competition between companies to attain these customers and workers; are all that are needed to protect each player from exploitation by another. For government to step in, or for executives to listen to their consciences, would mean imposing upon the personal freedom of consumers and workers to make those choices themselves.

It is the position of this thesis that it is this counterargument to the push for regulation and CSR – synthesised in a broad ranging thesis which exalts the free market as the answer to virtually all problems - that has been most powerful in the influence Friedman's work. This thesis thus concentrates primarily on providing a more or less direct counter to Capitalism and Freedom and Free to Choose by synthesising the arguments which show the invalidity of Friedman’s initial counterarguments. The structure, and character of the work are thus constructed with this goal in mind; but to provide a more detailed and academically referenced work than what Friedman provides in either work.

The structure is as follows. Part I has introduced Friedman's concepts and his influence, given a brief on the nature of the problem, and is now introducing the design, structure and method of the work.
Friedman calls himself a 'classical liberal', and touts his ideas as being in the tradition of great economic and philosophic thinkers of the classical liberal tradition such as Adam Smith and John Stuart Mill, giving the impression that he ‘stands on the shoulders of giants’. Part II calls into question these 'classical liberal' credentials, and demonstrates that Friedman's ideas are in fact quite extremist when compared to his predecessors. His conception of the 'Invisible Hand' indeed comes from a quote from Adam Smith; however Chapter 3 shows it to be little more than a grotesque caricature of the complex political economy of Smith, which showed a suspicion of private enterprise, an emphasis on a role for ethics and a quite more expansive role for government than what Friedman advocates. John Stuart Mill (1859/1998) is also characterised as having stated the case for Friedman's philosophy with a quote from his essay *On Liberty* (see Friedman & Friedman, 1990; Friedman, 2002b); but Friedman's political economy again not only fails to appreciate the complexity of Mill's philosophy but even directly contradicts the quote chosen.

Part III addresses Friedman's revisionist position on early capitalism, concentrating on Britain and the U.S.. Friedman has claimed that these represent his ideal and that developments which took place in this period were dependent on their adoption of policies supported by his theories, and that the perceived evils of the period were simply relative to the improvements it produced (Friedman & Friedman, 1990). Part III considers whether indeed people became better off under a Friedman-style policy regime and whether improvements in living standards were dependent upon the extreme free market capitalism which Friedman advocates. The question here (despite how Friedman phrases his praise of the 19th century) is not whether capitalism represented an improvement on the oppressive system of feudalism which came before it, but whether wellbeing was or would have been helped or hindered by a more regulated and ethical transition to capitalism. The evidence presented shows that the early transition actually caused decreases in the wellbeing of many; and that in fact people did not really begin to share in the prosperity of capitalism until regulatory reforms and the union movement stepped in to protect the citizenry from the excesses of the free market. It also traces the rise of the corporations, and evaluates Friedman's views on the supposed efficiency and enterprise of the early railroads.

Part IV more directly covers the flaws in Friedman's assertions about microeconomic issues, while simultaneously giving a clearer picture of the extent of corporate malfeasance than that offered by Friedman. Friedman's assertions about freedom of choice, the distribution and availability of information, the efficacy of the ‘price system’ in performing the functions Friedman attributes to it, the ability of the 'Invisible Hand' of the free market to correct and prevent mistakes, and the effects of regulation are evaluated.

Part V concerns Friedman's assertions about the nature and causes of financial crises, inflation and deflation. Friedman's assertion that the control of the monetary base by financial authorities is the
key to macroeconomic stability, and that discretionary monetary bodies should be replaced with a rule-based expansion of the money supply, is assessed, as are the origins of financial crises and the results of the application of Friedman's policies. A treatment of the current global financial crisis in light of Friedman's theories is presented.

Part VI begins with a consideration of Friedman’s ontological and epistemological positions, including his criteria for the judgement of theory and his ideas on the nature of reality. His contention that theories should not be judged by their assumptions is considered and refuted. It then summarises the historical context in which Friedman's policies have risen to prominence and the current state of the world; and demonstrates the difference between the theorised and actual action of the 'Invisible Hand'. It further offers some elements of an alternative political economy and proposals for curbing the destructive aspects of the 'Invisible Hand' before concluding with a call for continuing research and empirical study which exposes flaws in the free market system.

**2.3 Methodology and Methods**

While acknowledging the heterogeneity of theories of qualitative research, Denzin & Lincoln (2005) offer the following by way of definition:

“Qualitative research is a situated activity that locates the observer in the world. It consists of a set of interpretive, material practices that make the world visible....qualitative researchers study things in their natural settings, attempting to make sense of, or interpret, phenomena in terms of the meanings people bring to them” (Denzin & Lincoln. 2005, p. 3)

This idea of 'locating the observer 'in the world' seems in stark contrast with the quantitative abstractions which form the foundations of Neoclassical economic theory. It is something which Friedman did not embrace in much of his scholarly work (The Optimum Quantity of Money, with its simplistic parable a notable exemplar). However, in his most important works – Capitalism and Freedom; Free to Choose; and even Monetary History; location of the researcher 'in the world' – through the use of history to explain the present – featured heavily (and, it might be argued, contributed to their success). His thesis that people are best off when they are 'free to choose', in spite of the risks inherent in particular behaviours, also seems in the spirit of this definition, embracing subjectivity.

In the debate between the advocates of Neoliberalism and its critics, the use of histories and examples to illustrate the present has been rather a state of the art, at least amongst the most popular works. On the one side, as stated above, Friedman himself did this in his most popular works; but so did Hayek in The Road to Serfdom (1944/2007) and The Constitution of Liberty (1960/2006). On the other, Galbraith's The Affluent Society (1998), Korten's When Corporations Rule the World (1995), Klein's No Logo (2000) and The Shock Doctrine (2007), and Bakan's The Corporation
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(2004) all share an emphasis on history and examples in making their case. However, this is not limited to 20th century and early 21st century works – the method dates back even to the works which formed the very foundations of political economy. Adam Smith’s (1776/1952) The Wealth of Nations contains nary an equation or interview analysis but is nothing if not a collection of historical facts and examples.

The design and methodology of this thesis is in continuity with this tradition in political economic thought. The theories both criticised and espoused in this thesis are analysed in their relation to history and reality. Statistics and quantitative factors are cited and analysed where relevant; as is empirical research – quantitative, qualitative and mixed method - but no attempt will be made here to abstract from reality and model mathematically in the way that much of the specific economics literature does.

However, this thesis will attempt to be more rigorous in its combination of theory and history than many of the works mentioned. Naomi Klein’s (2007) work on The Shock Doctrine sets a high standard for its attention to historical facts and the traceability of those facts through extensive research and detailed referencing; and is a stand out in this regard, far exceeding the empirical rigour of most of Capitalism and Freedom or Free to Choose (which tend to make broad brush generalisations with little-no attention to detail and very limited referencing) as well as Bakan (2004) or Korten (1995). This thesis aims to approach this level of empirical (though accepting some advantage for Klein (2007) in regard to resources and therefore the level of detail); but also to address theory directly in a way that Klein (2007) has chosen not to do.

As to the question of what kind of sources the data will be drawn from, it will first be stated that the nature and broad scope of the subject matter do not lend themselves to the qualitative tradition of direct contact with people in the form of interviews or direct observations. Klein (2000, 2007) and Bakan (2004) use this method in their works, but, quite apart from the greater resources (and in Bakan’s case, access to world famous authorities) of these researchers in comparison to the PhD candidate, in Klein’s case in particular this is ancillary to textual analysis and the analysis and synthesis of secondary data. More to the point, to attempt such an exercise in this case would be, for the most part, an exercise in redundancy and duplication. The data required to answer the stated questions and achieve the objectives of this thesis are already available through the wealth of literature – theoretical, empirical, and historical - on the various facets which this thesis covers. They merely require further analysis and synthesis. Therefore it is from this secondary data that the bulk of this thesis is written.

The direct analysis of primary texts – including, for instance, Smith’s (1776/1952) Wealth of Nations - is also a feature of this thesis. In addition to Friedman; authors whom Friedman cites as his
ideological founders (with Friedman seeing himself as the torch bearer of their tradition) are analysed directly through their works; and the content and meaning of these works compared to that apparently ascribed to them by Friedman.

2.4 Limitations of the Research

Firstly, Milton Friedman has been chosen as the primary theorist on whom this thesis focuses, because of his level of influence in both the institution of policy in recent times and in the management and economic literature. This is necessarily the exclusion of other theorists. However, while neoclassicism still enjoys some degree of heterogeneity, it is Friedman’s extreme ideas which have been the most important drivers of the Neoliberal agenda.

Further, while the level of empirical and historical detail can be seen to largely exceed that of most of Friedman’s *Capitalism and Freedom* or *Free to Choose*, and other major works, the scope of the subject matter and the limitations of the thesis still mean that at times a fairly broad brush approach to history must be taken. Again, however, this can be seen as in the tradition of other comparable works.

While some attempt to address events in other nations is made, there is also a particular bias toward centring the study in the United States in particular, and to a lesser Britain (though the latter receives more attention in discussions of the early history of capitalism due to the central role it played there). The reason for this is simply the central role these nations have played in the world economy, their influence on the policies of other nations (indeed, it may be argued that successive U.S. governments have been more successful in promoting Friedman’s policies overseas than through the polity at home), and their long traditions of capitalism. For a more detailed analysis on the worldwide spread of Friedman’s doctrines in the late 20th and early 21st centuries, see Klein (2007).

Finally, as has been indicated, students of economics may find the lack of mathematical equations and models disconcerting. However, it seems logical (and this is considered more extensively in Chapter 21) that what is important about these models, more than the mathematics is itself, is the extent to which the (often qualitative) inputs and assumptions of such models have been correctly chosen, and whether these models correctly represent reality. Further mathematical modelling, quite simply, is largely unneeded to make these (mainly qualitative) assessments. For a discussion of the flaws of Neoclassical economics in a more mathematically rigorous setting, see Keen (2001).

As explained previously, the following section looks at Friedman's claims to continuity with a 'Classical Liberal' tradition; giving special attention to two authors given particular prominence in Friedman's writing: Adam Smith and John Stuart Mill.
PART II. STANDING ON THE TOES OF GIANTS: THE BETRAYAL OF THE CLASSICAL LIBERALS
3 Adam Smith.

3.1 Introduction to Part II: Friedman as carrying on Smith and Mill's 'Classical Liberal' Legacy.

Friedman (2002, & Friedman, 1990, & Roberts, 2006) is fond of calling himself a 'classical liberal’. In Friedman's eyes, he and Friedrich Hayek were carrying on the 'Classical Liberal' tradition, giving new life to those ideas and philosophies in a world which had strayed too far from them. According to Friedman (2002), the modern term 'liberalism' used in the United States distorts the use of the term which had been prevalent in the late 18th and the 19th centuries. Two authors in particular were of interest to Friedman and are quoted in his work – Adam Smith and John Stuart Mill.

Friedman frequently cites Adam Smith as an ideological ally, particularly with regards to the ‘Invisible Hand’ concept (see Friedman, 2002a; Friedman, 2002b; Friedman & Friedman, 1990). In a 2002 interview, Friedman names Adam Smith's Wealth of Nations as the first of his five favourite libertarian books (Friedman, 2002b). Indeed, Friedman in a way is seen by some (including himself) (see Coates, 2007; Cross & Winslett, 1987; Krugman, 2007; Lantos, 2001; Klein, 2007; Werhane, 2000) as the carrier of the torch of the classical liberal ideals that Adam Smith proposed. New York Times columnist Leonard Silk remarked that “Adam Smith is generally hailed as the father of modern economics and Milton Friedman as his most distinguished spiritual son” (Silk, 1976, p. 43, cited in Van Overtvelt, 2007, p. 91). Smith's name appears on no less than 28 of the pages of Free to Choose (Friedman & Friedman, 1990).

Another important classical liberal figure with whom Friedman claims continuity is John Stuart Mill – indeed it has been said that “Friedman's libertarian ethical view was rooted in John Stuart Mill's On Liberty” (Pasour, 2008, p. 37). In naming his five favourite libertarian books, Friedman (2002, p. S1) cites Mill's essay On Liberty as having made “the most concise and clearest statement of the fundamental libertarian principle, 'The only purpose for which power can be rightfully exercised over any member of a civilised community, against his will, is to prevent harm to others''' and expresses similar sentiments (accompanied by the same quote) in Free to Choose (Friedman & Friedman, 1990).

Friedman's use of Smith and Mill goes beyond merely citing them as influences in the development of his political economy. Friedman has positioned himself as the modern interpreter and disseminator of their political economic legacy. Friedman invokes the names of Smith and Mill to give the impression that his ideas are not merely his own opinions, but part of a greater tradition in philosophical and political economic thought – to “stand on the shoulders of giants” and lend his ideas the weight of those celebrated intellectual titans and champions of liberty. In his discussion of the Chicago School, of which Friedman became the most prominent disciple and teacher, Friedman
(2008, p. 323n) describes how, when questioned on the primacy of self interest in the production of beneficial effects, most Neoclassical economists will attempt “to shift the responsibility for this assumption on to Adam Smith”; while Harcourt (1994/1995, p. 230) laments that “Adam Smith is frequently invoked as the patron saint of freely competitive markets”. Of no one is this more true than Friedman and his followers.

This claim of carrying on the “classical liberal” tradition and being an effective torch-bearer for the political economic legacies of Smith and Mill is examined in the following. Through more careful reading of Smith and Mill, it is shown that, far from being the 'spiritual son' of either Smith or Mill, Friedman has in fact bastardised and co-opted their ideas into an extremist position which their writing expressly contradicts. Smith may indeed have coined the term “the Invisible Hand”, but Friedman's modern interpretation, which has become the dominant one, is stripped of all of Smith's qualifications and concerns; and Friedman's claim that his conception of 'liberty' follows naturally from Mill's is also demonstrated to be little more than a crude parody of Mill's more nuanced political economic thought.

3.2 Smith in Friedman

Friedman uses two particular quotes in an attempt to demonstrate that his idea of business doing the most good when it single mindedly pursues profits is supported in the work of Smith. One is that:

“It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their own advantages. Nobody but a beggar chuses to depend chiefly upon the benevolence of his fellow citizens.” (Smith, 1776/1930, p. 16, cited in Friedman & Friedman, 1990, p. 189).

The other is the 'Invisible Hand' quote itself, abbreviated somewhat here in Friedman:

“As Adam Smith put it, an individual who 'intends only his own gain' is 'led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good” (Friedman & Friedman, 1990, and Smith, 1776/1930 (no page given), cited in Friedman & Friedman, 1990, p. 2).

Indeed, Friedman uses the idea of the 'Invisible Hand' throughout Free to Choose (Friedman & Friedman, 1990) in particular to demonstrate that the self interested actions of business in particular, when freed from regulation, will almost always be beneficial. In this context, Friedman appears to be implying that Smith advocated the same kind of political economy as he was: what Lasch (1995, cited in Bronk, 1998, p. 90) has called the “paradox of a virtuous society based on vicious individuals”, unrestrained by the more visible hand of government. Friedman also gave an address to the Mont Pelerin Society in 1976 entitled “Adam Smith's relevance for 1976”. In it, he goes into more detail on his views of Smith, while also attempting to extrapolate Smith's ideas to policies and
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trends in that era.
Smith's ideas on justice and the role of government, his particular objections to and concerns about certain types of private enterprise (notably corporations), and his particular ideas about ethics and self-interest, are addressed here and compared with Friedman's own political economy and his views on Smith.

3.3 Justice, Liberty and The Role of Government

As outlined, Friedman's (1990, 2002) political economy allows for almost total freedom in economic arrangements, with only coercion and fraud being prohibited within very narrow limits. Similarly, Smith (1776/1952, p. 300) recommends that “every man” be “left perfectly free to pursue his own interest in his own way”, but this as based on an important condition: “as long as he does not violate the laws of justice”. Smith does not in Wealth of Nations go further into what consist the laws of justice; perhaps because he had already articulated these in Theory of Moral Sentiments. Far from Friedman's idea of giving individuals the ‘freedom’ to allow personal choice and contracts to decide what constitutes justice (Friedman, 2002, Friedman & Friedman, 1990), Smith proposes a clear and universal hierarchy:

“The most sacred laws of justice, therefore, those whose violation seems to call loudest for vengeance and punishment, are the laws which guard the life and person of our neighbour; the next are those which guard his property and possessions; and last of all come those which guard what are called his personal rights, or what is due to him from the promise of others.” (Smith, 1790/2002 p. 98)

If ‘justice’, then, preserves life first, property second, and contracts third (as per Theory of Moral Sentiments), then this already calls into question the lack of an obligation to consumers to refrain from harming them or their property as advocated by Friedman. In addition, while Friedman has written on the futility of regulating the rate of interest, Smith (1776/1952) was a staunch advocate of a cap on interest rates (laws against 'usury'), believing that such a cap promoted stability by ensuring that only creditworthy borrowers were lent to. Friedman (1976, p. 9) calls this a “highly uncharacteristic passage”: most likely because it so clearly contradicts his own views. One might speculate that the flagrantly irresponsible lending which characterised the lead up to the Great Depression and the age of Friedman's preeminence from the 1980's to the present (see Part V) might never have occurred.

Friedman (2002; & Friedman, 1990) does admit some role for government in the control of externalities. However, he warns that this should be extremely limited, and consist not in absolute regulation but in a monetary taxation (putting a monetary price charge, for instance, on pollution) – and even then this type of market ‘interference’ should be limited (Friedman, 2002; Friedman & Friedman, 1990). Friedman (& Friedman, 1990) is generally sceptical of the dangers of pollution – not viewing it as a long-term and imperative problem but instead arguing that anti-pollution
measures are something which have only been undertaken for the convenience of wealthier people; at the expense of the ‘lower cost of things’ (p. 257) which pollution would allow. The real long-term health effects and degradation of the biosphere seem of no concern to Friedman. Other than this, Friedman allows for little role for government in regulating commercial behaviour.

Since externalities such as pollution were largely not an issue in Smith’s time, Smith gives little direct account to them, and simply (rightly) assumes that all costs of production are borne by the producer and passed on to the consumer in the form of higher prices. Since they often (as above) violate the rules of justice, they might conceivably fall under the second of the three duties which Smith (1776/1952, p. 300) argues that the ‘sovereign’ (government) must undertake: “first, the duty of protecting the society from violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions”.

In Book 5, Chapter 1 of *Wealth of Nations*, Smith (1776/1952) outlines his ideas regarding ‘the expenses of the sovereign’, including discussion of the extent of warranted government action and the performance the three roles of government he outlines immediately prior. Other than on issues of externalities and other negative impacts of business (which will be expanded upon later), Friedman would seem somewhat in agreement with Smith on the first two issues (though with reservations about the second in terms of harm done by corporations), but on the third Friedman and Smith differ significantly. While Friedman (2002, & Friedman, 1990) advocates privatisation on almost every front - roads, infrastructure, and even education - and goes so far as to argue that, in situations of ‘technical’ monopoly (e.g. railroads), private unregulated monopoly is the best option; Smith is far more cautious; having much less confidence in the ability of private enterprise to best serve the public interest in such cases.

Indeed, unlike Friedman (2002, & Friedman, 1990), whose writings on government consist mostly in describing how oppressive the ‘interference’ of even democratically elected government can be and how it should largely step back and privatise; Smith (1776/1952), while living in a pre-democratic period and so demonstrating a healthy scepticism toward government, nonetheless gives the ‘sovereign’ a greater role than Friedman would advocate (Korten, 1995; Stilwell, 2002). Privatisation was not the sole answer; it was a consideration but one which was to be met with equal scepticism, as the following quote regarding transportation demonstrates:

“*The tolls for the maintenance of a high road cannot with any safety be made the property of private persons. A high road, though entirely neglected, does not become altogether impassable, though a canal does. The proprietors of the tolls of the tolls upon a high road, therefore, might neglect altogether the repair of the road, and yet continue to levy very nearly the same tolls. It is proper, therefore, that the tolls for the maintenance of such a*
Thus Friedman (2002, p. 36) directly contradicts Smith when he lists “publicly owned and operated toll roads” amongst a “far from comprehensive” list of activities which government should not undertake. In fact, Friedman (1976, p. 12) acknowledges his disagreement with Smith on this point, stating that Smith had “insufficient grounds” for making it, but where Smith details his argument on the topic, Friedman simply disagrees and leaves it at that. Friedman (1976) and Smith disagree on a number of other issues in the realm of government, including privatisation of education and the provision of postal services, though Friedman mostly restricts his critique to rhetorical questions (though he goes into more detail on the education issue in *Free to Choose* (Friedman & Friedman, 1990), the implication of which his audience is expected to agree with without further discussion.

As Harcourt (1994/1995) remarks, “Smith approved of the government providing an efficient infrastructure for society”. Smith believed that matters of infrastructure, far from being something which should be the exclusive province of private enterprise, should instead be carefully assessed on a case-by-case basis to determine whether in fact there are built-in protections for the consumer or whether indeed there is the potential for abuse. In the latter case, Smith clearly advocates for government provision.

Further, while in all respects Smith often laments a lack of direct alignment between the self-interest and monetary reward of those employed by the public and their performance of their job (as Friedman seems to make much of); he was more concerned with the simple act of ‘defraying’ the costs of these nonetheless government maintained institutions through an additional payment on those who made direct use of them; which in most cases would supplement, rather than replace, the sponsorship of the ‘sovereign’ (Smith, 1776/1952).

On the whole, Smith's political economy allows for a substantially greater and more complex role for government than Friedman's. Nowhere does he expressly reject the notion of consumer protection, nor indeed the protection of workers, and he does not even reject 'combination' (unionisation) of workers. Bishop (1995) further points out that in fact Smith's suspicions of special interest groups facilitating destructive regulations were exclusively directed at merchants and joint stock companies. Indeed, his tirades on regulation are precisely the opposite of those Friedman most emphasises. Where Friedman (& Friedman, 1990) concerns himself principally with countering consumer and worker protections, Smith's (1776/1952) only real target for deregulation in *Wealth of Nations* is those regulations designed to protect business interests. In this light, Friedman's (1976, p. 3) appeal to “include not only enterprises protected from competition but also trade unions, school teachers, welfare recipients, and so on” among those whose interests regulations should not protect does not appear to have the continuity with Smith's own views that Friedman appears to imply it does.
In fact, Friedman's (1976) discussion of Smith, and his invocation of Smith in the 1976 address to support his own views on particular issues, is replete with arbitrary inferences and the use of quotes which are generally beside the point being made. In discussion of the then proposed Humphrey-Hawkins Bill to target a 3 percent unemployment rate through (presumably Keynesian-style) government measures (p. 4-5), Friedman cites in critique a quote by Smith discouraging the direction of private capital by government, despite the fact that such an employment target would most likely involve direct government employment. Indeed, it is difficult to see how it would otherwise be so – to the knowledge of this researcher, no serious bill in the U.S. has ever been proposed to mandate private enterprise to employ a minimum number of people. He attempts to imply that comments by Smith on the excesses of government in his time (which, again, were principally protections for capitalists as well as the waging of wars) can be used as a direct critique of the consumer protection measures present in 1976 (p. 5-6). In commenting on John Kenneth Galbraith's Affluent Society (originally published 1958), “with its stress on the contrast between private affluence and public squalor”, Friedman asserts that Smith's Wealth of Nations gives a “devastating 1776 review” of these ideas by citing a quote arguing against the prohibition of importing luxury items (p. 6-7). The leaps of extrapolation which Friedman has made in drawing these links between Smith's views and his own appear nothing short of superhuman.

3.4 The Corporation

Smith (1952/1776) was in many ways highly critical of Joint Stock Companies – the corporations of his day - as a form of organisation; suspicious both of the agency relationship and the inclination of managers to act in the best interests of their stockholders; and of the privileges granted them by the state:

“The directors of such companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnership frequently watch over their own….Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventurers. They have, accordingly, very seldom succeeded without an exclusive privilege, and frequently have not succeeded with one. Without an exclusive privilege they have commonly mismanaged the trade. With an exclusive privilege they have both mismanaged and confined it” (Smith, 1952/1776, p. 324)

However, his condemnation was not universal. Smith (1952/1776) did set out conditions under which he felt that the Joint Stock Company could be useful. The primary condition under which it could be successful (without privilege) was that “all the operations ore capable of being reduced to what is called a Routine, or to such a uniformity of method as admits of little or no variation”. However, Smith (1952/1776) made further restrictions upon the circumstances under which such a company would be desirable:
“To establish a joint stock company, however, for any undertaking, merely because such a company might be capable of managing it successfully; or to exempt a particular set of dealers from some of the general laws which take place with regard to all their neighbours, merely because they might be capable of thriving if they had such an exemption, would certainly not be reasonable. To render such an establishment perfectly reasonable, with the circumstance of being reducible to strict rule and method, two other circumstances ought to concur. First, it ought to appear with the clearest evidence that the undertaking is of greater and more general utility than the greater part of common trades; and secondly, that it requires a greater capital than can be easily collected into a private copartney” (Smith, 1952/1776, p. 330-331)

The industries said to have met these conditions were those of banking, the provision of insurance, the management of canals for navigation, and the management of “a canal, an aqueduct, or a great pipe for bridging water to supply a great city”(Smith, 1952/1776, p. 330). This is, of course, in stark contrast with Friedman, who regards corporations as being superior in carrying out almost any enterprise including most of the functions performed by government (Friedman, 2002; Friedman & Friedman, 1990).

3.5 Sympathy, Self Interest, and the Invisible Hand

A more complete version of the ‘Invisible Hand’ quote which Friedman uses in support of his theories reads as follows:

“First, every individual endeavours to employ his capital as near home as he can, and consequently as much as he can in the support of domestic industry; provided always that he can thereby obtain the ordinary, or not a great deal less than the ordinary profits of stock. As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value, every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be the greatest value, he intends only his own gain, and 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. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest, he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it” (Smith, 1776/1952, p. 193-194)

The ‘Invisible Hand’ statement itself was actually used with regard to the use of import tariffs and prohibitions. Smith argued that such regulations do not increase the wealth of the nation, only redirect it. By artificially making the regulated industries more attractive to local merchants, these merchants would be directed to those industries and away from others. Smith argued that, left to their own devices (without these artificial incentives), merchants would either be forced to compete with the foreign imports; or if they were to find that the foreign imports were able to be more effective and efficient at producing the goods than they are; they would redirect their capital to other
industries where they could achieve their own legitimate competitive advantage. Because of the merchant’s natural preferences to be close to home, the merchant will prefer to redirect their capital to domestic rather than foreign industry. The society benefits doubly from cheaper goods (of the type which would otherwise be made more expensive by tariffs) on the one hand and the produce of the additional industry undertaken by local merchants on the other. Thus, the society benefits from the merchants’ being left to pursue their own self-interest without help from intervention by government – the ‘Invisible Hand’ (Smith, 1776/1952).

However, note that the original statement of the ‘Invisible Hand’ depends directly on the merchant being a human being and thus having interests other than maximal monetary gain. The merchant’s “preferring the support of domestic to that of foreign industry” (Smith, 1776/1952, p. 194) is dependant upon the fact that “every individual endeavours to employ his capital as near home as he can” (Smith, 1776/1952, p. 193). The modern corporation has no person, has no concept of ‘home’; and so will employ its capital in that country which maximises its profits; and can divide its capital among many places according to which offers the best profit incentive for that particular process. The ‘race to the bottom’; with poorer countries competing to offer the lowest price of labour and least environmental regulation to attract the investment of the corporate leviathan; is the result.

The fact that Smith is effectively saying that those individuals who trade for their own private interest will increase the wealth of the nation more effectively than those trading purely for the benefit of the ‘public good’ will not be debated here. Smith indeed believed that merchants would be more effective in their trade when they were doing so for themselves more than for charity. However, it does not appear that Smith advocated the idea that in trading for their own interest, people are abrogated of any other sense of social responsibility or personal ethics. Instead, there is much evidence to suggest that the idea of Smith as advocating the sort of amorality which Friedman proposes is a fallacy.

It is important to note that Smith was in fact a Professor of Moral Philosophy at Glasgow University (Lux, 1990; Sen, 1992; Skinner, 1989; Skouser, 2001). In addition to the revered Wealth of Nations, Smith also wrote The Theory of Moral Sentiments(1790/2002; originally published 1750) which outlines his system of moral philosophy. Friedman (2002; & Friedman, 1990) has largely ignored Theory of Moral Sentiments in his popular works, though he does cite it briefly in his 1976 address. Lux (1990), in maintaining that Smith is in fact largely to blame for the development of Neoclassical economics, argues that Smith underwent a change in thinking between writing Theory of Moral Sentiments and Wealth of Nations. Friedman's colleague at Chicago, George Stigler, was also known to have expressly attempted to separate the Adam Smith of Wealth of Nations with the Adam Smith of Theory of Moral Sentiments (Freedman, 2008). It is argued here that, in fact,
Smith’s work in *Theory of Moral Sentiments* provides an ethical framework on which the political economy of *Wealth of Nations* is based; and this is in congruence with other readings including those by Bishop (1995), Harcourt (1994/1995), Montes(2003), Rothschild, 1994; Sen (1992), Skinner (1989), Skousen (2001), Stilwell, (2002), and Werhane (2000); as well as supporting other readings of *Wealth of Nations* not directly referring to *Theory of Moral Sentiments* (Korten, 1995). The fact that Smith wrote several revisions of both books, with the 5th final edition of *Wealth of Nations* published 1789 and the 6th and final edition of *Theory of Moral Sentiments* published 1790, certainly appears to point to point to the idea that Smith's development of theories of political economy did not displace those on moral philosophy (Haakonsen, 2002, in Smith 1790/2002).

*Theory of Moral Sentiments* is written with painstaking attention to detail, but one can nonetheless glean from the book a few basic principles. Firstly, the idea that human beings have an inherent sense of 'sympathy' – “How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to them, though he derives nothing from it, except the pleasure of seeing it” (Smith, 1790/2002, p. 11). This is in contrast with his contemporary Bernard Mandeville’s (1732/1988) assertion that all human actions are essentially selfish and that morality is little more than a hypocritical illusion. The sense of sympathy is said to be based in our ability to imagine ourselves in the position of others; and thus a “fellow-feeling” (Smith, 1790/2002, p. 13) with them. No matter one’s level of morality or particular set of moral or cultural values, then; this sense of sympathy, of having a sense of the pains and joys of others, is the basis of all moral values, and is contained within all people.

Friedman (1976, p. 16) shows awareness of this sense of sympathy in *Theory of Moral Sentiments*, stating that “Smith regarded sympathy as a human characteristic”. However, he goes on to state that sympathy was “itself rare and required to be economised” (ibid). It is difficult to understand how, given the dominant place of ‘sympathy’ in *Theory of Moral Sentiments*, Friedman could mistake Smith for believing that sympathy was a ‘rare’ human characteristic. Indeed, in the very first paragraph of the work, Smith insists of sympathy that it:

“is by no means confined to the virtuous and humane, though they perhaps may feel it with the most exquisite sensibility. The greatest ruffian, the most hardened violator of the laws of society, is not altogether without it” (Smith, 1790/2002, p. 11).

Moreover, while Friedman (1976, & Friedman, 1990) pays lip service to the direction of these sentiments to private charity, asserting that it was greatest in the 19th century when, he contends, greater economic freedom prevailed (he cites no sources on the assertion, and indeed has been known to simply make up such figures (Freedman, 2008)), in fact Friedman's political economy, particularly with regard to corporations, exalts self-interest while prohibiting the exercise of moral
sentiments in the conduct of business (Friedman & Friedman, 1990; Friedman, 2002).

Smith also states that: “In the beneficial or hurtful nature of the effects which the affection aims at, or tends to produce, consists the merit or demerit of the action, the qualities by which is entitled to reward, or is deserving of punishment” (Smith, 1790/2002, p. 22, italics added). The ‘aims’ provision shows that Smith is not the objective, detached consequentialist he is often perceived to be, that indeed intentionality was an important concern for Smith; and this is demonstrable in a number of other sections throughout the work. This also leads to an emphasis on the importance of a sense of justice, as well as the potential benefit of a sense of beneficence; the latter being something which Smith believed not to be entirely necessary, but nonetheless highly desirable. A sense of justice, however, is imperative: “Society may subsist, though not in the most comfortable state, without beneficence, but the prevalence of injustice must utterly destroy it.” (Ibid, p. 101). As discussed, by ‘justice’, Smith clearly means not only the observance of law; but a more universal sense of ethics – a refraining from harming others.

As to the question of whether Smith was an apologist for unlimited greed, again The Theory of Moral Sentiments provides significant evidence to the contrary. Smith states that “to feel much for others, and little for ourselves, that to restrain our selfish, and to indulge our benevolent, affections, constitutes the perfection of human nature; and can alone produce among mankind that harmony of sentiments and passions in which consists their whole grace and propriety.” (Smith, 1790/2002, p. 30). Even from a utilitarian/consequentialist perspective, Smith clearly regards greed as socially destructive when he states that:

“The great source of both the misery and disorders of human life seems to arise from overrating the difference between one permanent situation and another. Avarice overrates the difference between poverty and riches...The person under the influence of...those extravagant passions is not only miserable in his actual situation, but is often disposed to disturb the peace of society in order to arrive at that which he so foolishly admires.” (Ibid, p. 173).

Smith’s conception of self-interest also went well beyond self interest and the desire for material wealth. Indeed, peoples' self interest included people's relationships with their fellow human beings; their desire to not only be praised but be praise worthy; to be both loved and lovable; and to avoid not only being hated but being worthy of hatred. (Smith, 1790/2002).

German scholars have pointed out “Das Adam Smith Problem”: a seeming contradiction that his work in Theory of Moral Sentiments and Wealth of Nations seems to present; , that of emphasising 'sympathy' and altruism on the one hand and self-interest on the other. (Coase, 1976; Freedman, 2008; Haakonssen, 2002, in Smith, 1970/2002; Oakly, 1994; Skouer, 2001). As Haakonssen (2002, in Smith, 1790/2002, p. xxiv) concisely points out, however, “These two ideas...only contradict each

11 The sources I have cited here all vaguely refer to “German philosophers”, “German scholars” or merely “Germans” as I have done here.
other if Smithian sympathy is misinterpreted as benevolence and self-interest wrongly is narrowed to selfishness and then taken to be the reductive basis for all human emotion”. Just as “Corporate Social Responsibility” need not include charity as such, so “self-interest” in business need not exclude consideration of others. Indeed, as Skousen (2001, p. 23) rightly contends, “Smith's ideal society would be infused with virtue, mutual benevolence, and civic laws prohibiting unjust and fraudulent business practices...his 'economic man’ is cooperative and fair without harming others”. Oakley (1994), in attempting to reconcile 'Classical Economic Man' in the work of Smith, similarly writes of a “balance” of sentiments in each human between sympathy and self-interest (see p. 65). Without any sense of responsibility, the Corporation has no such sentiments.

Smith believed that people need one another to produce and obtain the things that each want and need; that each attempting to produce all of the goods and services they want and need themselves is not nearly as effective and efficient as each person or each group of people specialising in one thing or group of things; one product, one action in an assembly, one type of service, etc – essentially, one ‘job’ in the division of labour . People will thus inevitably want things which they do not produce themselves, and thus have to get them from others. In order to obtain these things; rather than relying on the kindness of others, they will be more successful if they offer them something in return – to buy the things they want, be it goods, services, or labour.

If all of this seems elementary, that is because it is the basis of any capitalist system – this idea of exchange, of gaining advantage from the self-interest of others. Rather than relying on mutual kindness; which is often fickle, unpredictable, and unstable; people find it more agreeable all round to offer something in return for the goods and services which they receive, such that the offering from one (e.g. an amount of money) bears some proportion to the offering from the other (e.g. a given amount and quality of goods and/or services). When people provide one another with mutual advantage in this way, when they engage one another’s ‘self-love’, this seems reasonable, and is altogether more reliable than the often transient, fickle, unstable nature of human kindness; whose proportional distribution will depend largely on the temperament of each individual, rather than on an agreed price.

So Smith (1776/1952) regarded self-interest as a tool with which people can induce others to provide the things that they want. It was not however an advocacy of giving organisations carte blanche to pursue profits without heeding the effect of this pursuit on the interest of others. Friedman's cooptation of Smith to support his theories in this respect renders the appearance of Smith's ideas as little more than a crude caricature of their true intention, devoid of the complexity of Smith's thought.

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12 ‘Economic man’ is a term used by conventional Neoclassical economists to describe a person driven solely by the pursuit self-interest.
4 John Stuart Mill

4.1 Mill and Friedman

Ebenstein's (2007) biography of Friedman describes how reading Mill introduced Friedman to libertarian thought, and claims that Friedman was heavily influenced by Mill. More than this, however, Friedman has used Mill's definition of liberty in his writing not merely as a quote from someone whose influence he is citing but as an apparent demonstration of Friedman's own conception of liberty. Mill is also one of the 'classical liberals' whose tradition Friedman claims to be carrying on. In this way, Friedman is attempting to not only cite Mill but to co-opt Mill's ideas to support his own.

As with Smith, however, Friedman's extreme individualism and emphasis on market mechanisms over all others are in stark contrast with Mill's much more qualified political economy and philosophy. As will be shown, much of the content of Friedman's policies and economic analysis directly contradicts Mill's stated positions on the same issues; and for Friedman to claim to be the torch bearer for Mill's philosophy and political economy into the 20th and 21st centuries seems a gross misrepresentation of Mill's ideas.

4.2 On Liberty and its Limits; and Society and its Government

According to Friedman (2002, p. 12), “As liberals, we take the freedom of the individual, or perhaps the family, as our ultimate goal in judging social arrangements”. Friedman conceives of 'freedom' almost exclusively in terms of a freedom of action – being 'free to choose' to largely do whatever one wants to do; to enter into whatever contract one chooses (however harmful others might perceive the contract to be); without interference from government (Friedman & Friedman, 1990; Friedman, 2002). He further states that “in a (free) society freedom has nothing to say about what an individual does with his freedom; it is not an all-embracing ethic. Indeed, a major aim of the liberal is to leave the ethical problem for the individual to wrestle with” - implying a severely limited role for society in determining broad ethical boundaries (Friedman, 2002, p. 12).

Friedman's role for the government is, as has been explained, severely limited. Broadly, fraud and coercion are to be limited; but these things are very much ill-defined, and when Friedman goes into detail about measures to alleviate actions which could easily be interpreted as one or both of these things, he makes his objections clear (Friedman, 2002; Friedman & Friedman, 1990). Friedman does give broad support to antitrust laws, and sees some role for government in the provision of education (though insisting that private schools will better serve the interests of 'consumers') and a base level of poverty alleviation (though exclusively through the provision of cash); but for the most part emphasises the protection of property rights and enforcement of contracts (ibid). He explicitly rejects any attempts at 'fair' distribution of income, emphasising so-called 'equality of opportunity'
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over what he calls ‘equality of outcome’ (Friedman & Friedman, 1990).

Friedman expresses an unwavering faith in the superiority of private ‘free' enterprise over nationalised service provision, even to the point of emphasising a general preference for private unregulated monopolies over government or even private regulated monopolies in cases where a particular service is subject to a largely unavoidable 'technical monopoly' (Friedman, 2002). There is also in Friedman an expression of a sentiment that 'Socialism' in any form is inherently unconducive to personal freedom as he conceives it, and that 'economic freedom' (dependent upon the adoption of a capitalist system) is a necessary condition for 'political freedom' (Friedman, 2002).

Mill expresses many similar sentiments to Friedman – an emphasis on the freedom of the individual; a general distaste for the excessive exercise of authority even in democratically elected governments, lamenting the “tyranny of the majority” (Mill, 1859/1998, p. 8); and an appeal to allow people to decide their own fates. However, Mill’s constraints on the freedom of individual action show a complexity which is simply not evident in Friedman. Consider, for instance, the culpability of inaction. No such concept rears its head in Friedman; and indeed Friedman touts the virtue of self interested action largely to the exclusion of other considerations. In Mill, however; though admitting that the need to compel in this case is often the exception rather than the rule, “A person may cause evil to others not only by his actions but by his inaction, and in either case he is justly accountable to them for the injury....In all things which regard the external relations of the individual, he is de jure amenable to those whose interests are concerned, and if need be, to society as their protector.” (Mill, 1859/1998, p. 15-16). One might consider in this case the instances of companies such as Shell operating in countries under oppressive governments who claim no responsibility for the deaths and oppression of protestors carried out to maintain their interests (see for instance Bakan, 2004; Banerjee, 2008) – these organisations likely see interference in such matters as acceptance of the 'social responsibility' which Friedman so laments (Friedman, 1970/2002; Friedman, 2002).

Where Friedman emphasises the barter and exchange of individuals in individual contracts almost exclusively, Mill also gives greater thought to those actions which cannot be achieved without a general consensus: “inasmuch as the custom cannot be observed without a general consent to that effect.....it may be allowable and right that the law should guarantee to each the observance by others of the custom” (Mill, 1859/1998, p. 100). In On Liberty, Mill (1859/1998) uses the relatively mundane example of the observance of one day of the week for leisure (with provisions made that the few who do work so that others may enjoy leisure are given a “proportional increase in earnings” - Mill, 1859/1998, p. 100); but in Principles of Political Economy the idea of things which must be generally observed to be effective is discussed as a broad exception to laissez faire, and the
example of the regulation of work hours is given (Mill, 1871/2006) – exactly the kind of thing to which Friedman would object.

But this is not all in Mill that justifies the regulation of the production processes of industry – indeed, while insisting that consumers be allowed to make informed choices about the products they buy, even if these choices may cause them physical harm (for instance, in the purchase of 'poisons' and drugs); Mill distinguishes this quite strongly (in a way Friedman does not) from restrictions on how and to what standards these products are made. Consistent with the doctrine that “as soon as any person's conduct affects prejudicially the interests of others, society has jurisdiction over it, and the question whether the general welfare will or will not be promoted by interfering with it, becomes open to discussion” (Mill, 1859/1998, p. 83-84); Mill contends that

“Trade is a social act. Whoever undertakes to sell any description of goods to the public, does what affects the interests of other persons, and of society in general; and thus his conduct, in principle, comes within the jurisdiction of society” (Mill, 1859/1998).

While admitting (on practical, rather than philosophical grounds) that the 'doctrine of Free Trade' is in general the best way of determining prices, Mill also refers to

“the limits of that doctrine; as for example, what amount of public control is admissible for the prevention of fraud by adulteration; how far sanitary precautions, or arrangements to protect workpeople employed in dangerous occupations, should be enforced on employers...that they may be legitimately controlled for these ends, is in principle undeniable” (Mill, 1859/1998, p. 105-106)

Crucially, this shows that Mill has little to none of Friedman's faith in the self interest of business to produce these protections of its own accord. His statement in regard to prohibitions on the sale of drugs and poisons – that “these interferences are objectionable, not as infringements on the liberty of the producer or seller, but on that of the buyer” (Mill, 1859/1998, p. 106) – shows that he in no way share's Friedman's tendency to equate the actions of producers with being necessarily responsive to consumer demands. Indeed, the 'Invisible Hand' argument in this regard is nowhere to be seen in Mill, and in fact On Liberty (Mill, 1859/1998) appears to justify many of the very systems of regulation which Friedman (& Friedman, 1990; Friedman, 2002) so vehemently opposes.

Mill's allowances for the sale of drugs and poisons – and of risky acts in general - are also conditional on informed consent. According to Mill (1859/1998):

“If either a public officer or any one else saw a person attempting to cross a bridge which had been ascertained to be unsafe, and there were no time to warn him of his danger, they might seize him and turn him back, without any real infringement of his liberty; for liberty consists in doing what one desires, and he does not desire to fall into the river....Similar considerations, applied to such a question as the sale of poisons, may enable us to decide which among the possible modes of regulation are or are not contrary to principle. Such a precaution, for example, as that of labeling the drug with some word expressive of its dangerous character, may be enforced
without violation of liberty: the buyer cannot wish not to know that the thing he possesses has poisonous qualities” (Mill, 1859/1998, p. 107).

But the enforcement of warnings – or indeed the investigation of possible negative effects of products for the purpose of warnings – is given no credence by Friedman, who insists that the self interest of business will almost always compel them to make the consumer sufficiently aware (Friedman & Friedman, 1990).

Friedman's preference – in cases of 'technical' monopoly (cases where the nature of an activity tend toward monopoly being the only feasible state) – for private, unregulated provision over government provision or regulation of the provider; essentially giving the private operator free reign (Friedman, 2002). Again, this is in contrast with Mill, who in his Principles generally recommends government provision or tight government oversight in such infrastructural endeavours (Mill, 1871/2006).

4.3 Socialism and Distribution

Mill also demonstrates an inconsistency with Friedman's extreme positions on any form of socialism and the inseparability between individual freedom and competitive capitalism (Friedman & Friedman, 1990; Friedman, 2002). Friedman argues that the view that real 'democratic socialism' can be achieved is a “delusion...a society which is socialist cannot also be democratic, in the sense of guaranteeing individual freedom.....economic freedom is...an indispensable means toward the achievement of political freedom” (Friedman, 2002, p. 8). Mill's (1871/2006; 1879/1967) views on socialism – or at least elements of it – however, are much more temperate, even favourable. Indeed, Heilbroner (1999) in his classic work The Worldly Philosophers places Mill among the 'utopian socialists'.

Most telling of the difference is the fact that, with the exception of what Mill (1871/2006; 1879/1967) calls the 'St Simonist' form of socialism (in which wealth is divided according to the decree of the rulers), Mill's objections to the various forms of socialism and communism proposed at his time are practical rather than being grounded in an overarching sense of freedom; and his conclusions were that these forms should not be dismissed out of hand before they had been tested. According to Mill:

“it must be evident that this system does no violence to any of the general laws by which human action, even in the present imperfect state of moral and intellectual cultivation, is influenced; and that it would be extremely rash to pronounce it incapable of success....With regard to this, as to all other varieties of Socialism, the thing to be desired, and to which they have just claim, is opportunity of trial.....It is for experience to determine how far or how soon any one or more of the possible systems of community of property will be fitted to substitute itself for the 'organisation of industry' based on private ownership of land and capital” (Mill, 1871/2006, p. 213-214)

13 Sadly, the despotic Bolshevik communism with which we now associate the word 'communism' can be said to have had most in common with the 'St Simonist' form as discussed by Mill.
Nor does Mill share Friedman's preference for the 19th century conditions of capitalism (discussed in Part III), even over the socialist thought of the time. In defending the system of private property Mill (1871/2006) argued that, as with the better of the communist systems, the ideal form of a state based on private property had not been tried; but when comparing communism to the state of society in which he lived, Mill contended that “The restraints of Communism would be freedom in comparison with the present condition of the majority of the human race” (Mill, 1871/2006; p. 209). While wary of the potential for creating uniformity and homogeneity in communism; Mill admitted that “this is already one of the glaring evils of the existing state of society” (Mill, 1871/2006, p. 209). For Friedman to write of “golden age in both Great Britain and the United States in the nineteenth century” (Friedman & Friedman, 1990, p. 3) seems directly at odds with such sentiments as expressed by Mill.

The question of how the income of a nation is to be distributed is also one on which Mill and Friedman can be seen to be at odds. Friedman, while insisting that his laissez faire system of free enterprise would create an 'equality of opportunity', laments any attempts by government to promote a greater level of what he called 'equality of outcome', and any attempt to distribute income according to any principle of 'fairness' (Friedman & Friedman, 1990, p. 134). According to Friedman, “there is a fundamental conflict between the ideal of 'fair shares' …...and the ideal of personal liberty” (Friedman & Friedman, 1990, p. 135) (emphasis in original). Again, however, it may be said that Mill's discussions of communism are unsupportive of the idea of such a 'fundamental conflict', and indeed Mill has been known for expounding the idea that, while laws of production were somehow 'natural', the laws of distribution could be decreed according to the desires of society (Heilbroner, 1999; Mill, 1871/2006; Screpanti & Zemagni, 1993; Stilwell, 2006).

### 4.4 On Labour and Labour Unions

A chapter in Free to Choose (Friedman & Friedman, 1990), entitled 'Who Protects the Worker?', is devoted to a tirade on the failings of labour unions. Friedman asserts that labour unions can only raise work and pay standards for their members at the expense of higher unemployment and a higher cost to consumers. Friedman insists that:

“The most reliable and effective protection for most workers is provided by the existence of many employers.....The employers who protect a worker are those who would like to hire him. Their demand for his services makes it in the self-interest of his own employer to pay him the full value of his work. If his own employer doesn't, someone else may be ready to do so. Competition for his services – that is the worker's real protection” (Friedman & Friedman, 1990, p. 246).

This, of course, is an extension of the 'Invisible Hand' argument present throughout Friedman's work.

Again, Friedman's market zealotry can be contrasted with Mill's (1871/2006) more temperate
treatment of the issue. Mill agrees that trade unions cannot raise the wages of workers to any great
degree above the 'market rate' without creating unemployment (1871/2006). However, unlike
Friedman, Mill does not see trade unions as a distortion of the market mechanism – on the contrary,
unions are seen by Mill as a crucial part of it:

“It is a great error to condemn, per se and absolutely, either trades unions or the collective action of
strikes....demand and supply are not physical agencies, which thrust a given amount of wages into a labourer's
hand without the participation of his own will and actions. The market rate is not fixed for him by some self-
acting instrument, but is the result of bargaining between human beings.....those who do not 'haggle' will long
continue to pay, even over a counter, more than the market price for their purchases. Still more might poor
labourers who have to do with rich employers, remain long without the amount of wages which the demand for
their labour would justify, unless, in vernacular phrase, they stood out for it: and how can they stand out for terms
without organised concert? What chance would any labourer have, who struck singly for an advance in wages?
How could he even know whether the state of the market admitted of a rise, except by consultation with his
fellows, naturally leading to concerted action? I do not hesitate to say that associations of labourers, of a nature
similar to trade unions, far from being a hindrance to a free market for labour, are the necessary instrumentality
of that free market; the instrumental means of enabling the sellers of labour to take due care of their own interest
under a system of competition” (Mill, 1871/2006, p. 932) (emphasis added)

Note how, in the above, Mill dismisses out of hand the idea that atomised individual action – the
cornerstone of Friedman's theories (Friedman, 2002; Friedman & Friedman, 1990) – could produce
a correct market price for labour. Clearly, like Smith, Mill has acknowledged what Friedman refuses
to – that there are clear power inequalities between employers and employees; and that
organisations such as labour unions are often a necessary counterbalance to this. The Invisible Hand
is best served at times, not by atomised action, but by individuals binding together.

4.5 Trade, and Infant Industries

Both Friedman and Mill advocate free trade generally, and both have, for the most part, opposed
import tariffs. However, Friedman's extremism is revealed in his unwillingness to consider
exceptions – for instance, the protection of new industries in a country so that local producers may
acquire the skills and knowledge necessary to compete in the international market before exposing
them to free international competition.

While placing the condition that it should only continue for a relatively short time and only in
particular industries which the country has the potential to excel in, Mill makes the case for such
protection as follows:

“The only case in which, on mere principles of political economy, protecting duties can be defensible, is when
they are imposed temporarily (especially in a young and rising nation) in hopes of naturalising a foreign industry,
in itself perfectly suitable to the circumstances of the country. The superiority of one country over another in a
branch of production, often arises only from having begun it sooner. There may be no inherent advantage on one
part, or disadvantage on the other, but only a present superiority of acquired skills and experience. A country
which has this skill and experience yet to acquire, may in other respects be better adapted to the production than those which were earlier in the field: and besides, it is a just remark of Mr. Rae, that nothing has a greater tendency to promote improvements in any branch of production, than its trial under a new set of conditions. But it cannot be expected that individuals should, at their own risk, or rather to their certain loss, introduce a new manufacture, and bear the burden of carrying it on until the producers have been educated up to the level of those with whom the processes are traditional. A protecting duty, continued for a reasonable time, might sometimes be the least inconvenient mode in which the nation can tax itself for the support of such an experiment.” (Mill, 1871/2006, p. 918-919)

However, Friedman (& Friedman, 1990) is categorical in his opposition, describing the argument as a “smokescreen” (ibid p. 49) and asserting that “the so-called infant industries never grow up” (ibid). Friedman insists that all such industries should be exposed to the rigours of free competition from their inception.

4.6 Some Further Remarks

It can be seen from the above discussion of Mill and Smith, that Friedman's claims to being 'classical liberal' carrying on the ideologies and theories of these theorists into the 20th and 21st centuries, are, at best, superficial; at worst wholly erroneous. Certainly, Mill and Smith generally promoted free markets and capitalism, as well as (in Mill's case in particular) individual freedom from government interference; but their beliefs were tempered by exceptions and complications which seem not to be present in Friedman.

Indeed, Friedman's claims that “liberalism has, in the United States, come to have a very different meaning than it did in the nineteenth century” (Friedman, 2002, p. 5) and that he uses “the word liberalism in its original sense” (ibid, p. 6) seem to have no foundation in the writings of the classical liberals here studied. Mill's emphasis on personal freedom while having a concern for workers and inequality; his concerns with consumer protection in certain cases; his view of trade unions as a necessary counterbalance to wealthy employers; his sympathy with the goals of socialism – all seem more consistent with the modern American idea of 'liberalism' than with Friedman's free market ideas. Friedman's 'classical liberal' credentials are little more than a smokescreen.

Part II has put to rest Friedman's (and, by proxy, neoliberalism's) claims of continuity with the ideas of Adam Smith and John Stuart Mill. Part III looks critically at the revisionist history of Smith's and Mill's time put forward by Friedman, looking at a time when he claims his laissez-faire principles were probably most in force; and the reasons behind their ultimate rejection.

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PART III. THE INVISIBLE HAND IN ACTION: FRIEDMAN'S FAVOURITE TIME IN HISTORY
5 The Old Order and the Path to Industrial Capitalism

5.1 Introduction to Part III

According to Friedman, “the combination of economic and political freedom produced a golden age in both Great Britain and the United States in the nineteenth century” (Friedman & Friedman, 1990, p. 3), and has described this time as “the hey day of laissez-faire” (Friedman, 2002, p. 190). Most, Friedman argues, benefited over all from pure market capitalism, and this made the remaining poverty not greater in proportion, but only more conspicuous - “the very progress of society made the residual evils all the more objectionable” (Friedman & Friedman, 1990, p. 4). Friedman's claim amounts to the idea that the 19th century in Britain and the United States more closely approximated his ideal political economic system than other times in history, and that the level of economic 'freedom' during those times accounted for a rapid growth in prosperity which made the hardships endured worthwhile in the aggregate. It is a point (like many others) on which Friedman gives little historical detail, but the implication is nonetheless important: that largely unregulated capitalism is the best way to produce rapid gains in material wellbeing, that the negative effects of unregulated capitalism are necessary to achieve these gains, and that this is clearly demonstrated by an assessment of history. The later attempts to curb these 'residual evils', Friedman would claim, have taken the world down the path of excessive government oppression, without due reason. The 'classical liberal' ideals were abandoned in favour of an interventionist state.

Thus in the very earliest stages of capitalism, there is in some ways a more pure case of Friedman-type theories prevailing in political economy, of the 'Invisible Hand' being allowed to reign free, than in the present day western world. Part III aims to show, through a much more thorough survey of the historical record, that in fact the prosperity described could have benefited (and in Britain ultimately did benefit) from a less extreme form of capitalist development than Friedman advocates. The 'Invisible Hand' emerges as far less than the panacea Friedman imagines it to be. As fundamentally, however, Part III demonstrates the origins of the initial moves toward regulation and greater government intervention in economic life. It shows that the failures of the market were such that they could not but be moderated, and demonstrates that in the British case at least (most American intervention came later), moderating the failures of the market was not accompanied by a slow down in the beneficial effects of capitalism (indeed rather the opposite). In the case of the United States, the chapter also goes on to demonstrate that the creation of the corporate form was

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14 In this section I have used terms, such as 'manufactures', to be found in the literature (particularly the older literature and that of the time described) but which have fallen into disuse; or used other terms such as 'combination' in a way that they were then, but are no longer, used. In the former case in particular, I feel that the fate of such terms is unfortunate, since they are often highly descriptive ('manufactures', for example, is much more specific than simply 'products' or 'goods'). I also think there is some merit to referring to things as they would then have been referred to.
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not the result of a natural progression of capitalist systems, nor a true expression of freedom, but actually went against the principles upon which America was founded, and that far from being an engine of efficiency the unregulated corporation became a harbinger of wealth expropriation and waste facilitated by privileged treatment.

This section begins by placing the improvements which Friedman claims for capitalism in the context of the system which preceded capitalism. It then goes on to document the development of capitalism, its successes and ‘residual evils’; while giving consideration to the reasons for these and for the reasons for the development of regulation to protect citizens. It also evaluates whether these regulations were in fact detrimental to the wellbeing of the society, as Friedman might claim them to be.

5.2 Feudalism..

The period of laissez-faire capitalism must be understood in the context of what came before it: the systems which it essentially replaced. At the time of Adam Smith’s writing Wealth of Nations in the mid-late 1700s, Britain’s economy was in a somewhat transitional phase – “the old order of the Middle Ages was well along its way to breaking up, but a new order to replace it had not yet taken definitive shape” (Lux, 1990, p. 14-15). The ‘old order’ here referred to was the system of feudalism.

Feudalism was built around a system not only of coercion but of mutual obligation and sustenance (Cameron, 1993; Lux, 1990). The privileged lords were charged with providing protection and maintaining order; while under them a peasantry laboured in support of the society, working the land and paying a portion of their production (as much as 50 percent, perhaps more) to the lord (Cameron, 1993; Landes, 1998; Lux, 1990).15 While it could be said to some extent that the lords ‘owned’ the land, it did not have many of the features of ‘property’ or a ‘commodity’ with which ownership is now associated. The lords could not sell the land; indeed (the concept did not exist for some time): the transfer of land (which was rare) could only occur “either by gift deed or by conquest” (Lux, 1990, p. 15). Lords similarly did not “own” the serfs; nor was there any question of a market relationship – the serfs were “bound to the soil. Lords might come and go, but, except in periods of great stress, the peasant cultivators whether nominally free or servile would remain secure in their tenures, protected by the ‘customs of the manor’ and occasionally by documentary evidence” (Cameron, 1993, p. 49).

Peasant artisans lived in the towns; but again did not participate in a market system for labour as

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15 A third role was provided by the clergy, who were said to look “after the spiritual welfare of society” (Cameron, 1993, p. 48)
such. The artisans worked in specialised guilds according to their particular trade or craft. These guilds worked as a kind of artisan collective. They set down specifications which all in that craft would comply with – including the setting of prices, production methods, and quality standards; as well as the conditions of work – they forbade work on Sundays and other holidays, as well as at night. The system was based on a set of moral principles, and the sense that the moral considerations trumped the commercial (Landes, 1998; Lux, 1990).

These systems did afford the participants some degree of security. However, they were oppressive in the extent to which they limited life choices – there was little made of the modern concept of ‘freedom’. There was also enormous inequality between the lords (who made up only about five percent of the population) and the rest of the population (Cameron, 1993); and the peasants were also often vulnerable to the whims of the former (Lux, 1990). That capitalist development might provide an improvement upon this situation does not seem unlikely, but there is not here any reason to suppose that Friedman's particular brand would provide any more of an improvement than a more moderate or even leftist one.

5.3 Enclosure and Private Property

As implied earlier, by the 1700s much of this institutional framework had been undermined (Cameron, 1993; Landes, 1998; Lux, 1990). Beginning in the 1000s but not making consistent progress until the 15th Century, the lords, in order to garner economic advantage, began to fence the commons and claim them as their own property (ibid). This had the effect of displacing (and often impoverishing) the peasants who had previously relied upon the commons (Hobson, 1965/1926; Lux, 1990):

“It was by no means willingly that they left the land to become migrating groups of displaced and vagrant poor, eventually to be transformed into the wage labourers and factory workers of the British industrial system. In just one sixteenth-century riot protesting this displacement, some thirty-five hundred people were killed” (Lux, 1990, p. 18).

While Landes (1998) praises enclosure for helping create incentive for economic development, there can be little doubt this displacement caused much harm to the poorer, unlanded classes, at least in the short-term (Hobson, 1965/1926; Lux, 1990).

In any case, by the mid 1700s more than half of all arable land in England had been enclosed; but this picked up pace considerably after a series of enclosures by an act of Parliament after 1760 (Cameron, 1993; Landes, 1998; Lux, 1990). Agriculture was now carried out “either by yeomen or by free tenants; agricultural labourers, themselves often owners of small plots inadequate for their sustenance, were hired as needed” (Landes, 1998, p. 238). Feudalism and serfdom in the old sense were apparently well on their way to being phased out without any sudden or violent abolition or revolution (Cameron, 1993; Landes, 1998). Private property was now well and truly
institutionalised.

By the mid-18th century, Britain was already in many ways capitalist. Though there was still comparatively little industrialisation, a number of the necessary conditions for capitalism were satisfied by that time. The bulk of manual labour was by now carried out, not by independents producing products for their own sale and profit, but by workers earning a wage and employed by people who largely owned the means of production. This was facilitated by the investment in means of production by such employers; who presumably had some wealth which was not required for current consumption (Hobson, 1926/1965). Cole (1952, p.32) also points out that the institutions which facilitate capitalism – “rich merchants, joint-stock concerns, banks and credit agencies, and even trade unions” - had already gone a long way toward being developed. However, Cole (1952) elaborates that its capitalism was based more primarily on trade and the operations of merchants who purchased and resold finished products made by a number of small-scale producers than on the concentration of employment and production into large factories. Merchants and traders, therefore, were of central concern in the British economy of the time, and were much favoured by policies.

5.4 Mercantilism

Smith (1952/1776) dubbed the dominant economic system of his time the ‘Mercantile system’; and is said to have popularised this title. More recently it has been referred to simply as ‘Mercantilism’.16

The policy of the time was heavily nationalistic and concerned with wealth largely in the interest of increasing the power of the nation and the finance of wars and conquest; rather than increasing the actual prosperity of the common people. One of the basic foundations of mercantilism was the notion that the accumulation of gold and silver was the primary method of increasing the wealth of a nation (Cameron, 1993; Grampp, 1944; Hobson, 1965/1926; Lux, 1990; Smith, 1952/1776). Regulation was concerned not with increasing the population’s ability to better their lives through increased purchasing power; nor with protecting both the worker and the consumer from exploitation by manufacturers; but instead with reducing the costs of production (for instance, through downward regulation of wages) and increasing the favourability of trade so that the merchants and the State could acquire for themselves more riches. Smith (1952/1776) was highly critical of these policies; and in fact a large proportion of Wealth of Nations is a direct critique of the mercantile system.

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16 Cameron (1993) argues that to describe the economic policies of the time as a coherent system is inaccurate; as it was constructed as a series of reasonably disparate measures; which Smith somewhat artificially attempted to systematise. However, Cameron (1993) does go on to describe some basic artifices of the economy of the time; and it is in such a set of artifices that we can broadly refer to a system of ‘mercantilism’.
5.5 The Early Joint-Stock Companies

The legal framework granting business enterprises with the distinctive characteristics of a modern corporation (i.e. limited liability for stockholders; separation of ownership and management; and the creation of an entity separate from the people who consist it) began to appear in Britain toward the end of the 16th century (Bakan, 2004; May, 2006). Many of the early corporate charters, such as the Muscovy Company (1555) and the East India Trading Company (1600); included grants of monopoly in the trade of goods with a certain part of the world (Cameron, 1993; Hobson, 1967/1926; Iyer; 2006; May, 2006). Many of these had their own private armies to facilitate their interests abroad. In the late 18th century, for instance, the East India Company essentially gained imperial rule of India in a form of privatised colonisation (Iyer, 2006).

By the late 15th and early 16th centuries, heedless speculation in the area of joint stock companies was rife (Bakan, 2004; Henderson, 2000; May, 2006). Investments were made in everything from the Joint Stock Company for Transporting One Hundred Maids to be Made Wives, to a Company for Carrying out an Undertaking of Great Advantage But No One to Know What It Is (in the latter case the promoter disappeared with the two thousand pounds raised before any undertaking could be carried out) (Henderson, 2000). From 1690 to 1695; ninety three corporations traded – this number was reduced to twenty by 1698 (Bakan, 2004). The separation of ownership and control allowed directors to gamble heedlessly with other people’s money; often with knowingly fraudulent statements about the company’s prospects (Bakan, 2004; Henderson, 2000; Iyer; 2006; May, 2006).

The South Sea Bubble of the early 18th century would become a watershed example of this (Bakan, 2004; Cameron, 1993; Garber, 1990; Henderson, 2000; Iyer, 2006; Lal; 2006; Landes, 1998; May, 2006; Temin & Voth, 2004). In 1711, the South Sea Company was granted a monopoly over (British) trade in the South Seas; and this was ostensibly the reason for its formation. The prospects of this, however, were limited given Spain’s control over South America; and the company did only very limited trade (ibid). Its real primary source of revenue was through loans to finance the government’s prosecution of the Anglo-Spanish war (Cameron, 1993; Garber, 1990; Iyer, 2006; Lal; 2006; Temin & Voth, 2004). In 1719, the company directors made a bid to massively increase the proportion of debt which they would assume for the government, and used, among other measures, significant bribery of officials to ensure the bid’s success (despite a competing bid from the Bank of England) (ibid). This generated speculation based on the potential return from interest rates and the

17 Banking and insurance were other important industries of early joint-stock companies (Cameron, 1993; Hobson, 1967/1926).

18 The Company would be ended in 1858; as Britain assumed direct control over India – Queen Victoria became Empress of Hindustan (Iyer, 2006).
share price rose steadily (ibid); however, the company’s directors sparked further speculation by spreading false stories of the possibility of a deal with Spain which would facilitate its originally stated trading goals (Bakan, 2004; Iyer, 2006).

At this time, seeing the success of the South Sea Company, a large number of new ventures, many of them wholly fraudulent, sprung up and began generating speculation of their own; and existing companies also experienced a rise in share price (Garber, 1990; Iyer, 2006; Temin & Voth, 2004). The company’s directors, wishing to increase market confidence (and rid the company of revenue competition), petitioned parliament such that in June of 1720, the ‘Bubble Act’ was passed, banning the formation of joint-stock companies without specific royal charters (ibid). The company’s stock price, having briefly stalled, rose again rapidly after the passing of the act (Iyert, 2006). Now the directors began to sell. Others followed suit and the price fell steadily – eventually to 135 pounds in September, having reached 1000 pounds at the end of June, leaving thousands bankrupt (ibid). Despite public outrage, the company’s directors largely escaped serious punishment – fines were incurred but no jail time (Bakan, 2004; Garber, 1990).

The Bubble Act remained in place for 105 years until its repeal in 1825. During this time; the government heavily restricted the formation of corporations (Bakan, 2004; Cameron, 1993; Lal, 2006; Landes, 1998; May, 2006). According to Landes (1998):

“Big projects typically went to large partnerships with assets vested in trustees. Not a happy solution in a world of unlimited liability ‘to the last shilling and acre’. Yet the absence of serious legal change for a century testifies to the solidity of these undertakings and the general vitality of the British economy” (Landes, 1998, p. 257)

Indeed, the Act did not prevent the advent of the Industrial Revolution; which was already well on its way in England by 1825 (Cameron, 1993).

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19 Bakan’s (2004) analysis of the case appears to imply that the Bubble Act was passed in the wake of the South Sea Company’s decline as a direct reaction against the directors of the company – in fact, the Act was passed before the decline of the company; which seems more supportive of the contention that the Act was passed at their behest.
6 The Precipitation of Revolution

6.1 Introduction

Beginning some time during the 18th Century, a series of social, commercial and technological developments occurred in England which resulted in the transition from an economy based primarily in agriculture, and one whose manufactures were produced primarily by people working from their own homes (who often owned their own tools); to one in which the majority of the population was engaged in the production of manufactures, where a greater proportion of the population lived not in rural villages but in towns and cities, and in which production was centralised into a series of factories owned by employers (Ashton, 1961/1948; Cameron, 1993; Cole, 1952; Cootes, 1968; Hobson 1965/1926; Landes, 1998). It was also one in which the use of human skill and effort was in many cases replaced (or at least supplemented) by the use of the precise regularity of machines; and in which inanimate sources of power (using the conversion of heat, produced by the burning of mineral fuels, into productive force) was substituted for animate sources (ibid). This period of transition was to become known as the ‘Industrial Revolution (ibid).’

Cameron (1993) argues that the term ‘revolution’ in this regard is a patent misnomer; pointing to the gradual nature of development leading up to, and over the course of, the period. Ashton (1961/1948, p. 2) agrees that “The word ‘revolution’ implies a suddenness of change that is not, in fact, characteristic of economic processes”. Indeed, mercantile capitalism was still largely the status quo during the early stages of the ‘revolution’, and this had already been in existence for centuries; and industrialisation continued well after the mid-19th century dates which many date as the end of the Industrial Revolution (Ashton, 1961/1948; Ashworth, 1952; Landes, 1998). The inventions which better facilitated the use of machinery had already begun to appear at least by the late 17th century; and other precipitating factors had their origins before then. Landes (1998, p. 187), however, reconciles the term by defining it in such a way as to be inclusive of the key element of an “instance of great change or alteration in affairs or some particular thing”, while acknowledging the gradual nature of that alteration - emphasising “deep rather than fast” change. Some of these changes, such as enclosure, have already been alluded to above. The following considers more

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Cameron (1993) rightly argues that specific dates given to the onset and end of the ‘industrial revolution’ are strictly arbitrary; and so here I will refrain from attempting to provide one. While the progress of laissez faire can be traced with some accuracy by looking at legislative dates; there is no such marker for the ‘industrial revolution’. Thus; a necessarily vague beginning period ‘mid-late 18th century’ is here offered; which is consistent with the bulk of dates offered; though many of the inventions and processes which enabled this ‘revolution’ occurred before this time (see Ashton, 1961/1948; Cameron, 1993; Cole, 1952; Hobsbawm, 1957; Landes, 1998; Taylor, 1975). I will further offer no end period to the ‘industrial revolution’ (some have offered the mid-19th century; but it is again difficult to perceive any slow in the progress of industrialisation by this time) and instead end the period covered in this chapter with the end of the Victorian age in Britain and of the ‘Gilded Age’ in the United States.
directly the factors which precipitated the onset and progress of the ‘industrial revolution’ in England (where it occurred first).

6.2 Agriculture

Landes (1998, p. 214) notes that “one can hardly exaggerate the contribution of agricultural improvement to Britain’s industrialisation”. The changes in agriculture which occurred leading up to and during this period served two main purposes in the development of England as an industrialised nation. One was to increase the productivity of the land to an extent that the (increasingly populous) nation could be fed by a smaller proportion of the population engaging directly in the production of food. The second was to cause a large proportion of those who had previously been agrarian producers to seek employment as wage-labourers in the manufacturing industries in the towns and cities; either by ‘freeing’ them from the land or driving them off of it (Cole, 1952; Cootes, 1968; Hobson, 1965/1926; Mantoux, 1966; Thompson, 1980).

Despite advantages in terms of facilitating cooperative work arrangements and use of resources, the open field system of agriculture under the feudal system had limited innovation in agriculture. By allowing for unilateral experimentation in new and more effective methods, the process of enclosure, however callously and oppressively it was instituted, would facilitate the innovation and subsequent increased productivity in agriculture necessary to feed an industrialised nation. These combined innovations greatly increased the overall productivity of agriculture beyond that of subsistence to one which could support a greater number of people (Cameron, 1993; Cootes, 1968).

However, a disproportional cost of these new innovations was borne by the poorest among the peasantry, who were given little or no consideration in the process of enclosure, especially those enclosures carried out after 1760. Those who had no papers to demonstrate their holdings were evicted from their land; and even those with such proof were often forced to pay the expenses of enclosure (hedging, fencing, and the expenses of the Parliamentary Commissions who carried out the enclosure) without being able to afford it, forcing them to sell to the highest bidder. None were seen to have claim to the commons, on which they had previously been allowed to graze their livestock - this was simply claimed by the landed aristocracy. This created in many cases a state where the land which they did own was insufficient to meet their subsistence; forcing them to seek employment elsewhere (Cole, 1952; Cootes, 1968; Hobson, 1965/1926; Mantoux, 1966; Thompson, 1980).

The ownership of agricultural land (and production) thus became more concentrated in a few hands, and a “proletariat of dispossessed cultivators” (Hobson, 1965/1926, p. 13) was created in England. It would initially be among these people, driven from their homes, that the new industrial capitalists
would find cheap wage labour to work the new machinery of the industrial revolution.

### 6.3 Industrial Invention

The simultaneous occurrences of the improvement of agricultural method and the displacement of people previously tied to the land could not in themselves, however, facilitate anything which might feasibly be described as an ‘industrial revolution’. Industrialisation required the development both of industrial machinery and of a more efficient means of powering it.

The most important developments in industrial machinery in terms of the transition to the factory system occurred in the textile industries, which had hitherto been characterised by a slow and labour-intensive process of production. The establishment of the earliest modern industrial factory occurred in the silk industry in the 1720s using mechanical techniques brought from Italy, and by about 1760 silk would be an established factory industry (Cootes, 1968). Toward the middle of the 18th century, innovations would spread to the much more important wool and cotton industries, so that by the early 19th the transfer of cotton spinning from being a home-based activity to one carried out in factories was near completion by the early 19th century (Ashton, 1961; Cootes, 1968). It was the introduction of steam power, however, which would give manufacturers real choice in selecting sites to establish factories (Cootes, 1968; Mantoux, 1966).

Like the development of agriculture, the new inventions also had less direct social implications through the displacement of people from their traditional ways of living and working. The poor people who had previously eked out an important source of income from home-based hand spinning were naturally uneasy about the new concentration of production in large factories.\(^{21}\)

### 6.4 The Improvement of Transportation

The widespread construction and use of the machinery and the trade in the goods it helped produced, however, could not have been achieved adequately to produce an industrial revolution without the aid of a more efficient transportation system than could previously be seen in Britain. The implementation of not only improvement in roads but, much more importantly, of the construction of canals, would provide this system to facilitate the beginning of the industrial revolution (Cameron, 1993; Deane, 1965; Landes, 1998).

Landes (1998, p. 215) takes rather a Friedman-like position on the improvement of transportation: he insists that the superior development of Britain’s canal and road systems is attributable to “a simple reason: nowhere else were roads and canals typically the work of private enterprise, hence responsive to need (rather than to prestige or military concerns) and profitable to users”. This is a misleading oversimplification of the problem. Certainly, private enterprise was superior to the

\(^{21}\) Hargreaves of the spinning ‘jenny’ had his house vandalised by angry hand-spinners in 1767.
unpaid labour of people with no interest in the maintenance of the systems which had characterised previous methods. However, to attribute the advantage solely to private enterprise ignores the aforementioned natural advantages in water systems which Britain enjoyed. As importantly, though, it assumes that private enterprise has a monopoly over responsiveness to need – which makes an assumption about the nature of government which, while probably in many ways true of the government of the time; is not a necessary fact. For instance, government coordination was eventually required to better link the disparate qualities of turnpike roads (Cootes, 1968). It is also important to note that the roads were not initially run by profit making enterprises as such (Cameron, 1993)

### 6.5 Empire, Trade and Commerce

Even all of these factors – the development of agricultural methods and relationships (and the displacement which this caused), the progress in the invention of industrial machinery and the means of powering it, and the development of more efficient means of transportation; could not have produced an industrial revolution in Britain at that time without the advantages gained by trade with other nations – of the importation of goods which could not be adequately produced (or at least not with any advantage) in the mother country; and of the access to markets for the new industrial produce beyond those afforded by the domestic trade. Cole (1952) states the case:

“Invention in industry, though we are apt to think of it as the main cause of British economic growth, came rather as a response to widening commercial opportunities than as the original stimulus to the extension of trade; but of course it soon reacted powerfully on commercial development. The rapid growth of British prosperity depended mainly not on improved methods of production but on the successful expansion of markets abroad, which gave the merchant not only the means of disposing of a gradually increasing quantity of British goods but also a position of pre-eminence in the entrepôt trade with Europe in both Asiatic and American products. British industry was doubtless quick to respond to these expanding opportunities, but the original impetus came much more from commerce than from industry itself” (Cole, 1952, p. 36)

However, there is no sign here of ‘free trade’ – mercantilism, protectionism and imperialism were still largely in force for the bulk of the period ascribed to the industrial revolution. The Navigation Acts (of 1651, 1660 and 1663) in particular sought to protect British merchants and to establish a framework for the most profitable exploitation of the colonies in the interest of the Nation (Hobson, 1965/1926). Though they would be adjusted frequently over time, they remained consistent in three major tenets (Cootes, 1968).

The first stipulated that all trade between British colonies (and between Britain and its colonies) was to be transported in British or colonial ships. This had less a commercial intent than one concerned with defence – it was designed to stimulate the British shipping industry, and through this, more importantly, the training of a large cohort of seamen who could be employed in the defence of the
nation in time of war.  

The second gave Britain a monopoly over the provision of manufactures to its colonies. This included not only a prohibition of importation from other countries but of production in their own countries – in effect a coerced trade. Thus there was a guaranteed market for the British manufacturers; free from competition with other nations. This in turn would help generate the sales needed to make the new industrial factories economical.

The third prohibited the colonies from exporting particular commodities (among them sugar, tobacco, cotton and rice) to nations not of the British empire (Cootes, 1968). This had two important effects for Britain. First, it provided Britain with a relatively cheap supply of raw materials (in particular cotton) for the production of the manufactures which it was to resell to these same colonies; in addition to the cheap supply of consumer goods for the nation’s populace. Second, it allowed British merchants to then re-export the goods to the European continent; which provided an important addition to their revenues.

The navigation acts were just one part of a general use of force and coercion by the British. The British textile industry benefited from the destruction of the Indian textile industry not only by way of protective regulation but by more brutal methods which included cutting off the thumbs of Indian master weavers (Banerjee, 2008) while also forcing other Indians to cultivate indigo. This in addition to the use of forced slave labour from Africa (Banerjee, 2008; Eltis & Engerman, 2000; Singhal, 2001).

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22 Smith (1952/1776, p. 197) gave this aspect his grudging admiration on these defence grounds – though he insisted that it was “not favourable to foreign commerce, or to the growth of that opulence which can arise from it”.
7 British Industrialisation

7.1 Revolutions: Industrial and Otherwise

E.P. Thompson (1980) is emphatic about the importance of the French Revolution (begun 1789) in the making of the English working class; and, while not directly a reorganisation of the English economy, no discussion of the period would be complete or even adequate without giving some attention to its influence. The Revolution, apparently inspired by the American rebels from some decades before, began in 1789 after accusations that the aristocracy and monarchy had been living extravagantly and reaping undeserved rewards while the country’s people suffered. When the concerns of the parties went unheeded open and violent revolution broke out, with a large number of murders and executions; including among others the King Louis XVI and his Queen Marie-Antoinette.

Why this discussion in a section concerned primarily with the progress of economic development? Immediately obvious is its role in the precipitation of wars in which England was involved – first with the revolutionaries who were attempting to spread revolution across the globe, and second with the imperial ambition of Napoleon, the latter’s ascendance to power having been facilitated by the initial revolution and reaction against it. Both of these had dire effects for the poor in particular. ‘Press gangs’ of sailors forcibly recruited men into Britain’s understaffed (and underpaid) military (over 10% of the British population were serving in the military by the later stages of the conflicts (Cootes, 1968). The poor were also forced to increase their share in financing the wars through increased taxation. Further, the scarcity of wheat brought about by trade blockades meant that corn (wheat) prices during the time of the wars with France escalated to particularly high levels; which benefited the wealthy landowning farmers though the agricultural labourers who worked the land existed nonetheless on starvation wages, while the people as a whole had to pay substantially more for bread, and the factory workers also suffered severe unemployment due to the restrictions in trade from the blockades.

As significant (and perhaps more pertinent to this thesis), however, may have been the Revolution’s role in; on the one hand, striking fear into the hearts of the aristocracy and the landed interests (who had spectacularly been the target of the French revolution); and on the other, emboldening and inspiring those who had not yet felt the benefit of industrialisation, and rightly felt themselves unjustly unrepresented in the process of government, to speak out and to engage more forcefully in advocation of their own interests – in planting, as Thomson (1980) puts it, the ‘liberty tree’. This helped to precipitate new efforts by the landed and wealthy classes (who clearly had the government’s ear and in many cases, unlike the poorer, unlanded classes, the right to engage in the political process) to protect their interests with legislation and exclude the poor from governance.
and the determination of policy. It also, however, helped give rise to a number of associations of working class people pursuing involvement in policy and freedom from the oppressive conditions of the emergent industrial capitalist system. Finally, they hoped to use regulation for their own advantage rather than continue to allow their oppression by the powerful to go on unabated. These will be further discussed in the following.

7.2 The Plight of the Working Class in the Late 18th and Early 19th Centuries – an overview

The years of war with France would also mark a substantial increase in the rate of enclosure. In the 22 years between 1793 (the beginning of open hostilities with France) and 1815 (the year of the battle of Waterloo and Napoleon’s defeat), over 1,900 acts occurred, compared to 1,355 for the previous 33 years (Cootes, 1968), forcing more off of the commonly held land and into paid employment. Despite the progress of industrialisation, the majority of the population was still engaged in agriculture until quite late in the process of industrialisation – and as explained previously these workers were among the worst paid.

Under reforms to the Poor Law (a system originally set up in the late 16th century in order to provide relief to the poor) in the late 18th and early 19th century, which would become known as the Allowance or Speenhamland System, parishes who collected rates for the assistance of the poor, unemployed, disabled and destitute; would now assist those actually in employment; enabling the capitalist farmers to keep wages down further while their workers were forced to accept charity and the parish expenses greatly increased. Later, in 1834, parliament passed the Poor Law Amendment Act (to be known as the ‘New Poor Law’) (Cole, 1948; Cole, 1952; Cootes, 1968; Thompson, 1980).

Thompson (1980, p.295) describes this as “perhaps the most sustained attempt to impose an ideological dogma, in defiance of the evidence of human need, in English history”. The principle purpose of the New Poor Law was to deter people as much as possible from seeking poor relief and force them into the workforce (Cole, 1948; Cootes, 1968; Thompson, 1980). Under this, the unemployed were forced to enter workhouses, deliberately made, as an assistant commissioner of the period remarked, “as like prisons as possible” (cited in Thompson, 1980, p. 295), in order to obtain poor relief. Conditions in these workhouses were indeed quite appalling and resembled those of a prison – deliberately designed to be even worse than the very worst of those provided by private employers (Cole, 1948, Cootes, 1968; Thompson, 1980). Food was provided at barely subsistence level, and Cootes (1968, p. 131) notes that at times “inmates were fed in a trough like pigs, six at a time”. Families were separated, as were the sexes; possessions were confiscated for the duration of stays; visitors were prohibited as was drinking and smoking; meals were made silent,
and strict obedience and discipline was enforced – this in addition to the hard labour served. At times the physically ill would be looked after by the mentally ill in unsanitary workhouse infirmaries. Children, destitute mothers and those forced to enter the workhouses due to old age were mixed indiscriminately with hardened criminals. Some preferred to face starvation rather than enter a workhouse – but still Thompson (1980) cites statistics showing dramatic increases in the number of people in the workhouses between 1838 and 1843 - “The most eloquent testimony to the depths of poverty is in the fact that they were tenanted at all”. (Thompson, 1980, p. 296).

The conditions in the factories and mines will now be discussed. Of these it is tempting to simply say that this is a subject which has had so much written about it that it need not be repeated here. However it is felt that it us important to remind the reader of these things lest they have been forgotten (or, rather, deemphasised by those such as Friedman seeking to paint a more favourable picture); and perhaps even to illuminate some aspects which may have escaped some readings on the subject.

Mantoux (1966) contrasts the conditions of factory workers with those of the home-based workers who were their predecessors, supporting the above assertions of the decrease in leisure and freedom of the worker, the creation of an “impassable gulf” (p. 409) between employer and employed and a depersonalisation of such relationships. A ‘journeyman spinner’ of the period airs some of the grievances in this regard:

“There they are (and if late a few minutes, a quarter of a day is stopped in wages) locked up until night in rooms heated above the hottest days we have had this summer, and allowed no time, except three quarters of an hour dinner in the whole day: whatever they eat at any other time must be as they are at work. The negro slave in the West Indies, if he works under a scorching sun, has probably a little breeze of air sometimes to fan him: he has a space of ground, and time allowed to cultivate it. The English spinner slave no enjoyment of the open atmosphere and breezes of heaven. Locked up in factories eight stories high, he has no relaxation till the ponderous engine stops, and then he goes home to get refreshed for the next day; no time for sweet association with his family; they are all alike fatigued and exhausted” (cited in Thompson, 1980, p. 220).

Landes (1998, p. 210) notes that there was difficulty finding labour for the early factories among these tradesmen - "Where, then, did the early mill owners find their labour force? Where else but among those who could not say no? In England that meant children, often conscripted (bought) from the poorhouses, and women, especially the young unmarrieds”. Eventually they would be joined by those forced out of their previous employment, and offered such little alternative under the Poor Laws.

The deterioration in the character of child labour is perhaps most illustrative of the dysfunctional nature of early industrialisation. Child labour was by no means new, and children of preindustrial home workers frequently worked long hours assisting their parents. However, it can at least be said that they were under the instruction of their parents, who presumably in most cases cared sincerely
about their wellbeing, and would adjust the workloads on human terms. They worked in the home, and they learned important skills which could be used in future self-employment. This was not the case with the 'parish apprentices' forced to work in the factories - their workload, conditions and skill levels were dictated solely by the drive for profit and efficiencies.

Children were chosen for a number of reasons: their small size made them ideal in certain situations, they were more easily made to obey, and they were cheap, fetching only a small fraction of an adult wage or sometimes simply meagre food and lodging. Many of the early factory workers were orphans and the poor (who had come under the 'care' of the Poor Law authorities due to the poverty of their parents) forcefully sent by the parishes charged with their care (who had 'sold' them to the factory owners) to be imprisoned in the factories for a number of years (Cole, 1948; Mantoux, 1966; Thompson, 1980). The wage earning labourers, repulsed at the prospects offered for them in these occupations, at first refused to send their children, but were eventually “driven by want” (Mantoux, 1966, p. 411) to do so.

The factory children worked days of 14 to 18 hours. They were frequently beaten and whipped – not only as punishment for even the most minor fault or mistake, but to increase efficiency by forcing them to work harder and keep them awake when they fell asleep from exhaustion. Thompson (1980, p. 382) relates a story told by a minister of the time of:

“a boy who had been found standing asleep with his arms full of wool and had been beaten awake. This day he had worked seventeen hours; he was carried home by his father, was unable to eat his supper, awoke at 4 a.m. the next morning and asked his brothers if they could see the lights of the mill as he was afraid of being late, and then died. (His younger brother, aged nine, had died previously: the father was ‘sober and industrious’, a Sunday school teacher.)” (Thompson, 1980, p. 382)

The factories themselves were overcrowded and unventilated, the ceilings low, the air thick with dust and moisture from various elements of the production processes, the food provided often rancid and insufficient - all in the name of efficiency. Disease - including lung diseases reminiscent of the asbestosis of the present age - was widespread in this unseemly environment, but it was not only this which tainted the health of the children. The pitiful hours left to sleep after the excessively long and hard day of labour, the cramped conditions and the nature of the labour itself forced upon young children (as young as five or six) ensured the misery and ill-health of these vulnerable employees at a crucial time of their development; and those that survived the apprenticeship often grew with "crooked backs, and limbs deformed by rickets or mutilated by accidents with machinery" (Mantoux, 1966, p.16). Suicide attempts were not uncommon as the children attempted to escape their plight. At the end of their arduous tenure, few of these children were left with skills in a trade which would help them in future employment, so narrow were the tasks assigned them.
The adults also suffered with long hours in these harsh working conditions - Voth (2003, p. 224) points out that “while hours were not short in 1750, they increased by approximately 20-35 percent over the following century” - and suffered similar health affects. Meal times in the preregulatory environment were left to the discretion of the employer, and even when an agreement had been made that these would be provided for a certain period of the day, these would frequently be shortened by such underhanded tactics as speeding up the progress of the factory clock during mealtimes (Mantoux, 1966). Though they were not bound in the same way that the children were, to say that they were expressing their freedom in choosing these conditions is highly dubious.

F.D. Eden, "a disciple of Adam Smith" (Mantoux, 1966, p. 418), remarked that "The man who has only the unsubstantial property of labour to offer in exchange for the real visible produce of landed property, and whose daily wants require daily exertion, must, it may be said, from the very nature of his situation, be almost entirely at the mercy of his employer"; and the employment relationships brought about during the 'Industrial Revolution' only served to exaggerate this inequality of power. Left 'free' to pursue profits without obligations to workers' health and wellbeing, in an environment where no real protection for the unemployed and the worker existed to ensure that any minimum standards were met, these early capitalist employers (and the legislators who supported them) demonstrated the folly of unregulated capitalism.

### 7.3 Combination and Unionisation

Given the conditions described above, and the limited political power which the working class enjoyed, it seems unsurprising that the early period of industrialisation in the 18th Century saw the birth of the trade union movement in Britain. Mantoux (1966) explains the lack of any real trade unionism and the temporary and contingent nature of combination prior to the 18th Century by citing the difference in the relationship between employer and employed which emerged during that period:

“As long as the distinction between master and man working side by side in small workshops is almost negligible, as long as the journeyman can cherish the hope of one day becoming a master, grievances and disputes remain unconnected incidents without much significance. It is only when two distinct classes of men are formed, the capitalist employers on the one hand and the wage-earners on the other, with no hope for the vast majority ever to be admitted to the more favoured class, that the opposition of interests becomes permanent fact, that instead of temporary combinations permanent societies make their appearance, and that strikes follow one another like engagements in a lasting contest” (Mantoux, 1966, p. 75)

Town-based organisations known as ‘trade clubs’ began to emerge in the early 18th Century. These generally involved parleys on the acceptance of new apprentices and putting aside money for members suffering unemployment, but when the need arose they could combine against employers who desired to cut wages or refused increases in response to the cost of living. Wool combers,
tailors and weavers were among the first to combine in this way.

Strikes, occasionally accompanied by violent riots, became gradually more frequent over the course of the eighteenth century, with varying degrees of success – though not all of these were the result of action by permanent unions. Often they were merely “a spontaneous reaction to human hunger or oppression” (Ashton, 1948/1961, p. 133), and the combination and organisation disbanded as soon as the action had been settled (win or lose). The employers, however, remained at an advantage: strikers could be prosecuted for ‘conspiracy in restraint of trade’, and various acts of parliament were passed specifically against unions and strike action in particular trades. For instance, an Act prohibiting weavers from combining to increase their wages or otherwise regulate trade was passed in 1725; the penalties for strike action included jail time, transportation to Australia; and in the case of vandalism or personal threats could even incur the death penalty (Mantoux, 1966). Despite this, by the end of the 18th century many of the trades in many parts of England had formed into trade unions.

In 1799 and 1800 two acts of parliament, to be known as the Combination Acts, set a penalty of up to three months imprisonment (with hard labour) for any attempt by workers to engage in any combined action designed to raise wages or regulate working hours, codifying what had effectively been legal policy previously into a more federalized and simple system. While the acts were not invoked in prosecutions as much as might otherwise be expected, their prohibitive effect was ubiquitous, and many trade unions were driven out of existence. However, while its effectiveness was limited and strikes occurred much less frequently, the trade union movement continued (most often in secret).

In theory, the Combination Acts also applied to employers. However, though they doubtlessly infringed the Acts often, the concentrated power which employers enjoyed meant that proof of a conspiratorial combination was nearly impossible. As Deane (1965, p. 149) puts it, “Who could prevent a group of three or four employers – who might effectively constitute the whole of the employers’ side of the wage bargain in any particular region - from entering into a gentleman’s agreement to reduce wages?”. In contrast, the fact that a combination of employees required the concerted effort of many on the same issue meant that employers could easily invoke the Act and call in the police or even the military whenever their interests were threatened.

The Acts of 1799 and 1800 were not repealed until 1824, after a campaign led by a London tailor named Francis Place around 1820 and supported by M.P. Joseph Hume. This not only repealed the

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23 Interestingly, Place was not generally a union advocate, and had opposed union demands in the past. In fact he believed that the Combination Laws were largely the only thing keeping trade unionism alive, and that their repeal would allow employees and employers to bargain in a more cooperative way (Thompson, 1980). His optimism (or cynicism) is strangely replicated in the rhetoric of the advocates of the ‘human resources’ approach to employment relations.
Combination Acts but gave trade unions a new legitimacy by explicitly prohibiting prosecution for the formation of trade unions. The previously repressed activities of the unions were now allowed to commence unabated, and a spate of strikes sprung up across England. However, by 1825 outraged employers, among others, had successfully lobbied parliament to reinstate elements of the previous acts – persuasion or intimidation of non-unionists became an offence, and unionists were “not allowed to ‘molest’ or ‘obstruct’ either employers or fellow workers”, effectively making strike action somewhat difficult (Cootes, 1968; Thompson, 1980).

However, the provision for the formation of trade unions – an important step – remained, and the union movement gathered pace. The first truly national trade union, the Grand General Union of Spinners, was formed in 1829, and in 1830 its architect, John Doherty, orchestrated the ambitious project of a National Association for the Protection of Labour, which aimed to unite all trades in Britain. It lasted only two years, but during this time claimed membership of over 100,000; and in 1833 it would be replaced by a Grand National Consolidated Trades Union (GNCTU), with over 500,000 members from a wide variety of trades (Cootes, 1968; Thomson, 1980). However, the GNCTU would soon suffer a critical setback after several members of a union which was to join the GNCTU were sentenced to transportation to Australia for taking an oath to the union. The law under which they were prosecuted was one designed to prevent naval mutinies. The GNCTU, its members now more fearful of action, fell apart soon after.

For a time, though it did continue, trade unionism would take a back seat to combination for general political action and parliamentary reform. The ‘Chartist movement’, for instance, was born in the late 1830’s after a union put forward a Charter of political demands to create greater equality of political say and counter the growing political power of the moneyed factory owners, though this was put down rather swiftly (as was a later attempt to revive it) (Cole, 1948; Cootes, 1968; Rayner, 1931; Thomson, 1980).

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24 The latter was the brainchild of one Robert Owen. Owen was interestingly himself an employer, but one who distinguished himself quite markedly from many of his contemporaries. In 1800 he had become the managing partner of the cotton mills of New Lanark (in Scotland); but rather than taking the cost minimisation approach of his competitors, instead set out deliberately to improve the lives of the 2000 workers in his employ. Hours were limited to ten and a half per day, but high wages were also paid; and even in sickness or temporary periods of unemployment his employees could count on a wage. But his paternalism went further than this. He improved the (previously very poor) housing in the area; opened shops where his employees could buy essentials at cost price; and provided free schooling to children under the age of ten. His employees, as Rayner (1931, p. 103) puts it, were given “every incentive to self-respect and self-improvement”. Despite these expenditures, he still made good profits, and the New Lanark mills became famous (Cootes, 1968; Rayner, 1931; Thomson, 1980). Robert Owen was not only a philanthropist but also a radical idealist with a liberal world view (he often spoke out against the oppressions of organised religion) and a vision of a cooperative, more than a competitive, society, and had tried, unsuccessfully, at various times over the early 19th century to push his agenda in parliament and to set up communities according to this vision.

25 After a prolonged and widely popular protest, the government eventually granted pardon to the members in 1836; but by now the overall damage was done.
It was not until the 1850s that trade unions would again begin to feature prominently. Perhaps somewhat ironically, it was at first among the better paid workers that unions gained greater ascendancy; but they did so with a fresh strategy. While previous unions had attempted to circumvent the market mechanism, these attempted to make more advantageous use of market powers. For instance, many of the unions servicing various crafts concentrated on restricting the number of apprentices in these crafts at any one time, thus increasing the scarcity of their labour and its value according to the forces of supply and demand. These unions were also better funded, and in the event of a strike could support members long enough to engage in a convincing siege. However, these more centralised trade unions preferred negotiation over strike action (Cootes, 1968).

An important forward step was taken in 1868, with the formation of the Trade Union Congress (TUC). Unlike the previous two attempts at a multi-industrial, concerted union effort; which sought to amalgamate various unions into a single organisation; the TUC was rather a congress for the establishment of common policy among a number of unions. This was a more lasting arrangement and within a few years the delegates to the TUC represented members totalling over a million. Trade Unions were also to find greater legal protection for their practices; with an 1871 act of parliament granting them the ability to register and have their property (as organisations) protected under law; and later an 1875 act removing the restrictions on nonviolent picketing and making conspiracy laws no longer applicable to union activity (Cole, 1948; Cootes, 1968; Rayner, 1931; Thompson, 1980).

At first, however, such well-organised and funded organisations as emerged in the 1850s could not be the reality for the lowest paid workers; and these, who perhaps most needed the support of organisation, remained largely unorganised. Thus their efforts remained haphazard and, occasionally (when violence occurred), in fact detrimental to their purpose. Again, the unions were able to gain greater strength when their members were in stronger bargaining positions anyway – favourable market conditions (near full employment) resulted in the success of several strikes in the late 1880s because employers were unable to replace striking workers with others. The new working class unions which emerged during the late 19th century tended to enroll workers on an industrial, rather

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26 One of the more successful working class combinations of this period occurred in Rochdale; where in 1844 a group of weavers saved up to form a Cooperative store to supply basic commodities such as flour, oatmeal and butter; unadulterated by the watering down that was commonly undertaken by shopkeepers of the time. The store supplied these to anyone at normal prices, but distributed the profits (after running cost and a payment of five percent, interest on the original capital) not just to the original investors but among all of the customers; in proportion to how much they had bought in the store previously. The customers could then reinvest these dividends into the store for a share in the interest; and regardless all had a direct stake in the success of the business. Soon other, similar cooperatives were formed in other parts of Britain; and these eventually amalgamated into one very large cooperative, which by the 1930s had over 40 million pounds in capital and boasted one sixth of Britain’s population as cooperators (Rayner, 1931).
than a craft basis; and tended to be very willing to use their newfound market power and legal protection in industrial action when their demands for improved wages and working conditions were refused by employers.

7.4 The Corn Laws and Trade

One of the most important repeals of regulation, meanwhile, was not a consumer protection measure or piece of workers’ rights legislation but one designed to protect private enterprises. The advent of the Corn Laws was one of the few situations in which the working class found themselves side by side with their employers in political action. In the first place, it was a tax on everyone for the sole benefit of the landowners and farmers – and this was disproportionately so for the working classes; who would have to pay a greatly inflated price for their bread. Indeed, Thompson (1980, p. 348) notes that “When the Corn Laws were passed in 1815, the Houses of Parliament had to be defended from the populace by troops”. The agricultural workers, still the worst paid of all workers in Britain, received no benefit from the laws in the form of better wages (ibid).

But the manufacturers had a further interest in their repeal. Adopting the theories of Smith and other economists on trade, it was argued that Britain should allow itself to specialise in manufacturing for export, allowing other countries to provide food if they could do so more efficiently. If the tariffs on imports were to be removed, it was argued, then consumers would benefit from cheaper goods on the one hand (also allowing the possibility of driving wages even further down); but, more importantly, the increased revenue which people in foreign countries attained by selling this food would also in turn be used to buy British manufactures (Cootes, 1968).

7.5 Industrial Progress, The March of Early Reform and the Improvement in the Plight of the Worker

Industry continued to progress through the 19th century, and prosperity increased (Cameron, 1993; Rayner, 1931). The British rail lines made particularly strong progress in this time, and by 1852, most of the main lines of modern day England had been completed (Cootes, 1968). The rail lines were primarily the work of private enterprise, and, given the large amount of capital involved, this was mainly in the form of joint-stock companies. 1825 had seen the repeal of the Bubble Act, which had severely restricted the formation of joint stock companies. While in force since its passing in 1720, The Bubble Act had required separate acts of Parliament for the formation of joint stock companies; after 1825 this became easier, though at this stage the formation of joint stock companies and the granting of limited liability was still a special privilege granted by royal charter and not given to just anyone, and the companies were only granted charters for specific actions (for

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27 Previously, very large partnerships had often come to be called ‘companies’, but there was no separate legal entity as in a joint stock company; and there was certainly no limited liability.
example the building of a particular railway) (Rayner, 1931). The broader conception of the corporation had not yet taken root.

However, this was also facilitated by reforms and regulations. Somewhat contrary to Friedman's assertions, in Britain at least, the recognition that greater government action needed to be taken in the protection of the populace by the mid 19th century (in concert, interestingly enough, with the increase of political freedom and democracy). A Factory Act of 1933 concerned principally with limiting the hours worked by children was admittedly of the sort which Friedman (& Friedman, 1990) gives approval to, but successive acts, driven by union agitation, sought to limit such things as the exorbitant work hours which prevailed at the time (Cole, 1948; Cootes, 1968; Rayner, 1931).

While an adherence to laissez-faire principles, and lobbying by commercial interests (notably private water companies appalled at the idea that they might actually have to supply sanitary water), had prevented it from doing so previously, the British government also became increasingly interventionist in ensuring public health from the 1870s (Cootes, 1968; Szreter, 2003). This was in recognition of a public health crisis caused by the unregulated capitalism of the past century – with no particular epidemic to contend with, life expectancy in the 1830s and 1840s “plummeted to levels not seen since the crisis years of the Black Death” (Szreter, 2003, p. 424) – a point which is perhaps one of the clearest contradictions of Friedman's argument regarding residual evils in an over all improvement. In addition to the lack of clean water, an 1842 report on the sanitary conditions among the working classes showed “hundreds of thousands of families living in waterlogged cellars, terrible overcrowding in damp, unventilated houses; unpaved streets full of refuse, and an almost total lack of proper drainage and sewage disposal” (Cootes, 1968). The measures taken by government included both public provision of sanitation and clean water and regulation of building to ensure health; producing dramatic improvements in health and life expectancy.

Other forms of regulation had also begun by then, including worker protection of conditions and one of the earliest forms of consumer legislation was enacted in 1844, compelling train providers to provide seats for third-class passengers (Cootes, 1968). Nor did this increased regulation coincide with any decline in the rate of economic development – indeed, real (inflation adjusted) wages did not improve in earnest until this time (Cole, 1948; Tucker, 1935/1975; Voth, 2003), and economic growth was substantially more pronounced after the 1850s than before (Ashworth, 1952; Voth, 2003).

So it can be said that in Britain at least, regulation necessarily developed as a reaction to the ills of the time; and that it also paralleled an increase in the political voice of the common worker. As
importantly, it did not appear to hinder the progress of industry in the way that Friedman might theorise. The United States, however, was slower to embrace regulation, and perhaps more persistent in its faith in free markets. Moreover, it was in the United States that private corporations would gain new prominence.
8 America's Laissez-Faire and the Rise of the Corporation

8.1 Introduction

The discussion now turns to the development and ascendancy of America (later the United States) in the 19th Century. Milton Friedman cites 19th Century America as being even more representative of his ultimate vision of a prosperous, ‘free society’ than England; due to the fact that “it started with a clean slate: fewer vestiges of class and status; fewer government restraints; a more fertile field for energy, drive, and innovation; and an empty continent to conquer” (Friedman & Friedman, 1990, p. 3). In saying that America had ‘fewer governmental restraints’, Friedman appears to place more value on the fact that America had much fewer safety and labour regulations than on the fact that Britain became much freer in its trade while America remained heavily protectionist. Lux (1990) similarly cites the ‘guilded age’ after the civil war in the United States as the closest approximation of the world which conventional economists envision; though his views of the outcomes it produced (and would produce were it to be repeated) are far less favourable than Friedman’s. These outcomes are here examined.

It is also important to note that it was in America that the modern corporation most gained ascendancy (Korten, 1995; Nace, 2003; Perrow, 2002). It was also in America, rather than Britain, that the corporation developed its current form and gained ascendancy as a dominant economic institution. In Britain, the old trading companies were steadily being phased out of existence; with their monopolies revoked most were unable to survive in a competitive economy. The British enterprises which built their railroads were often localized, and the new joint stock companies were essentially seen as partnerships between the interests of private capital and those of the state, and thus heavily regulated (Perrow, 2002). The American corporation began in perhaps an even more heavily regulated environment; but as the 19th century progressed, rather than the increasing regulation seen in Britain, the 19th century saw a steady decrease in the restrictions applied to the corporation while its rights were expanded; giving rise to the ravenously profit seeking enterprises now seen (Bakan, 2004; Davis, 1905/1971; Korten, 1995; Nace, 2003; Perrow, 2002). Friedman's discussions of 'corporate social responsibility' become particularly relevant here.

8.2 The American Revolution and the Early Attempts to Curb the Corporation

As America first established itself as a republic after the Revolution of 1776, there were few signs that it would become the centre of corporate capitalism, and indeed the corporation was viewed with suspicion in the early Republic (Korten, 1995; Nace, 2002; Perrow, 2002). Britain’s trading
companies; among them the East India Company, Hudson’s Bay Company, and the Virginia Company; had been instruments of colonial control and exploitation in America before the Revolution; with the Navigation Acts protecting their interests. Indeed, Nace (2002) suggests that the American Revolution was at least in some part “an anticorporate revolt” (p. 39) and that the Boston Tea Party (the event largely regarded to have begun the Revolution) was at least as much an economic action as a political one – “a well-targeted attempt to block the British East India Company from carrying out a specific plan to monopolise American commodities markets, starting with tea” (p. 42). It seems natural, therefore, that the people charged with determining the early republic’s constitution and early legal framework initially set out to limit the power which corporations could accumulate; while still recognising the potential advantages the corporate form offered (Maier, 1993; Nace, 2002). Thus the debate regarding corporations which was undertaken during the late 18th century centred more on the limitations to be placed on corporations than on the privileges to be granted to them.

The fears of corporations which were expressed during these early times were in many ways similar to those expressed today, and in some cases influenced by those expressed by Adam Smith – that, if insufficiently regulated, the privileges granted corporations could potentially limit the freedom of others and the effectiveness of the market; that they would lead to excessive concentration and maldistribution of wealth and power (and drive out smaller capitalists); and that they might use their wealth to influence governments (Maier, 1993; Nace, 2002; Perrow, 2002). It should also be noted that these fears were certainly not anticapitalist in their nature; indeed the fear was not that capitalism itself was the problem, but that the corporation could limit the beneficial effects of market capitalism by concentrating these benefits in the hands of a few – “that some foolish and wanton assembly may parcel out the commonwealth into little aristocracies, and so overturn the nature of our government without remedy” (‘A Connecticut Newspaper’, 1787; cited in Perrow, 2002, p. 34).

So, how to limit the corporation so that society could reap its benefits without suffering its most grievous potential consequences? The debate at the 1787 constitutional convention centred first on who should be charged with controlling the corporation. When it was proposed that charters should be issued federally, many states opposed the idea on the grounds that “granting such powers to a central government created the risk that an American version of the East India Company might come into being.” (Nace, 2002, p. 47); and even a proposal granting the federal government limited powers to grant charters in particular cases was rejected. It was argued that the authority to grant charters should be kept to as local a level as was feasible. Ultimately, no mention of corporations was made in the constitution; and the power to grant charters would rest with the states (Nace, 2002).
The restrictive attitude toward corporations remained through much of the early life of the republic. The early attitude toward incorporation was that it should be granted for public, rather than private, interests (Maier, 1993; Nace, 2002; Perrow, 2002). An 1809 statement by the Virginia Supreme Court indicated its opinion that if an applicant’s “object is merely private or selfish; if it is detrimental to, or not promotive of, the public good”, then no charter should be granted (Nace, 2002, p. 49). Charters were not issued in industries and situations where nonchartered businesses were already in successful operation; and charters were, for the most part, restricted to such quasi-public works as bridges, canals, toll roads, banks, and the like (Maier, 1993; Nace, 2002). It should be noted that, for the most part, this restricted use of the corporate charter can be seen to meet Smith’s (1952/1776) aforementioned conditions for the desirable function of the joint stock company.

The restrictions which charters placed on the corporation in early 19th century America were numerous. The charter was issued for a limited period of time (typically between twenty and thirty years), after which time a renewal would have to be applied for. The corporation would be limited to performing a specific task (for instance building a particular canal way), often with specified performance requirements (e.g. completion dates and production output minima); and with activities falling outside of the corporation’s charter expressly banned. Further, its property ownership was limited to that which was needed for the performance of this task. Corporations were generally limited in where they could operate (most often restricted to the state in which their charter was granted), and were also generally not allowed to own stock in other corporations. Reinforcing the idea of the corporation as a public institution rather than a profit making machine for private enterprise, regulation limited the amount of capital which a corporation could control as well as the profit it could make; and in some cases profits were to be used to buy back stock, such that private investors (stockholders) would ultimately be eliminated and the corporation would become “a public entity under the supervision of the state legislature” (Nace, 2002, p. 51). Corporations were prevented from being dominated by large individual investors with requirements for a minimum number of stockholders and leveraging such that small stockholders had greater proportional power. Perhaps most significantly, limited liability was not generally granted; so that shareholders would remain responsible for the debts of the company from which they stood to benefit (Estes, 1996; Korten, 1995; Nace, 2002).

**8.3 Expansion under the Law**

Until at the 1840s most industry in America was carried out on a relatively small, local scale (Chandler, 1977; Josephson, 1934; Korten, 1995). Craft artisans, often working from their homes, and farmers were still predominant during this period (Chandler, 1977; Korten, 1995), and the use
of machines and machine-based labour was mostly limited to the textile and arms industries (Chandler, 1977; Perrow, 2002). The ownership of business was usually individual or among a small group of partners, rather than corporations (Chandler, 1977; Nace, 2002). Despite this, economic growth was fast – output of manufacturing goods increased by 59 percent per decade on average between 1809 and 1839, by a massive 153 percent in the 140s, and by 60 percent in the 1850s, so that by 1860 America’s per capita manufacturing output was exceeded only by England’s (Nace, 2002). Technological advancement in the 19th century in some cases surpassed that of England (Cameron, 1993; Landes, 1998). At least in the early periods, average per capita incomes were also higher and conditions better in America than in Europe (Cameron, 1993; Landes, 1998). Josephson (1934, p. 5) also notes that “although there were instances enough of large inequalities of wealth and power, there was more individual equality than in other countries”.

Despite this, the potential usefulness of the corporation had already been recognised, and the number of acts of incorporation soon began to rise (Nace, 2002). However, the aforementioned restrictive attitude toward corporations remained through much of the early life of the republic.

The charter under which the corporation was incorporated thus became a powerful instrument of government in the regulation of corporations. If governments felt that a corporation had failed to meet the conditions of its charter, the charter could be revoked, effectively dismantling the corporation. For example, a turnpike corporation could have its charter revoked for failing to keep its roads in adequate repair. In the year 1832, the state of Pennsylvania revoked the charters of no less than ten banks. Private enterprise was allowed to profit, but only so long as the state was able to gauge the benefits it provided (Nace, 2002).

Nonetheless, the early factories of the period were already beginning to demonstrate the potentially harmful effects of unregulated capitalism (Perrow; 2002). Though generally owned by merchants in the traditional partnership firm, the merchant owners, often distant from the factories themselves, placed the management of the mill’s day to day operations in the care of a salaried agent (Chandler, 1977) - anticipating, to a degree, the agency relationship which would come to characterise large organisations . According to Perrow (2002, p. 54) “The Manayunk mills (in Philadelphia) were…quite possibly more exploitative than similar mills in Britain, contrary to most impressions today”. The American factory labourers never received the regulatory protections which progressed through the 19th century in Britain. A standard day’s work was twelve hours (even for children as young as 7 performing hard labour), but because workers were paid a daily, rather than an hourly rate, the natural inclination of employers seeking greater productivity was to extend the work day further. Meanwhile the a late arrival of as little as fifteen minutes was punished with the loss of a full quarter of a day’s wages, while one day off without a reason deemed adequate would result in a penalty of two days’ wages. Poverty and propertylessness increased in the factory towns while the
factory owners grew exceedingly wealthy (Perrow, 2002).

8.4 Expansion Above the Law

Chandler’s (1977) assessment attributes the rise of the corporation as a business form in the United States after the 1840s and particularly during and after the Civil War primarily to the productive need for larger organisations due to technological developments, and early on particularly in building railroads. However, this assessment fails to adequately acknowledge the crucial role played by developments in the legal framework regulating corporations (Bakan, 2004; Estes, 1996; Korten, 1995; Nace, 2002; Perrow, 2002).

As early as the 1810s, the legal limitations which the founders of the Republic had sought to place on corporations were already beginning to be undermined. The Dartmouth decision in the Supreme Court was one of the earliest examples of this (Korten, 1995; Nace, 2002; Perrow, 2002). Dartmouth College was a private college based in New Hampshire which was tax exempt and had other concessions under the law. Wishing to ensure greater accountability to the public interest, the state of New Hampshire wished to appoint trustees to the school board to help oversee the college’s operations (Perrow, 2002). The state’s petition was supported by Thomas Jefferson, another whom Milton Friedman claims as an ideological ally, quoting him and favorably discussing to his principles several times in Free to Choose (Friedman & Friedman, 1990).

“had written to the governor, (saying) ‘The idea that institutions, established for the use of the nation, cannot be touched or modified….may perhaps be a salutory provision against the abuses of a monarch, but it is most absurd against the nation itself’. To make a corporate charter sacrosanct, said Jefferson, would amount to a belief that ‘the earth belongs to the dead and not to the living’” (Nace, 2002, p. 85).

According to Perrow (2002, p. 41), “Chief Justice John Marshall was presiding over the Supreme Court, and he managed the case carefully, delaying it until he had a secure majority on the court and bringing up to the court’s review other cases that could help it”. However, the Supreme Court ruled in favour of Dartmouth; effectively enforcing the idea that a corporation, like a living, breathing person, has its own private rights. While future charters included a right of revocation in the

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28 It is worth briefly discussing Chandler’s (1977) work here. Chandler’s (1977) central proposition was that the development of modern business enterprises run by professional managers effectively replaced the ‘Invisible Hand’ of the market in determining the allocation and distribution of resources. However, while the researcher would agree with Chandler that the modern corporation demonstrates unprecedented levels of concentrated market power, there is disagreement with his thesis on a number of grounds. The point has already been made that Smith has been misinterpreted in the modern conception of the ‘Invisible Hand’. Further, it is contended that concentration of market power does not preclude the preeminence of market forces – indeed it may be argued that concentration is a natural progression in a truly free market. Finally, the idea that there was ever an even playing field between business, consumers and employees in an unregulated market in the way that the ‘Invisible Hand’ theory proposes is, it may be argued, demonstrably false, as shown by the current discussion in this thesis. The so-called ‘visible hand’ of management did not replace the free market – its power has simply been the natural progression of it.

29 See Chapters 1 and 5 of Free to Choose for Friedman's conflation of Jefferson's philosophy with his own. On pages 4-5 of the 1990 edition used here he particularly emphasises that attempts to regulate industry betrayed Jefferson's vision.
contract, by granting the corporation private rights, the Court set a precedent for the unravelling of the special regulations which the founders of the Republic had intended for corporations (Korten, 1995; Nace, 2002; Perrow, 2002). From here the progress of limiting and pairing back the regulation of corporations continued quite steadily over the course of the century. The legal advantages of corporations began to exceed those of individuals – a poor individual might be jailed for inability to service a debt of a few dollars, while large debts of corporations required only the surrender of corporate assets (Perrow, 2002).

Nor could the public now expect to be protected from the deleterious effects of the production processes of corporations. Protections for workers were explicitly denied – the blame for workplace injuries (and deaths) was placed solely on the worker, with no liability for the business (Perrow, 2002). Consumers were similarly placed at risk – “the common-law principle of implied warranty was overridden and replaced by a free-market doctrine that held, for example, that commerce would end if everyone could seek redress for implied warranties, and the person who could not look after his own interests in entering into a contract does not deserve judicial guardianship” (Perrow, 2002, p. 45). Meanwhile, society would be expected to wear the costs of any externalities caused, without recompense – for instance, an 1839 decision in Kentucky ruled that the pollution and noise to which residents of Louisville would be exposed by a railroad that was to run through it was simply a necessary side effect of the progress of industry and transport (Perrow, 2002).

### 8.5 The Gilded Age and the Railroads

In the mid-19th century, two important and related developments facilitated the more rapid ascent of corporate power and American industrialization. One was the increasing demand for building railroads, which became a dominant feature of American development from about the 1840s (Chandler, 1977; Josephson, 1934; Perrow, 2002; Trachtenberg, 2007). The other was the advent of the U.S. Civil War (1861-65) (Josephson, 1934; Korten, 1995; Lux, 1990; Nace, 2002; Trachtenberg, 2007). Both created an economic impetus for large-scale industrial production and distribution systems, while the disarray caused by the Civil War facilitated a political climate even more favourable to corporate interests.

With its vast expanses of land, industrialising America was characterized by a regional division of labour and economic activity which could be said to have exceeded that of any other single nation of the time (Cameron, 1993; Landes, 1998). Broadly, the South remained largely agrarian while the bulk of early industrial production occurred in the Northern states, but there were also divisions in terms of resources. Thus the impetus for the creation of large scale transportation systems was great. The only question was as to who would build such a system. While some argued for state provision, the spirit of laissez faire was embraced and the task was given to private enterprise; usually in the
form of chartered corporations.

Friedman cites the 19th century railroads in particular as exemplary of the benefits of free market capitalism, while lamenting later attempts to regulate it (Friedman & Friedman, 1990). According to Friedman, the railroads of the time were "highly competitive" (Friedman & Friedman, 1990, p. 196) and produced a veritable golden age for consumers tarnished only by "stories of financial manipulation and skullduggery". He celebrates the achievements of the largely unregulated private companies and laments the 1887 establishment of the Interstate Commerce Commission as ruining an otherwise spectacularly productive industry. According to Friedman, in the absence of the ICC the railroad industry would today be "leaner but more efficient as a result of greater technological innovation under the spur of competition" (Friedman & Friedman, 1990, p. 202).

There is little evidence that the provision of the railroads by private enterprise tended toward 'efficiency'. Massive land grants were given to the railroad builders free of charge; sometimes usurping the private land of smallholders; and, despite the fact that such land had been granted with the promise of building railways, it was often simply sold (Josephson, 1934; Lux, 1990). Subsidies were also demanded; and some towns were extorted on the grounds that the railroad would bypass them if they did not provide the subsidy, leaving them worse off than if no railroad had been built (Josephson, 1934). Resource wastage was also an issue. With no national coordination, duplicate railroads servicing the same areas were often built. Peterson (1971), Friedman's principle source on the matter, contrasts Friedman's celebration of the building boom with descriptions of "a misallocation of routes", and cites "The land-grant railroad boom, generating over-capacity, misrouting, and other malinvestment" as "unquestionably" contributing heavily to an 1873 depression (Peterson, 1971, p. 111) which would continue to 1879 (Josephson, 1934). Josephson (1934) writes of construction during the period:

"The work was carried on with a heedless abandon. It was sometimes found necessary to shift whole sections of the mountain line from one side of a valley to the other. In the severe winter weather of the mountain summits, tunnels had to be driven by the workers through the snow to the rock face, snow-sheds and galleries improvised to prevent settling, blasting operations had to be done over frozen ground, which must be reworked in the spring thaw. The haste of this great railroad construction....was afterward estimated by government experts to have caused a waste of between 70 and 75 per cent of the expenditure as against the normal rate of construction. Yet at the time there was little bewailing the cost of the American system of empire-building by private enterprise, owing to the general enthusiasm which attended its progress everywhere throughout the young industrial nation.....The great losses, fixed in an enduring capitalization, would be borne by future ages of Americans, but naturally concerned the enthusiastic railroad captains little at the moment" (Josephson, 1934, p. 87-88)

In addition to the resource costs borne generally by the people of America, the people building and using the railroads also frequently suffered substantial costs to their health and safety (Josephson, 1934; Perrow, 2002). While wages among American railroad workers were higher than in Britain,
the railroad industry consistently resisted improvements in safety, including those provided by devices such as the automatic airbrake and the automatic coupler. In 1889, one rail worker was killed for every 117 employed; with the figure as high as 1 in 12 (about 8.3%) for those injured - this in both cases more than doubled the risk when compared to Britain, with 1 in 329 killed and 1 in 30 (about 3.3%) injured. In some jobs the figure could be as high as 1 in 90. No safety legislation was to be introduced until 1893 with the passing of the Safety Appliance Act by a narrow margin in Congress. (Perrow, 2002).

Throughout the period, economic concentration grew. Conspiracies to collude emerged in several industries despite the passage of the Sherman Antitrust Laws of 1890 (Josephson, 1934) – not the least of these was the monopoly held by JD Rockefeller's Standard Oil Trust. One man, JP Morgan, meanwhile, by this time effectively controlled around 45-50% of the railroads (Josephson, 1934) – giving a lie to Friedman's portrayal of perpetually fierce competition.

All of this while the average worker survived on a barely subsistence wage even as their employers sought to undermine this further (Korten, 1995; Josephson, 1934), and this was accompanied by vast inequalities whereby a few earned $10 to $20 million per year while others earned only an average of $358 (ibid). Naturally, this would later give rise to a burgeoning union movement, whose number grew from 447 thousand to 2.073 million between 1897 and 1904 (Korten, 1995). But by then Friedman's 'golden age' was over.
9 Successes and Failures of Early Capitalism

A few points must be made about the 'golden age' which Friedman describes. First, the position of this thesis is that capitalism indeed ultimately resulted in an improvement over the feudalist system. This is not surprising, given that feudalism was in many ways a highly oppressive system which few in the western world would now advocate.

What is surprising, however, is that the gains in living standards came so slowly – in fact going backwards before improving. That people were forced out of their hard but otherwise healthy lives in the countryside to live in abject squalor in neglected cities and work even longer hours under horrific conditions, with little or no recompense in the form of increased purchasing power, is a blight on the development of capitalism. This is also true of the actual increase in mortality over the course of the most laissez-faire period of capitalism. What is even more surprising is that these actual decreases in living standards under the most laissez-faire domestic conditions of capitalism occurred in spite of great progress in technology and agriculture; and in spite of the colonial advantages which Britain enjoyed as a nation.

What is clear from at least the British data is that the trade union movement and increasing government intervention in the economy was essential for the improvement in the plight of the majority of the citizens, and that any increases in regulation after then have been simply a part of a natural progression. The prosperity which Friedman credits the free market with producing was not produced by an unguided 'Invisible Hand', but by its direction by collective action. Had government been more willing to protect its citizens from the worst effects of unheeded self interested actions, one might postulate that these improvements – social and economic – may have come sooner.

Both cases, moreover, show that the nations were given good reason to regulate. Businesses showed a callous disregard for the wellbeing of their employees in particular. Unfortunately, in the United States, the regulation did not come until later. Here, while industrial progress did occur, it was wildly destructive and inefficient – private enterprise showed none of the signs of being the robust engine of progress which Friedman (& Friedman, 1990) credits it with being. Josephson (1934), writing of the slowness of private enterprise to respond to the need for steel and the delinquency of infrastructure which resulted, wondered at:

"the significant lag between the interests of technical progress and those of business enterprise. Had not the rickety iron rails and bridges been collapsing everywhere for years with horrendous accidents as a commonplace of the time? Did not the freight cars which traveled over them remain small in tonnage capacity, keeping freight tariffs exorbitant? Did not numerous contentious factions cling to the small lines, having different track gauges, so that passengers and freight must be transferred after short hauls – a system obsolete before it was abandoned? One wonders if another form of society, wondered that was not dependent for its innovation upon the providential 'blind hand' of commercial struggle,
would not have moved more rapidly in matters which affected the general population so deeply” (Josephson, 1934, p 108).

That industrial progress which did occur, moreover, was heavily dependent on the involvement of government.

Over all, the evidence shows that capitalism can be an effective wealth creating machine – but is helped, not hindered, by restrictions on the working of the 'Invisible Hand' and by government action. Friedman's 'Invisible Hand' was not the benevolent engine of prosperity and happiness that he made it out to be, and only when tempered by government and combined action did the benefits of capitalism flow through to the majority of the population.

Having shown the fallacies of Friedman's view of the history of early capitalism, the next section turns more directly to his theories. Part IV explores both the theoretical flaws in Friedman's assertions about the magic of the 'Invisible Hand' and the empirical reality which contradicts them.
PART IV: SUPPLANTING GOVERNMENT, GOVERNANCE AND ETHICS WITH THE MARKET.
10 The Informed Choice?

10.1 The Mutually Informed Transaction and the Price System

Friedman has made the assertion that market transactions are necessarily beneficial to all parties. If both parties choose to enter into a transaction, it is argued, then both have exercised their freedom to enter into whatever contract they so choose – no one would pay money for a product that doesn't give them value in excess of the value of the money they paid for it, and no one would accept a job unless the compensation received was in excess of the disutility caused by doing a job. This creates a condition of “coordination without coercion” (Friedman, 2002, p. 13) whereby both parties' interests are satisfied voluntarily without the need for government intervention (Friedman & Friedman, 1990; Friedman, 2002). This assertion is critical to his advocacy against most forms of regulation.

Friedman places only one proviso on the beneficial nature of said transactions: that the transaction is “bi-laterally voluntary and mutually informed” (Friedman, 2002, p. 13). This condition is given little attention in Capitalism and Freedom (Friedman, 2002) and indeed can be said to have been basically taken for granted. Yet it is undoubtedly crucial to the argument that people entering into a transaction are exercising their freedom in doing so and will therefore necessarily benefit from it – if a party enters into a transaction without cognisance of crucial information (or the transaction is otherwise nonvoluntary) then they cannot be said to have adequately expressed their freedom in the transaction, which in turn seriously calls into question the beneficial nature of that transaction for the aforementioned party.

In Free to Choose, Friedman (& Friedman, 1990) does make some attempt to explain how it is that a largely unregulated free market ensures that transactions are mutually informed without the need for regulation. Simply put, Friedman's assertion is that, in general, the 'price system' efficiently transmits all necessary information to all necessary parties. Consumers transmit their information to producers through offers of money (demand), which causes businesses to create products which consumers want. Businesses in turn transmit information about costs and demand by the prices at which products are offered, and also have an incentive to transmit information about the products themselves to consumers. Similarly, business transmits information to workers (in response to demand from consumers) by offering jobs and workers transmit information to business by offering their labour at a given price (Friedman & Friedman, 1990).

This 'price system' is credited with a remarkable efficiency and effectiveness in transmitting relevant information:

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30 Friedman (& Friedman, 1990, p. 13) erroneously attributes this idea to Adam Smith, calling it “the key insight of Adam Smith's Wealth of Nations”. As has been shown, Smith, in both Wealth of Nations and Theory of Moral Sentiments, put in many more provisos than Friedman would have his readers believe.
“The price system transmits only the important information and only to the people who need to know....The people who transmit the information have an incentive to search out the people who can use it and they are in a position to do so. People who can use the information have an incentive to get it and they are in a position to do so” (Friedman & Friedman, 1990, p. 15).

Friedman (& Friedman, 1990) uses the rather inane example of pencil production as illustration here. But he goes on to say that government interventions to protect the safety and wellbeing of consumers, workers and others distort the ability of the price system to relay important information to these parties – implying that said price system does a better job of relaying the important information on its own (Friedman & Friedman, 1990). The problem of businesses under-informing consumers and workers, and producing dangerous products or engaging in dangerous production processes, Friedman says, is grossly overstated by critics. Friedman has even made the allegation that, in many cases, safety regulations actually cost more lives than they save - by stifling innovation, delaying or preventing access to beneficial products, and misallocation of resources (Friedman & Friedman, 1990; Friedman, 2006). These claims are here examined.

10.2 The Extent and Nature of Critical Information Asymmetries

As implied above, Friedman has argued that crucial information asymmetries between business and consumers or business and workers – which distort the voluntary nature of transactions – are very much the exception rather than the rule, and do not constitute an adequate case for regulation. Nor are they seen to constitute an argument that business executives should consult their consciences when making business decisions – the profit motive will cause them to make good products because of fear of consumer backlash (Friedman & Friedman, 1990; Friedman, 2002).

But this idea that problems relating to such information asymmetries; including those which result in human death, sickness and injury; are somehow rare, quickly corrected by the market place, and unworthy of nonmarket government intervention; is simply not borne out by the facts. Clinard & Yeager's (1980) sweeping study of corporate malfeasance over an extended period of time is alone enough to seriously question the validity of such claims. But even this only represents a small proportion of the incidence of such malfeasance.

Friedman (& Friedman, 1990) cites the automobile industry as one which was dynamic, innovative, and tremendously beneficial to consumers and workers alike; but would become stifled by the regulatory requirements of government organisations such as the National Highway Traffic Safety Administration. The real story of the US automobile industry, however, sheds a far less favourable light on the matter.

the Corvair was that “its rear wheel was mounted on a control arm which hinged and pivoted on an axis near the centre of the vehicle.” (Hartley, 2004, p. 135). This caused severe problems with steering, as the outside wheel would begin to ‘tuck under’ the car during turns. The problem was exacerbated by the massively uneven weight distribution of the car (with the bulk of the parts at the rear) (Hartley, 2004; Helms & Hutchins, 1992; Nader, 1991) which Chevrolet had attempted to control by simply recommending strict and highly differentiated tyre pressures for the front and rear – 15psi for the front and 26 psi on the rear when cold (‘after car has been parked for three hours or more or driven less than 1 mile’) and 18 psi front and 30 psi rear when ‘hot’. Even if not for the controversy regarding the effectiveness of such a measure, to place the burden of such strict vigilance on consumers is, to say the least, unrealistic (Nader, 1991).

The ‘tuck under’ of the rear wheels in the Corvair made for a series of accidents in which the Corvair was the only car involved – at the same time as General Motors continued its campaign to emphasise the fault of the driver in road accidents, it was at the same time producing a car which effectively took a significant element of the driving out of the driver’s hands. The problem was such that a number of companies soon began to cash in on the faulty design by offering a fix for it. A California company called EMPI, for instance, was one of the first to develop an accessory stabiliser specifically for the Corvair, and other companies soon followed suit. Even GM dealers at one stage began offering a fix for the problem as an optional extra. None of these, however, emphasised the dangers of driving a Corvair without such a device installed (Hartley, 2004; Nader, 1991).

By October of 1965, over 100 suites alleging the role of the Corvair’s design in causing motor vehicle accidents had been filed throughout the United States (Hartley, 2004; Helms & Hutchins, 1992; Nader, 1991). GM consistently asserted, as it had always done, that vehicle accidents were caused not by faulty vehicles, but by negligent drivers (Lee, 1998; Hartley, 2004; Nader, 1991). Most of these suits were settled out of court; and in none of them did General Motors present testing and engineering information on the car. GM’s refusal was such that one trial resulted in a default decision against them because of their persistent failure to comply with court orders to produce this information (Hartley, 2004; Nader, 1991).

However, these problems were not such that they only became known after the inundation of lawsuits. As Hartley (2004, p. 135) states, “these cars were tested on proving grounds, in laboratories, and otherwise analysed by engineers to provide information about any design limitations before being put into production. Actually, a considerable internal controversy arose among GM engineers about what some felt were some serious design flaws.” However, costing and styling factors, and the imperative to get the car to market quickly, prevailed, and the car was thrust upon the unknowing consumer, complete with design flaws (Hartley, 2004; Nader, 1991).
The pressure to change the design was gathering pace by the mid-1960s. Not only were there the large number of lawsuits, but even GM executives were losing family members to crashes involving Corvairs (Hartley, 2005). Finally, at the insistence of the head of the Chevrolet division, GM would install a stabilising bar which counteracted the steering problems of the car in the 1964 models (to be released 1965) (Helms & Hutchins, 1992; Hartley, 2004). Frustratingly for critics, this fix was revealed to cost only an additional $15 per car (Hartley, 2004).

In 1965, Dr. Seymour Charles, a GM stockholder and the founder of a group calling itself Physicians for Automobile Safety, made calls for management to recall all remaining Corvairs which still had the dangerous handling problem and install the fix which was put on the 1964 model. Even GM’s chief litigation lawyer was in favour of such a recall, having driven the car on proving grounds and experienced a rollover (but was apparently unhurt – tragically, he died three weeks later of cerebral thrombosis, age 54). However, no recall was made – the dangerous cars were allowed to remain on the road (Hartley, 2004).

But the content of the book’s attack on the state of automotive safety is far from being restricted to this one vehicle. For instance, 1953 Buick Roadmasters (Buick was/is owned by GM) had a deadly defect which would cause them to leak brake fluid, ultimately leading to brake failure. GM knew of the defects at the most one year after the release of the cars, but failed to recall the model – only if the cars were brought in to dealers for repairs (of any kind) were they fitted with a correction - but again without informing the customer.

Another example is when in late 1964 Ford issued a letter to 30,000 owners of 1965 Fords which was worded like a request for a simple product upgrade. The letter read:

“In order to provide you with the highest quality product available, the Ford Motor Company has decided to improve the rear suspension arm attachment by adding a reinforcement bracket to each side...We would like you to bring your Ford car up to current specification and appreciate your cooperation in making your car available to your Ford dealer for this purpose.” (Nader, 1991, p. 43)

Ford executives insisted that the modification was simply to provide a smoother ride - it was in fact correction of a crucial safety defect; the arm attachment in a car without the modification could break loose and cause the car to veer out of control.

Frank & Lynch (1992) write of an elderly woman who was killed when the accelerator on her Chevrolet car locked as she was travelling at 25 miles per hour in 1969. The defect which caused the accident – a rubber motor mount which had a propensity to break, in this case causing the engine to fall out of place and jam the accelerator – had been known to GM as early as 1965, when engineers from its Pontiac division found the defect; correcting the problem in Pontiacs and passing the information on to other divisions. Despite continuing reports of deaths and injuries resulting from the defect, not only did GM not act to recall the defective cars, but Chevrolets continued to be
produced with the defective design from 1965 right up to 1969, apparently because of the cost involved in correcting the design. Only after intense pressure from government, consumer groups, and the news media did GM finally recall the products in 1971 (Frank & Lynch, 1992).

The 1970s began with Ford’s production of the Pinto and its fire-prone fuel tank, which has become one of the classic cases in corporate violence quoted in the literature (see for instance Bromiley & Marcus, 1989; Clinard & Yeager, 1980; Dardis & Zent, 1982; Donaldson & Gini, 1996; Ferrell, Fraedrich, & Ferrell, 2005; Frank & Lynch, 1992; Giampetro-Myer et al., 1998; Gioia, 1992; Harwood, 1996; Jennings, 2006; Lee, 1998; Messick & Bazerman, 1996; Newton & Schmidt, 2004; Punch, 2000; Shaw, 2005; Smith, 1990; Svensson & Wood, 2003). The Ford Pinto was prone to leaking fuel into the passenger area in rear-impact collisions at speeds as low as 20mph; meaning that passengers who survived an initial impact could still face death by burning. Again, the problem was known pre-production and the car was only withdrawn after activists agitated and regulators stepped in. Estimates of the number of preventable deaths caused by the Pinto defect range from 27 (Hadreas, 1995) to 89 (from estimates gleaned from analysis of NHTSA data) (Dardis & Zent, 1982), to between 500 and 900 (Dowie, 1977).

Lesser known is GM’s production of its own compact car with a dangerous propensity for its fuel tank to explode during rear collisions – the Chevrolet Malibu. Amazingly (considering the Pinto controversy) the car was essentially a repeat of the Pinto – the fuel tank was dangerously placed in such a way that it would burst into flames in rear impact collisions at relatively low speeds. A later lawsuit by victims (who had survived despite suffering burns to 60 percent of their bodies during a collision in their 1979 Malibu) also involved revelation of the Ivey report, a GM cost/benefit analysis showing a calculation of safety against cost. Other GM documents revealed the cost of fixing the Malibu defect had been calculated at $8.19 per vehicle. The 1999 lawsuit awarded victims a total of $4.9 billion (later reduced to $1.2 billion), an unprecedented amount for a product liability case (Bakan, 2004, Ettore, 1999, Jennings, 2006, Mokhiber, 1998b).

The 1980s began with Ford again facing problems over product safety defects. This time it was transmissions that were the problem – without warning, an idling car could slip from park into reverse. Again Ford had known about the defect (and had lost a number of lawsuits as a result), but chose not to recall the car or even admit defect (Nader, 1991; Svensson & Wood, 2003). Nader (1991, p.xxxi) asserts that this defect alone has “killed over 500 people”.

The early 1990s saw the beginnings of the exposure of GM’s C/K trucks produced between 1973 and 1987 – like the Pinto and Malibu, these were prone to rupture at low speed impacts, only this time side rather than rear. Then in 1996, Ford was forced to recall 8.7 million vehicles with
defective ignition switches. The switches had a propensity for causing steering-column fires (Moll, 2003; Svensson & Wood, 2003). Again, Ford had known about the defect for some time but had failed to act on this knowledge, and indeed responded by denying allegations.

Finally, the 2000s has seen the Ford Explorer/Firestone debacle unfold. The Ford Explorer had a propensity for rollover accidents known by both Ford and tyre manufacturer Firestone at least since the 1990s, and yet again nothing was done until after agitation from outside sources, including regulators. While each company blamed the other, in reality both companies were aware that they were producing a product which was very potentially unsafe. The defect resulted in an estimated 271 deaths in the U.S. alone. (see Ferrell, Fraedrich & Ferrell, 2005; Noggle & Palmer, 2005).

Friedman (& Friedman, 1990) attempts to dismiss the Corvair case which featured in Nader's book by pointing to later tests which stated that “The 1960-63 Corvair compared favorably with other contemporary vehicles used in the tests” (NHTSA, 1972, p. 2, cited in Friedman & Friedman, 1990, p. 192). He also alleges that Corvairs have now become collector's items for car aficionados. But there are some issues with this reasoning. Firstly, he does not mention whether the tests were conducted on vehicles which had been modified in the way which corrected the problem but which GM did not make a standard feature of the car until after public outcry. Nor did he take into account the fact that the Corvairs in collections most likely had such modifications.

As importantly, however, the idea that the Corvair compared favorably with other American vehicles is rendered a moot point when one considers the above record. This shows a long history of the two most important players in the US car industry consistently engaged in unsafe practices without informing consumers of the risks involved.

Nor is the motor vehicle industry an exceptional case. A simple example of consistent under informing of consumers over a long period of time is that of asbestos manufacturers such as Johns-Manville, James Hardie and CSR, who had known of the dangers of asbestosis since as early as the 1930s and at least since the 1960s but chose to suppress these facts rather than protect workers and consumers alike from the disease and death that followed (Egillman & Billings, 2005; Hills, 2005; McKenna, 1996; McCulloch, 2005; Punch, 1998; Shaw, 2005; Wishloff, 2002). Writing in 1995, Punch (1995, p. 95) has contended that “over the next 30 years; 240,000 people....will die from asbestos related cancer”. Again, this was not simply a few actions by a few individuals in an otherwise ethical industry climate, but an entire industry where the price system failed over a long period of time to deliver crucial information to consumers.

The pharmaceutical industry is another case in point. While Friedman (& Friedman, 1990) points to the well publicised case of thalidomide (a sleeping aid which caused numerous birth defects) as an exceptional case which produced hysteria disproportionate to the overall problem,
Braithwaite's (1984) incisive study of the industry chronicles a long and expansive pattern of negligent or fraudulent safety testing, unsafe manufacturing practices, and other exploitation of information asymmetries – including the sale of products banned on safety issues in the U.S., often without adequate labelling (or even with fraudulent labelling), to people in countries with less stringent safety regulations. These have lead (or can be presumed to have lead) to countless human health problems; while the consumers suffering said problems have been largely unaware of the risks. In fact such under informing of consumers was so routine that many of these cases were not exposed for some time. More recent work by Moynihan & Cassels (2005) and Law (2006) is largely supportive of Braithwaite's (1984) thesis, showing that pharmaceutical companies continue to market products which internal testing has revealed to be unsafe, and both further point out that in many cases the drugs on offer which threaten life are not lifesaving medications (see also Thompson, 2004). Again, the problem is not limited to peculiar organisations – it seems more difficult to find an organisation not somehow involved in exploiting consumers through information asymmetries.

The food industry also demonstrates the case of an entire industry in which malfeasant practices are carried out as a matter of course without informing consumers. The 1906 release of Upton Sinclair's The Jungle caused public outrage when it revealed the commonplace practices of the then unregulated U.S. meatpacking industry. While its primary goal was to target the hugely dangerous conditions under which industry workers laboured, as important were its revelations about the products being forwarded to consumers without their knowledge: the smell of spoiled meat was masked with chemicals, diseased animals were knowingly slaughtered as a matter of routine, and workers forced to work without break defecating and urinating on the kill floor. While legislation curbed some of these practices, the increasing concentration of meat production, particularly in the United States, has facilitated a continuing problem of unsafe practices by the industry (Schlosser, 2001).

In the U.S., food borne illnesses sicken 200,000 people, hospitalise 900, and cause the deaths of 14 – *every day*, with a quarter of Americans suffering some sort of food poisoning each year.  

For instance, anabolic/androgenic steroids (derived from the male sex hormone, testosterone) are promoted in such countries (without need for prescription) to help children gain weight (treatment for malnutrition and as an appetite stimulant), lose body fat, and reduce ‘excessive’ levels of fatigue. In these they are effective – but consumers are not informed of the dangerous side effects, including stunting of natural (bone) growth and maturation, liver tumours, and irreversible virilisation (development of masculine physical traits) in girls. In the first world such powerful hormones are used largely to treat more serious conditions, such as renal failure and terminal malignant diseases. Labels in such cases typically recommend a wide range of potential uses without warnings of such potential dangers (Braithwaite, 1984; Cross & Winslett 1987.)

The journalistic claims made in The Jungle would later be confirmed by federal investigations (see Schlosser, 2001).
(Schlosser, 2001). There is growing evidence that this is caused, not simply by poor food preparation, but by the practices of the industry, which is increasingly controlled by large corporations. In 1996 a USDA study on ground beef samples taken from meat processing plants found that 78.6 percent of the beef samples contained microbes – potentially harmful to human health- that are spread primarily by fecal material. A U.S.D.A. study published in 2000 found that about 1 percent of the cattle at U.S. feedlots carried the potentially deadly E.coli 0157: H7, and as much as 50 percent in the winter (Schlosser, 2001).

Cattle stand virtually shoulder to shoulder in crowded feedlots ankle deep in their own excrement for long periods of time. Much more than the grass and forage which constitute their natural diet, cattle are fed grain, which, while effective at making them put on weight, is unhealthy for the cows and requires the daily use of antibiotics to keep the cows alive (Schlosser, 2001; Singer & Mason, 2006). The cows are also given anabolic steroids (similar to the ones banned for human use which aid in athletic performance) to help them put on weight (Ibid). In addition, the cattle feed also typically contains animal byproducts – beef blood and fat, restaurant leftovers, chicken and pig meat, and chicken 'litter' (a concoction including dead birds , chicken feathers, spilled feed, and even fecal matter) – all of which increase the risk of health problems which can also make the meat the consumer eats potentially unhealthy (Ibid). Worsening the problem, the unrelentingly fast production lines used means that spillages of fecal matter during slaughter are commonplace and only rarely properly sanitised (Schlosser, 2001). Again, these are all standard practices going on largely without the knowledge of consumers.

The chemical industry is another area of concern. World Health Organisation estimates put the yearly number of poisonings from pesticide exposure at one million per year, 20 thousand of which result in deaths, though it is admitted that this may be an underestimate due to underreporting (Barrios, 2004). Other figures put the number of poisonings at as many as 25 million annually (Barrios, 2004), and Lynch & Stretesky (2001) put the number of deaths from pesticide exposure in the U.S. alone at over 10,000.

There are a number of reasons for this. Firstly, all six of the largest agrichemical industry giants, who between them control 73% of the global pesticides market, are known to export severely hazardous chemicals - often ones regulated on safety grounds in the developed world - to the developing world (Barrios, 2004; see also Cross & Winslett, 1987; Shaw, 2005). The people using these chemicals often are not properly educated or trained in their proper use, let alone in the health risks that they pose (Barrios, 2004). Even in the developed world, people are often unable to properly read and understand the labels on chemicals (Lynch & Stretesky, 2001). The developed world also faces a 'cycle of poison' as, unbeknownst to consumers, food is imported from the developing world which is infused with the very same poisons banned in their own country.
These chemicals build up in the environment, polluting water, soil and air; often persisting for long periods of time and build up in the food chain. Velasquez (2002) notes an EPA study which found that pesticides on the lawn were brought by foot traffic into the home, where in they accumulated to many times the amount on the lawn.

Health risks from such pesticide exposures include acute effects such as skin burns, paralysis, blurred vision, blindness and death; as well as chronic effects such as neurological damage, endocrine disruption and reproductive damage, birth defects, immune system suppression, kidney damage, lung and heart disease, and cancer (Barrios, 2004). Moreover, the problem is rising. Incidence rates of childhood non-Hodgkin’s lymphoma increased 30% in the 1973-1997 period, while brain cancer and acute lympholytic leukemia rates both increased 21%. Each of these types of cancer has strong links to exposure to pesticides in the home (Commission for Environmental Cooperation, 2004). The chemical industry, meanwhile, has consistently lobbied to have the burden of proof of safety on their products reduced (Stroshane, 1999) while producing research on risks which is biased in favour of continued use of their products (Gennaro & Tomatis, 2005). It is doubtful that organisations inform consumers of the extent of the risk they take.

10.3 What information and to what end?

Friedman's assertion that “The people who transmit the information have an incentive to search out the people who can use it and they are in a position to do so.” (Friedman & Friedman, 1990, p.15) appears to imply that corporations have an incentive to volunteer the information necessary to consumers for an informed purchase decision. As the above examples show, however, this is only partly true.

There can be no doubt that corporations, left free of regulation and pursuing only their own interest, have an incentive to distribute some information to consumers about the products that they are selling. From the corporation's point of view, the consumer needs to know something about the product and the benefit it offers if they are to offer money in exchange for it. Advertising, use of sales personnel, and other methods of promotion do, up to a point, provide such information, and enable consumers to make a choice between alternatives with more information than they might otherwise have. This is not being questioned.

However, the nature of that information will be limited by the self-interests of those corporations – the 'Invisible Hand' will lead them to distribute some pieces of information, but withhold others. Ford Motor Co. distributed information to buyers of the Pinto which informed them of the benefits of a smaller, more compact car – cheaper to buy, cheaper to run (important during the fuel crisis of the time), and made in America. They did not inform them that the car would spray fuel into the passenger compartment if a rear collision as low as 20mph occurred. Merck was motivated to
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inform consumers and doctors about the benefits of Vioxx\(^34\) – an arthritis pain reliever recalled in 2004 – over other medications serving the same purpose. It was not motivated to inform them about the concerns its own researchers had as early as 1997 about the potential for increased risk of heart attack, and the later evidence, again from internal Merck studies, that this risk could be more than double that of taking no drug at all and up to four times that of taking the non-steroidal anti-inflammatory drugs it sought to replace (see Law, 2006, Moynihan & Cassels, 2005, Thompson, 2004). The benefits of asbestos were promoted to consumers without the information about increased risk of cancer. The major players in the food production industry no doubt promote the taste and low price of the meat they produce without giving equal attention to the fecal matter and microbes which frequently contaminate it.

Friedman's answer to this – that the market provides information also, that the consumer can “judge the quality of complex products” (Friedman & Friedman, 1990, p. 223) by consulting retailers and consumer magazines – is simply unrealistic. Friedman asserts that “If we buy an item that turns out to be defective, we are more likely to return it to the retailer from whom we bought it than to the manufacturer”, and that the retailer will therefore be a good source of information for the consumer. This is a patently ridiculous statement when considered in the context of product safety. A person who dies in a car accident due to a defective car design, or who develops cancer due to exposure to particular chemicals, is unlikely to return the product to a retailer. Indeed, they (or their mourning relatives) are in many cases unlikely to draw a link between the illness, injury or death and a particular product with a safety issue when that issue is known only to the corporation that produced the product. Consumer magazines are similarly unlikely to be privy to the information internal to the corporation which reveals such a safety issue, and thus the issue may not be revealed until many years (and many injuries, diseases and deaths) after the launch of the product.

Friedman's other assertion is that the importance of reputation will cause companies to create products which are safe and effective – that 'goodwill' will be too important to them not to. This is again simply not borne out by the facts – as shown above by the endemic proliferation of unsafe products. It is difficult to speculate why this may be. One reason may be an optimism that the defect may never be discovered, or at least not until after so much profit has been made from it that the benefits outweigh the costs when it is. There is likely to be some truth to this. The lawsuits against companies such as James Hardie far from cover all of the profits made from asbestos. Furthermore, given the number of safety and health issues identified in the above, it does not seem unlikely that there are many which we still do not know about. This is particularly so when one considers the

\(^34\) The pain was traditionally treated with non-steroidal anti-inflammatory drugs (NSAIDS) such as aspirin and ibuprofen which caused a small increase in the risk of gastrointestinal bleeding, which Vioxx did not cause (Law, 2006, Moynihan & Cassels, 2005, Thompson, 2004).
high proportion of research which is sponsored by the very corporations likely to be exposed (Egilman & Bohme, 2005). By controlling information, the corporations are able to control the issue.

This selective distribution of information frequently does not require the 'fraud' which Friedman prohibits in his version of a free society. The corporations – and the people acting on their behalf - most often do not have to lie about the harmful nature of their products, because the right questions are so rarely asked of the people in a position to comment on that information. Had one not read about it from an outside source – published only well after the system had already become entrenched in the U.S. - it might seem patently absurd to ask if the meat produced by particular companies frequently came into direct contact with fecal matter. And it seems doubtful that one would think to ask about the integrity of a fuel tank in rear collisions had its weakness not been exposed by journalists and consumer advocates.

The mechanism by which this information asymmetry most often occurs, therefore, is not lying, but merely reliance on people's assumptions. The corporation has a simple job when it comes to information it needs about what consumers are offering them in exchange for its products – products are bought only with money of some sort, the offering is homogeneous and the price varies at an easily set value. But for the consumer, the facets of the products which they buy are infinitely variable and complex, and the ability to process this information is limited. At some point decisions have to be made to assume what they do not know – that meat is produced in sanitary conditions, for instance; that a car will not suddenly rollover during routine driving; that a new drug does not have side effects far in excess of its predecessor (or, at least, none that the company producing it already knows about); that the use of a chemical within the prescriptions of its label will not greatly increase the risk of cancer, etc.

But the corporations producing the products most frequently do know about the issues which may be most important to the consumer, and know that this information will most likely be within the realm of that which is assumed by the consumer. The corporation and its agents, who clearly have greater access to the information which consumers need than consumers do, are clearly in a position to choose which of that information is distributed. If they act in the interests of the corporation – as Friedman insists they do – they will be led by the 'Invisible Hand' to inform consumers of that information which encourages them to make a purchase, but not to inform them of information which might discourage that, including dangers to their safety. This fundamentally undermines the idea of a free market producing informed and mutually voluntary transactions.
11 Who Chooses?

11.1 The Consumer Dollar Democracy.

In Friedman's conceived world, the consumer is probably the most important director of economic activity. In regard to the price system, Friedman insists that “the controlling force is pecuniary demand” (Friedman, 1976/2007, p. 10). This power of ‘pecuniary demand' is ascribed properties of a proportional democracy:

“The existence of alternative ends implies that there must be some way of rating these ends and reconciling conflicting evaluations of these ends by individuals within society. In a free-enterprise exchange economy, this task is accomplished essentially through voting—voting in the market place with dollars. In effect, this is a system of effective, proportional representation that permits every group in the society to express its wishes to the extent of its dollar votes. The votes of the members of a free-enterprise exchange economy are manifested through prices, which, in turn, reveal the standards of the society” (Friedman, 1976/2007, p. 9).

Friedman admits that this is “not obviously 'just'” (ibid, p. 11) due to inequality in the ownership of resources (those who have more dollars have more votes), but maintains that it is more just than its alternatives. However, in doing so he compares it only to economies “governed largely by status or tradition” (ibid, p. 11) rather than more moderate capitalist and democratic alternatives.

It seems necessary to briefly address this 'voting' analogy in producing 'proportional representation', which Friedman generally sees as being democratically superior and more representative of choice than so-called “command” (government) attempts to distribute resources35 (Friedman, 1976/2007, p. 11). Certainly, price mechanisms do reflect to some degree signals of choice from citizens in desire for the distribution of resources. They can play some positive role in the coordination of complex inputs which any government would find very difficult to completely control centrally with any degree of success. However, the assertion that prices determined in the market are somehow superior in reflecting the aggregate desires of the population to measures determined by the government is simply fallacious. As Friedman acknowledges, with one dollar essentially being one vote, the market system is only proportionally representative according to the number of dollars one has: those with more dollars get more votes and so the market necessarily favours the interests of the wealthiest over those of the less wealthy.

In democracies, however, the 'command' decisions which Friedman so laments are in principle determined with an even distribution of resources: each person has one vote. Nothing could be more reflective of the aggregate desires of the population than this, certainly not the price mechanism. Government measures do have their faults, particularly given the representational nature of most democracies where citizens have only an indirect say in decisions made and the

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35 The points made in this regard have no doubt been made many times before, but they are so easily deduced logically that it seems unnecessary to reference them here.
problems which campaign funding create\textsuperscript{36}, though this points to problems to address in regard to the nature of governments rather than issues with governments \textit{per se}. However, it is clear that there is no good reason to suppose that 'command' measures will necessarily be inferior to 'market' determinants in regard to 'fair' distribution, and indeed there is some reason to suppose rather the opposite.

Friedman's further objection that “If prices are prevented from affecting the distribution of income, they cannot be used for other purposes” (Friedman & Friedman, 1990, p. 23), namely “transmitting information and providing incentives” (ibid.), even if it were partially true in and of itself, is also a typical Friedman 'strawman' argument. Government intervention in distribution need not prevent prices from affecting distribution – only moderate these effects on more equitable terms. Chapter 10 has also shown that the information transmitting powers of the price system are in any case unsatisfactory in and of themselves, and that the incentives which it provides can often be perverse and destructive to the wellbeing of participants in it. So all three of these functions of the price system – distribution, information transmission, and the provision of incentives – appear to be, at the very least, deeply flawed; and indeed it could be contended at the very least that they are not necessarily less so than 'command' attempts to perform the same functions.

\textbf{11.2 The 'Laws' of Supply and Demand}\textsuperscript{37}

As stated, Friedman conceives of consumers as the principal price setters in a market economy, or as Stilwell (2006, p. 164) has put it, “Shoppers rule”. Firms are reactive, the prices at which they offer products are determined by their reaction to consumer demands as well as the costs to the firm in producing the products. Prices are principally determined by consumers' preferences interacting with the alleged 'laws' of supply and demand. These stipulate that as (aggregate) demand (the number of consumers desiring a product, their level of desire, and their purchasing power) for a product increases in proportion to its supply, the price of each unit of the product will rise; an increase in the supply of a product in proportion to the demand for it will cause a decrease the price for each unit of the product. This mechanism in turn gives signals to firms to produce more or less of particular products. Firms require that consumers pay a higher unit price as an incentive to produce more; a lower unit price will create an incentive to produce less.

This interaction of supply and demand is said to tend toward an optimal price commonly described as the 'equilibrium' price. According to Friedman, “At this particular price, and only at this price, will the desires of demanders and suppliers be simultaneously satisfied” (Friedman, 1976/2007, p.

\textsuperscript{36} See Part VI for further discussion of campaign funding.
\textsuperscript{37} Wherever it is pertinent to do so, reference will be made explicitly to Friedman in this treatment of price theory. However, with the exception of his permanent income hypothesis and other elements not given treatment here, Friedman's theories can be deemed largely identical to neoclassical theories, and so critiques of these (though they may not be directly of concepts which Friedman is sufficiently explicit about) may be applied.
Friedman further contends that only a free market can ensure prices which meet this condition. Friedman makes a number of assumptions/contentions in making these assertions, some of which will be considered here.

One of them is “effective competition in translating consumer wishes into productive activity” (Friedman, 1976/2007, p. 10), or more tellingly “perfect competition”38 (Friedman, 1953), which means that in all industries there are a large number of (generally small) producers, each of whom is unable to affect prices by their choices as such – instead they must price according to the impersonal forces of the market. In Friedman (1953, p. 35), a firm in a perfectly ‘competitive’ industry “belongs to an 'industry' defined as a group of firms producing a single 'product',.”, where a “‘product’ is defined as a collection of units that are perfect substitutes to purchasers so the elasticity39 of demand for the output of one firm with respect to the price of another firm in the same industry is infinite for some price and some outputs”. Firms are also assumed to maximise profits, not only in intent, but in effect; which is to say that “firms behave as if they were seeking rationally to maximise their expected returns...and had full knowledge of the data needed to succeed in this attempt” (Friedman, 1953, p. 22).

'Perfect substitution' implies no differentiation between products, and 'profit maximisation' implies perfect information, and therefore uniform knowledge across firms (and between firms and consumers, as dealt with previously). Firms are also treated as if they produce one product (or, to look at it another way, products are treated as if the firms producing them produce only that product). Price is the only means of competition. Ultimately, since there is perfect information everyone must know the 'equilibrium' price, so that prices also tend to be uniform at the 'equilibrium' price: firms neither over charge (because competition ensures that consumers will not buy at a price above the 'equilibrium' price and so firms will not risk losing market customers by trying to charge above this), nor under charge (because this will cause a loss in profit margin). Note also that consumers need to know everything they need to determine their offers, a notion already discussed in Chapter 10.

According to Friedman (1976/2007, p. 10), the theory assumes that “there is freedom to compete but not freedom to combine”. 'Combine', however, is an ambiguously relative term. Presumably Friedman means the formation of monopolies (though he contends that where monopolies are technically necessary they should still not be regulated (Friedman, 2002)) and price collusion between companies who are ostensibly competitors. However, any organisation is in some way a

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38 Some economists have also tried to deal with 'imperfect' forms of competition such as monopolistic competition and oligopoly (Stilwell, 2006); but Friedman explicitly rejects this undertaking as frivolous and unnecessary: the theory of perfect competition works well enough (Friedman, 1953).

39 'Elasticity of demand' refers to the extent to which the demand for a product is responsive to increases or decreases in its price. A product is 'inelastic' to the degree that people will buy the same amount of it regardless of its price.
'combination'; and indeed 'combination' into large organisations may represent a more significant 'combination' than the price collusion of several smaller firms. Indeed, Galbraith (1978, p. 8) has identified 'organisation' as one of the most important “instruments of escape” from the authority of the market. The very existence of large corporations already limits the extent to which 'competition' can in this way can be called 'perfect'.

The means of competition being limited to price competition, whereby competition necessarily lowers the price, is also dubious at best, particularly with regard to competition between large organisations. Writing in 1953, the heterodox economist Joan Robinson had already identified 7 ways in which firms actually compete, including among them not only competition by lowering prices but various forms of differentiation, which “may be in respect of qualities which affect practical usefulness or pleasure to the consumer, qualities which appeal to snobbishness or pseudo-scientific notions, or simply methods of packing and labelling aticles”(Robinson, 1953, p.584); the inclusion of services with the product; competition by advertising and salesmanship including the level of promotion, the management of perception and the very persuasiveness of techniques used; and, particularly anathema to Friedman's conception, the use of a higher price to convey “the impression of better quality” (ibid), which in marketing texts has now been given the name “prestige pricing” (Kotler, Bowen & Makens, 2006, p. 469). Particularly where large organisations proliferate; and even more so in capital-intensive industries such as air travel, car manufacture and pharmaceuticals which tend toward 'oligopoly' (where there are relatively few firms in an industry); price competition is likely to be the exception rather than the rule (Robinson, 1953; Shapiro & Sawyer, 2003; Stilwell, 2006).

The idea that organisations can and do with full certainty constantly and correctly adjust prices to conditions of supply and demand is “exceedingly unlikelike” (Robinson, 1953, p. 586). Indeed organisations, possessed of incomplete information (and therefore uncertainty) about market conditions and a general aversion to being simply reactive to forces outside of their control, are likely to develop strategies (of varying degrees of success) to limit the immediate impact of the whims of the market (Galbraith, 1978; Pressman, 2007; Robinson, 1953; Shapiro & Sawyer, 2003; Stilwell, 2006). Friedman (1976/2007) assumes the absence of combination, but price collusion may not require express negotiation between parties and may instead be 'tacit', relying instead on observation and convention and a general awareness that price competition, particularly when unaccompanied by improvement in productive efficiency, is unprofitable for all involved; (Stilwell, 2006). Competition between such firms is thus more likely to focus on marketing and differentiation than on price as such (Stilwell, 2006). Firms with a large amount of market power, even where such efficiency improvement is made, may also have an interest in withholding supply to maintain prices (Pressman, 2007; Robinson, 1953). They may choose to delay increases in prices even where
demand exceeds supply in order to maintain market share, or alternatively maintain high prices even where there is oversupply in the belief that market share may eventually be eroded anyway and that current conditions should be taken advantage of as much as possible (Robinson, 1953). Firms also typically produce more than one product under a particular brand, and high margins on some products may be used as a means of subsidising lower margins on others (Robinson, 1953; Shapiro & Sawyer, 2003). Prices may also vary according to who is sold to; large buyers, for instance, may receive a discount (Pressman, 2007; Shapiro & Sawyer, 2003). Robinson (1953) also points out that, even where lower price is the means of competition used, producing firms may simply offer higher margins to distributors rather than ensure that savings are passed to consumers.

Firms also use prices to affect demand itself, rather than simply reflecting it (Shapiro & Sawyer, 2003). The use of 'prestige pricing' is used to increase demand for a product by giving an impression of quality and exclusivity (Kotler, Bowen & Makens, 2006); while unusually low prices may similarly be used to boost sales of a product; either for temporary gain, or to gain market share for a new product in the knowledge that either the product will attract higher prices once established or that economies of scale will increase margins at higher sales levels. They may also use it as a temporary measure to simply wipe out new competitors, increasing demand for their own products and decreasing those of less well-resourced competitors who cannot match their prices without taking unsustainable losses.

The picture which already emerges is one where the strategic choices of firms are at least as important as the 'demand' of consumers and the impersonal forces of the market, and probably more so (Pressman, 2007; Robinson, 1953; Shapiro & Sayer, 2003; Stilwell, 2006). This complex mix of competitive tools seems unlikely to tend toward anything which could be described as an 'equilibrium' price. But there are other assumptions in the 'supply and demand' theory which bear further scrutiny.

For instance, the theory also stipulates that “insofar as possible, production will take place by the use of such a combination of factors that the average returns to each separately will diminish (or at most remain constant) with an increase in the amount of that factor used relative to the amounts of other factors” (Friedman, 1976/2007, p. 136). This is the so-called “Law of Diminishing Returns”, or in Friedman (1976/2007, p. 131) the “Law of Variable Proportions”. This means that as production using 'fixed factors' of production (eg. a factory or equipment) increases beyond a certain point at a given price, the 'marginal productivity' of 'variable' factor s(which is to say, the net gain to the company from the last unit purchased of factors of production which vary according to the amount produced, eg the net gain on the wage of labour at a given amount) decreases until they are making a net loss, even assuming all products are sold at the given price. In other words, even if a company can sell all the products which their fixed factors (factory etc) can possibly produce at a
price which at lower levels of production is profitable, increased variable costs will ultimately
increase to a point where this higher level of production is unprofitable at the given price. This is
why a higher price is needed to stimulate increases in supply (Keen, 2001).

Keen (2001) gives a detailed explanation of the bases for this theory and why it is wrong, but in the
interest of concision I will be brief:\footnote{Keen (2001) himself admits that the detail of the matter is both boring and necessarily highly technical. Since a detailed account would do little more than repeat the detail of Keen's (2001) argument, it is felt that this brief dismissal, avoiding both boredom and technicality, better serves the purpose the thesis than the alternative.}: 'fixed factors' such as factories generally operate at a high
level of efficiency right up to maximum capacity; and are often endowed with much greater
capacity than the company is likely to need. Once production reaches beyond the minimum point at
which costs are covered, all levels of production become profitable, and indeed the average per-unit
cost may decline (Keen, 2001). In either case, increased demand need not involve the offer of a
higher price to create the incentive to increase supply - companies will continue to profit at the
given price right up to capacity, and indeed where unit costs decline they may even be able to offer a
lower price. A higher level of demand need not require a higher price to be met.

Furthermore, “wants”, ie the preferences of consumers, are for the sake of proving the theory taken
as “fixed” (Friedman, 1976/2007, p. 13), and Friedman further takes it for granted that that which
applies for the consumer can be extrapolated to the market as a whole (Friedman, 1976/2007). Friedman
offers the following explanation in this regard:

“Our purpose in investigating the demand curve of the individual is to learn more about the market demand
curve. If the demand curve of one individual depended critically on the behavior of his neighbour, we could learn
little about the market demand curve from analysis of the behavior of an isolated individual; the essence of the
phenomenon would be precisely mass reactions, and we would do better to stick to the market demand curve. The
analysis that follows, therefore, takes it for granted this is not the case, that the individual's demand curve
depends on his own relatively fixed preferences and on his objective circumstances, not immediately or directly
on what his neighbours are doing” (Friedman, 1976/2007, p. 35).

In other words, modelling the way in which consumers choose between products as individuals is
sufficient for understanding the behaviour of economies and societies as a whole – there is no need
to attempt to model 'society' per se, because 'society' is treated simply as the sum of the individuals
within it. Economists like Friedman can show that individual consumers are likely to demand less of
a product as its price rises, and aggregating this to society as a whole 'proves' a part of the so-called
'laws' of supply and demand. It is also a crucial factor in supporting the idea that the total utility of
society is best maximised at the 'equilibrium' price and distribution of income in a market guided by
the 'Invisible Hand' with everybody pursuing their own self interest (Keen, 2001).

When economists of Friedman's persuasion first attempted to prove that this aggregation could be
done, however, they in fact proved the opposite (Keen, 2001). Given that consumers have

40 Keen (2001) himself admits that the detail of the matter is both boring and necessarily highly technical. Since a
detailed account would do little more than repeat the detail of Keen's (2001) argument, it is felt that this brief
dismissal, avoiding both boredom and technicality, better serves the purpose the thesis than the alternative.
heterogeneous tastes, a redistribution of income between consumers may allow a consumer who gains from it to gain more additional utility (pleasure) than the utility lost by the consumer who loses in the redistribution (Keen, 2001). An obvious example may be that the additional utility gained by a very poor person with enough money to buy an additional loaf of bread is much greater than the utility lost by a millionaire losing the same amount of money. With consumer’s tastes impossible to determine objectively, it is thus impossible to determine that any particular price or distribution of income is in this sense ‘optimal’ (Keen, 2001). Undeterred, however, economists like Friedman have retained the theory by means of introducing an even more ridiculous assumption: that people spend an equal proportion of their income on products regardless of changes in their income (Keen, 2001). This amounts to saying that someone who has gone from being reliant on unemployment insurance to being a billionaire spends the same proportion of their income on, for instance, bread, now as then. Needless to say, that seems a lot of bread. Alternatively, one could say that someone who has gone from being a billionaire to being reliant on unemployment insurance spends the same proportion of their income on private jets, or diamonds, or shares, now as then.

Ultimately, it should become clear that in fact there are no ‘laws’ of supply and demand which can be consistently applied under tolerably realistic conditions. The supply of goods and their prices cannot be adequately described as simply being the product of consumer choice particularly; and certainly cannot be abstracted from the strategic choices of firms generally made under competitive conditions which rarely approximate the ‘perfect competition’ model assumed by Friedman. The price system is necessarily complex and inconsistent in its results. There is no good reason to suppose that a free market will tend toward any price in particular, and certainly no good reason to believe that prices determined in a free market will maximise over all utility.

11.3 The Creation of Wants

Friedman insists that products are produced with the aim of satisfying consumers’ wants and cannot sell if they do not satisfy the needs of consumers. Corporations, he insists, compete to produce products which make consumers better off (Friedman & Friedman, 1990). However, if these wants originate with the desire of business to sell (and thus convince people to buy) products; or as JK Galbraith (1998, p. 125) puts it in his seminal work Affluent Society, “it is the process of satisfying wants that creates the wants”; then “Production only fills a void that it itself has created” (Ibid). That is to say, that products are produced according to the sovereignty and desires of business; not of consumers – consumers are simply paying business for things which they would not otherwise need or want. Thus, with regard to more affluent consumers and nations, “The urge to consume is fathered by the value system which emphasises the ability of the society to produce. The more that is produced, the more that must be owned in order to
Ostas (2001, p. 292) similarly criticises the notion of ‘exogenous preferences’ (that is, production preferences exogenous to the corporation, i.e. originating in the consumer), stating that “Managers are no longer simply responding to consumer and worker preferences, but helping to shape those preferences with corporate policy both internal to the firm and with regard to the firm’s external market”. Ostas (2001) and Galbraith (1998) are also unified in the belief that any marketer; indeed, anyone with a background in business; knows intuitively and empirically that this is the case – that marketing and advertising in fact shape consumer preferences.

The process of advertising is undertaken with this specific intent – to create a want for a product which might not otherwise be felt by consumers. In the process of manipulating consumers (including children) into buying products, it is not uncommon to employ psychologists to exploit people’s insecurities and sense of self image. Lucy Hughes, vice president of advertising company Initiative Media; states with a certain pride: “You can manipulate consumers into wanting, and therefore buying, your products. It’s a game” (cited in Achbar, Abbott & Bakan, 2004). Hughes was co-creator of ‘The Nag Factor’, a tool derived from the results of a study (commissioned by the company) on the effects of children’s nagging on their parents' buying behaviour. ‘The Nag Factor’ categorised different types of ‘nag’ by a child and their effects on different types of parents. It is designed to help marketers to manipulate children into nagging their parents in such a way as to most effectively induce buying behaviour.

On this issue, Frank (2003, p. 489) provides a counterargument: “the Galbraith view of the process overlooks something fundamental: It is easier to sell a good product than a bad one. All an advertisement can reasonable hope to accomplish is to induce the consumer to try the product. If it is one she tries and likes, she will probably buy it again and again ....If it is one she tries and doesn’t like, however, the process ends there.” Frank (2003, p. 489) goes on to say that products which meet “real human needs” will be more attractive to produce.

This argument by Frank (2003), however, gives an incomplete picture of the nature of marketing and production. The fact is that, among affluent consumers, the ‘real human need’ (in terms of physical needs for food and warmth) are satisfied with only a meagre proportion of income; the rest of additional income is spent on “more elegant automobiles, more exotic food, more erotic clothing, more elaborate entertainment” (Galbraith, 1998, p. 115). Whether or not the product is ‘good’ in terms of satisfying its particular need or want; the fact is that these needs and wants themselves are increasingly created through manipulation by marketers.

The pharmaceutical industry is a case in point; albeit an extreme one. In 1976, then Merck CEO Henry Gadsden expressed his displeasure at the fact that Merck’s market was limited to sick people;
stating that he wished the company was more like (chewing gum company) Wrigley’s, and that it was his dream that Merck would market drugs to healthy people, and so ‘sell to everyone’ (Moynihan & Cassels, 2005, p. ix). Moynihan & Cassels (2005) report that this dream is now a reality for most of the large pharmaceutical companies; using significant hegemony over the definition of new ‘diseases’ (through sponsorship of industry-favourable research; and direct financial association with people charged with such definition), combined with advertising which plays on peoples’ fears, as to essentially create new ‘needs’ for drugs to satisfy. “The marketing strategies of the world’s biggest drug companies now aggressively target the healthy and the well. The ups and downs of daily life have become mental disorders, common complaints are transformed into frightening conditions, and more and more ordinary people are turned into patients” (Moynihan & Cassels, 2005, ix). Commonly the marketing of these drugs is designed to replace positive lifestyle changes (e.g. cholesterol lowering drugs) (Moynihan & Cassels, 2005); and Bakan (2004) points out that such investment in selling lifestyle drugs to well people in the developing world also diverts funds from developing life saving medications for conditions in the third world.

11.4 Pollution: No Choice at all

Corporations are a major source of the world’s environmental degradation, which is substantial and malignantly progressing (Bakan, 2004; Egilman & Bohme, 2005; Hayden, 2004; Korten, 1995; Lynch & Stretesky, 2001; Moser & Miller, 2001; Sass, 2005; Shaw, 2005; Sklair, 2002; Spitzen, 2005). Sklair (2002, p. 56) states that “While many TNCs... have begun to institutionalise in-house mechanisms for dealing with resource and pollution issues, many other TNCs, their subcontracting partners, and local firms ignore good practice in production and waste disposal, even where required to do so by law, and pose ongoing threats to the global environment”. The author goes on to state that “the survival of the planet and life on earth depends on breaking the economic power of the TNCs, the political power of the transnational capitalist class, and the culture-ideology of consumerism” (Sklair, 2002, p. 68).

Hayden (2004) describes the crisis resulting from oligopolisation of the hog industry, with factory farming of hogs. These include air pollutants (which cause increase risk of disease, not only to workers but to the neighbouring communities), as well as land and water pollution from manure (which contains traces of antibiotics and antibiotic-resistant bacteria developed from the use of antibiotics due to unsanitary conditions in such farms) – the factories have no sewage system, and manure and chemicals from it run off into nearby water sources (Hayden, 2004).

Oil companies continue to cause extensive environmental damage; both legal and illegal (Bakan, 2004; Dobson, 1992; Mokhiber & Weissman, 2006; Shaw, 2005). Despite being lead by CEO Sir

41 TNCs – Trans National Corporations
John Browne, whom even Bakan (2004, p.44) calls “one of the most outspoken advocates of social responsibility in big business today” and who actually broke industry ranks to defend the Kyoto protocol; BP, while marketing itself as a ‘socially responsible’ company, incurs frequent oil spills (which it often does not report) and industrial accidents (including 3 fatal explosions at 1 Texas refinery over a 4 year period 2001-2005) while lobbying to drill in fragile ecosystems in places such as the Arctic National Wildlife Refuge (Bakan, 2004, Mokhiber & Weissman, 2006). The Exxon Valdez oil spill and the practices of oil companies such as Shell in Nigeria are other more well publicised examples of companies’ disregard for environmental degradation.

Friedman (2002; & Friedman, 1990) claims that pollution represents consumer choice, and that consumers are to blame for the pollutive emissions of companies. There is some merit to this, but the fact is that consumers do not have control (or, in many cases, even knowledge) of the production processes which cause this pollution or of the lack of effort by companies to offset this. Consumers who buy meat are not demanding that effluent be concentrated in the way that it is, and while they bear some responsibility for the emissions from their cars, they are not demanding the destructive practices which characterise oil extraction. These are driven by organisations making choices about their costs, not by consumers.

Friedman also claims that “Typically....the people who would benefit most from the reduction of pollution are better off, financially and educationally, than the people would benefit most from the lower cost of things that would result from permitting more pollution” (Friedman & Friedman, 1990). In fact, the opposite is typically true. It is the poor of Nigeria who suffer under acid rain, skin problems, respiratory illnesses, hearing loss, damage to their homes and crops, contamination of fish and vegetation and prevention of adopting more traditional ways of life (Okeagu et al, 2006), while wealthier American companies and consumers benefit from the oil extracted. The people of Nigeria are not 'free to choose' these kinds of consequences. This is to say nothing of global warming, discussed in the next chapter, which threatens everyone but whose worst effects will be felt disproportionately by the poor.

11.5 No one Left to Choose

“....those who currently occupy management positions are not mere functionaries. They cannot be adequately described as ciphers who simply serve the predetermined needs of some higher entity (e.g. capital or the state) or who just act selfishly in accordance with their own personal interests. Caught between contradictory demands and pressures, they experience ethical problems; they run the risk of dismissal, they are ‘victims’ as well as perpetrators of discourses that unnecessarily constrain their ways of thinking and acting.”

(Alvesson & Wilmott, 1992, p. 7)

Friedman (2002; & Friedman, 1990) makes make much of the concept of ‘freedom’; and is quick to oppose regulation on the basis of ‘freedom’. In conceiving of the modern corporation, however,
Friedman (1970/2002; 2002) puts important restrictions on the freedom of one of the most important players: the managers of corporations. Such managers are seen by Friedman to have no right to impose their personal sense of ethics and moral responsibility when acting in their role as managers of the corporation. Friedman (1970/2002; 2002) actually argues that any attempt by a manager to act according to his own personal morality, which conflicts with the pre-stated goal of maximising shareholder profits, is actually immoral. Tragically, this conception of the corporation as being solely profit oriented is enshrined in law in the United States (Bakan, 2004; Hanson & Chen, 2004).

Friedman gives two main reasons for constricting managerial discretion in this way. One is the ‘Invisible Hand' argument about which this thesis is in many ways principally concerned (Friedman, 2002). This is countered in other sections of the thesis. The other, however, is concerned with the idea that the principal obligation of business is to its shareholders, and that shareholder interests can be presumed to be purely profit seeking (Friedman, 1970/2002). According to Friedman, managers have no right to impose costs on shareholders by acting according to their own consciences in, for instance, reducing pollution. He further contends that, should shareholders have particular ethical concerns they could “spend their own money on the particular action if they wished to do so” (Friedman, 1970/2002, p. 34).

The latter statement is patently false. In a corporation run by managers, with separation of ownership and control, shareholders have no opportunity to “spend their own money” to improve production processes in such a way as to render them less destructive in accordance with their own ethical principles. Money paid as dividends cannot be used to pay a living wage to workers, nor to reduce the pollution of the company, nor to improve the safety of a product produced or of the processes to make it. What this means is that in effect no one in a corporation – not the owners whose interests Friedman seems superficially to be advocating for, and not the managers – has a right to exercise ethical discretion.

Furthermore, managers are hired to spend shareholder's money in judgment of what is desired by shareholders. In this they have discretion, and are judged to be highly qualified. Ironically, the primacy which Friedman (1970, 2002) attaches to profits is itself a constriction of which desires of shareholders managers are allowed to pursue. No one is 'free to choose' goals other than profits.
12 The Market and Irreversible Consequences

12.1 The Self Correcting Market

Friedman's contentions about the need for consumers to be 'free to choose' and for corporations to be single-mindedly motivated by profits also rest in part on a variation of Joseph Schumpeter's (1950/1976) idea of 'creative destruction'. Businesses which are inefficient and/or do not meet the needs of their customers, the argument goes, will be put out of business, only to be replaced by ones which do a better job of this. Similarly:

“the advocate of government regulation will say, suppose the FDA weren't there, what would prevent business from distributing adulterated or dangerous products? It would be a very expensive thing to do......It is very poor business practice, not a way to develop a loyal and faithful clientele......Cases will arise where adverse effects develop that could not have been foreseen – but government has no better means of predicting such developments than private enterprise. The only way to prevent all such developments would be to stop progress, which would also eliminate the possibility of unforeseen favourable developments” (Friedman & Friedman, 1990, p. 223)

The free market, then, will correct cases of businesses doing things which are harmful by eating into profits and causing them to go out of business. When the effects of something like thalidomide are revealed, the massive consumer backlash will cause the business to lose substantial patronage and possibly drive that company out of business, as well as warning others not to make the same mistake.

A similar argument is made with regard to environmental regulation. According to Friedman (& Friedman, 1990):

“a far better way to control pollution than the present method of specific regulation and supervision is to introduce market discipline by imposing effluent charges. ...instead of requiring firm to erect specific kinds of waste disposal plants or to achieve a specified level of water quality in water discharged into a lake or river, impose a tax of a specified amount per unit of effluent discharged. That way, the firm would have an incentive to use the cheapest way to keep down the effluent....” (Friedman & Friedman, 1990).

This idea envisions a kind of self-correcting mechanism whereby the pendulum of safety and/or pollution vs. business cost swings toward equilibrium. It assumes that the cost – indirect through lost sales or direct through the aforementioned taxation – of producing an unsafe product or of generating excessive pollution will generally make it less likely that a company will do so.

This idea is superficially appealing, and central to Friedman's faith in the 'Invisible Hand'. While mistakes will be made on occasion, most companies will foresee the potential costs of the revelation of an unsafe product as outweighing the short-term profits to be gained from it. Similarly, a tax will cause pollution to be reduced by increasing its cost sufficiently, and if it doesn't then it shows that pollution is too important to be reduced.
It should be noted, however, that using Friedman's logic, profit driven businesses will not necessarily be motivated by market forces to altogether eliminate faults in their products or production processes which threaten human health. At best, they will be motivated to reduce the degree of the fault until their estimates of the potential benefits to the corporation – not the consumer – outweigh the costs (again to the corporation). The ultimate effect is to subject critical issues such as safety and pollution control to a monetary cost-benefit analysis undertaken by the company in its own interests, and works on the assumption that these cost-benefit analyses will be made correctly for the company. If the costs of polluting or producing an unsafe product outweigh the profits to be gained from engaging in these practices, then they will not be undertaken. If, however, the profits to be gained outweigh the costs (to the corporation) – and this is particularly likely in the event that the company believes that the issue will not reveal itself - then they will be (Bakan, 2004).

Of course, while the costs to the corporation can be weighed up in dollars and cents, the cost to a consumer burnt to death, or given terminal cancer, is fundamentally different, and difficult to factor in to such an analysis. Interestingly, the cost-benefit analysis made notorious by the Pinto case, used Friedman's faulty logic of acting as if costs and benefits to the corporation could be equated with those to society (and the consumer). The cost 'to society' of a burn death (estimated arbitrarily at $200,000) was compared with the cost to Ford of fixing the product defect in a bid to avoid regulation. The fact that a monetary cost to a business is fundamentally different from the costs borne by a burn death victim appears to have escaped them (Dowie, 1977; Hoffman, 1996; Lee, 1998; Shaw, 2005).

In the case of pollution, a tax will only cause a business to reduce its pollution to the extent that the costs of the tax to the business outweigh the benefits – if a manufacturer of cosmetics, or toys, or other luxury items, determines that the increased cost of pollution from a tax does not outweigh the profits they gain from polluting, then they will continue to pollute at a high level. From Friedman's point of view, this shows that society values the products more than it values its safety from pollution – but in reality this assumes that the people being affected by pollution, in addition to knowing about the pollution involved (as discussed in Chapter 11), are the same people buying the products. This may often not be the case, particularly in a globalised market.

Another major problem is that while the production of an unsafe product may end up being “a very expensive thing to do”, it may not be estimated to be more expensive than the profits to be gained from doing so. If this turns out to be an underestimate, then the company will lose money and perhaps (but not necessarily) be more cautious in the future – but not before devastating injury, disease and/or death is caused to the consumer. For these people, the correction of the market comes too late, and while the cost to the company in dollars may be great it is completely disproportional.
to that worn by the consumer.

**12.2 Global Warming – The Ultimate Irreversible Consequence.**

There is now a widespread consensus that human action – principally the burning of fossil fuels releasing carbon dioxide into the atmosphere – is causing a gradual increase in the earth's temperature and changes in its climate (Douglas, 2006; Hansen, 2008; Hoffert, 2006; McKibben, 2009; Neuman, 2009). The potential consequences if sufficient action is not taken are dire. Arctic sea ice is already melting, causing sea levels to rise and devastating coastal communities. While Lal (2006) dismisses global warming as merely a comfortable increase in heat levels, in fact even small increases in the earth's temperature could result in increases in extreme weather events and alternating floods and droughts, and McKibben (2009) cites a Pentagon commissioned report predicting that food shortages and increasing scarcity of resources caused by global warming could also precipitate an increase in wars.

The response from many has been disconcertingly lacking in urgency. Writing in the neoliberal Cato journal, Dolan (2006) breaks ranks to express despair at the positions taken by fellow market liberals – essentially to leave well enough alone and allow the 'Invisible Hand' to work its magic. Adding insult to injury, some are seeking to drill for, of all things, oil, under the very arctic ice whose melting is likely to facilitate some of the worst effects of climate change (Neuman, 2009; Williams, 2008).

In any case, Friedman's solution – of simply taxing at different rates to see how much the market values pollution (Friedman & Friedman, 1990) – is simply unworkable here. Outright prohibitions and limitations must be used because there is a threshold above which the consequences – which are inestimably dire on a global scale – become unable to be prevented. Once a certain temperature is reached, there is no possibility of reversing it by 'cooling', and even if it were possible by then the melting of the polar ice caps is likely to have been completed. The idea of blindly grasping at what price will create an incentive to sufficiently reduce emissions, and then possibly allowing such emissions to continue should the market decide it is willing to pay a very high price, seems rather crass given the high stakes. Further, given that these consequences are far into the future (though estimates put it increasingly less so, it seems) but almost certain should not enough action prevail, the idea that market 'corrections' can stop this from occurring is, at best, a highly risky proposition.
13 Government Action

13.1 Safety Regulation

One of the most powerful assertions that Friedman makes is that regulation is actually costing lives, not saving them. He asserts that the system of approval under the FDA in the U.S. prevents or slows the approval of important lifesaving drugs and slows innovation by increasing the cost to the pharmaceutical companies (Friedman & Friedman, 1990; Friedman & Roberts, 2006). This idea was recently repeated in *The Economist* (2007).

Friedman's arguments comparing the U.S. and Britain – in which he argues that more efficient approval of certain types of drugs has saved lives in Britain compared with the U.S. (Friedman & Friedman, 1990) – can be dismissed out of hand, because given that Britain has also had an approval system for drugs the argument in no way supports Friedman's advocacy of the removal of regulation, only that some regulatory systems are more effective and efficient than others. The answer to this would not be no regulation, but better regulation – a position which this thesis does not oppose in principle.

More compelling is the citing of an influential study which Friedman claims shows that market forces were sufficient in curbing unsafe practices and that the delays of life saving drugs caused by this regulation caused more lives to be lost than were saved through the protection of the government (Friedman & Friedman, 1990). However, the studies conducted by Peltzman (1973; and 1974 cited in Friedman & Friedman, 1990; Katz, 2008; Merrill, 1996) pertain specifically to amendments in 1962 which added the responsibility for approving medications for *effectiveness*. These were added to *already existing* legislation which required approval for *safety* (Peltzman, 1973). Indeed the quote which Friedman uses from the study – that “the penalties imposed by the marketplace on sellers of *ineffective* drugs before 1962 seems to have left little room for improvement by a regulatory agency” (Peltzman, 1974, p. 45, cited in Friedman & Friedman, 1990, p. 207, emphasis added) - says nothing about the implications for the safety of drugs which have not been through an approval process for *safety*.

For Friedman to use this in a diatribe about safety regulation is an outright misrepresentation of the facts. Drugs may be (and frequently are) effective for their stated purpose but simultaneously cause users to suffer side effects which outweigh the benefits of the drug. Thalidomide, for instance – the case of which Friedman (wrongly) uses to illustrate the above quote – may have been highly effective in its stated purpose as a sleeping aide and painkiller, and it is perhaps because of this *effectiveness* that its use – and heinous side effects – became so widespread in Europe. Meanwhile,

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the existing safety legislation enacted in the United States actually prevented thalidomide from being sold there (Peltzman, 1973). Similarly, Vioxx was highly effective as a painkiller, but simultaneously caused a greatly increased risk of heart attack. The Peltzman studies have nothing to say about the effects of safety regulation, which had existed since before the 1962 amendments he critiques. Friedman (& Friedman, 1990) supplies no other evidence for this claim on pharmaceutical regulation.

The fact is that Friedman supplies no real evidence that safety regulation of drugs is harmful, and in fact there is little evidence to supply. Ross (2007), in a review in *The Journal of Clinical Investigation*, condemns a key critic of drug safety regulation for the dismissal of the problem of information asymmetries (using typical Friedman logic, proposing for instance use of internet searches as a replacement for the safety information required under law), the emphasis (as in Friedman) on reputation as a deterrent to production of unsafe drugs, and apparent ignorance of recent market failures in the pharmaceutical industry (e.g. Vioxx) – in essence the lack of any real evidence provided. McClellan (2007), writing in *The New England Journal of Medicine*, also points out that adverse effects of drugs may go for many years without being reported because there is reliance on a system by which doctors, consumers or drug companies report adverse effects rather than using government surveillance of approved drugs. Theoretically, this could also mean that some adverse effects could go unreported indefinitely as consumers and doctors never make the link between a drug and its negative effects. As pointed out above, many of the drugs which have life threatening side effects are not themselves life saving (Briathwaite, 1984; Law, 2006; Moynihan & Cassels, 2005), and it has also been argued that the FDA would be more effective if it received better government funding and were its relationship with the industry were more constricted (Law, 2006; Moynihan & Cassels, 2005; Steineker, 2007; Wood, 2008).

A number of works have assessed the biases upon which many criticisms of regulation have been made (e.g. Heinzerling, 1998; Parker, 2003; Rascoff & Revesz, 2002). Parker (2003) has generally cited the fact that many of the claims are based on basic data errors, with some of the more influential studies not submitted for peer review. While estimates of regulatory agencies about the effectiveness of regulations are used as primary data, these are frequently revised using almost purely arbitrary estimates of the extent to which such agencies may overstate their effectiveness; with no studies cited or data made available on the means by which these estimates are made (Heinzerling, 1998; Parker, 2003). Arbitrary exclusions of cost savings from regulations are also made, as well as use of unpublished data with no traceability of where that data originated (ibid). Arbitrary data samples, and indeed samples inherently excluding the very most cost effective regulations while including regulations never put into force, are also used (Heinzerling, 1998; Parker, 2003) They also use guesses of 'future' costs and savings based on 10 year old data, thus
ignoring data on what actually happened in the intervening time (Parker, 2003).

While critics will emphasise side effects (indirect risks – Friedman's example of stifling innovation is one of these), they do not take into account indirect benefits of some regulations (Parker, 2003; Rascoe & Revesz, 2002) – for instance, the potential preservation of forests and the environmental and health (prevention of water contamination, etc) - benefits of that can be an excellent side effect to regulations regarding carbon emissions to prevent global warming (Rascoff & Revesz, 2002). The quantitative scorecards typically ignore all costs which cannot be assigned a monetary value (Parker, 2003). Cost savings provided by regulations are also either ignored or together or arbitrarily discounted (Parker, 2003).

Such studies have also failed to recognise the uncertainties inherent within regulation (Parker, 2003; Heinzerling, 1998). How can it be known how many people would be harmed by a product were it not regulated? Further, what have been the costs and benefits of areas where there has been a failure to regulate? Such questions are, at best, difficult to answer – but the previous discussion of information asymmetries should give some clue. The fact is that the extent of corporate misconduct, and again the slowness of the market to react, warrants strict regulatory oversight.

### 13.2 Superiority of Private Enterprise?

Friedman (2002) makes much of the superiority of unregulated, profit-driven private enterprise in meeting people’s needs. This faith in private enterprise extends even to cases of what he describes as “technical monopoly”, which may arise, naturally, because it is “technically efficient to have a single producer or enterprise” (Ibid, p. 28). In the provision of such monopoly, people are broadly provided with three choices: public monopoly, in which the particular enterprise is carried out by government; public regulation, in which it is carried out by private enterprise but regulated by government; and private (unregulated) monopoly, in which ‘free’ enterprise provides the service, largely free from regulation by government (Friedman, 2002). Such is Friedman's distaste for government and government regulation, he prefers an unregulated private monopoly in such cases.

Yet in reality, even in such cases where competition exists, private enterprise is simply ineffective and inefficient in providing services to the consumer. The mostly privately provided U.S. Health insurance industry is a case in point. Fearing that the U.S. may be headed toward ‘socialised medicine’, Friedman wrote the following in *Free to Choose*:

“Two major arguments are offered for introducing socialized medicine in the United States; first, that medical costs are beyond the means of most Americans; second, that socialized medicine will somehow reduce costs. The second can be dismissed out of hand – at least until someone can find me an example of an activity that is carried out more economically by government than by free enterprise. As to the first, the people of the country must pay the costs one way or another; the only question is whether they pay them directly on their own behalf, or indirectly through the
mediation of government bureaucrats who will subtract a substantial slice for their own salaries and expenses....In any event, the costs of ordinary medical care are well within the means of most Americans” (Friedman & Friedman, 1990, p. 115)

This is perhaps one of the clearest examples of Friedman's assertions being in stark contrast with the facts. The United States spends more – both per capita and as a percentage of GDP – on health care than any other industrialised nation (Dalen & Alpert, 2009; Matthews & Matthews, 2008). Worse, the people paying get less in return for their money. While other countries can boast universal coverage for less than what is spent in the U.S., in 2007, 45.7 million Americans – 15.3% of the population - were without any health insurance (DeNavas-Walt, Proctor & Smith, 2008). Millions more are 'underinsured', and face financial stress and/or lack of coverage (Davis, Stremikis, Schoen, Collins, Doty, Rustgi & Nicholson, 2009; Doty, Collins, Nicholson & Rustgi, 2009; Hillstein, Thorne, Warren & Woolhandler, 2009) – with altogether an estimated 72 million either uninsured or 'underinsured' (Davis, et al, 2009). Health care debts are the leading cause of bankruptcies in the United States, contributing to two thirds of all bankruptcies (Hillstein et al, 2009). The World Health Organisation ranked the U.S. last of 17 industrialised countries in a 2002 study, citing the U.S.'s poor record on health outcomes (Dalen & Alpert, 2009).

Ironically, it is the bureaucratic and administrative costs which so worried Friedman in regards to government that are now a major feature of distinction regarding the U.S. private enterprise system. These amount to nearly $70 thousand worth of costs to the physicians to interact with health insurance; and 7.5% of all health costs – where in the universal health care systems of Australia and the U.K. the figures are 2.8% and 3.3% respectively (Collins et al, 2009). US Medicare, meanwhile, is the most efficient aspect of the health system with only 2% of spending going to administrative costs.

Thus, firstly, in health insurance there is indeed clearly “an example of an activity that is carried out more economically by government than by free enterprise” (from Friedman & Friedman, 1990; p. 115). Secondly, just as government 'bureaucrats' take a 'large slice for their own salary and expenses', so corporate bureaucrats will seek to take perhaps an even larger 'slice'. By pooling funds through the tax system, consumers effectively save money.

Health care should be a basic human right. Clearly, the 'Invisible Hand' refuses to cater to this and instead allows for refusal of coverage. In this case it would be more effective for government to step in and fill the divide.
14 Wages and Labour.

14.1 The Employment/Wage Dichotomy

Friedman (2002, & Friedman, 1990) has also been critical of minimum wage legislation and of trade union efforts to increase wages, claiming that minimum wages will necessarily cost jobs. This is said to be because they artificially raise the cost of labour beyond its ‘market’ price, and the more labour costs the less total labour is likely to be hired. By enacting minimum wage legislation, Friedman argues, the government discriminates against people who might otherwise have a job were they allowed to accept a lower wage. It is similar for several working conditions – for instance, to the extent which occupational health and safety legislation increases costs, it will necessarily create unemployment. Friedman as always argues the point that contractual transactions between parties are always beneficial. This argument has also been extended in a neoliberal context to the use of sweatshop labour. Michael Walker, of neoliberal think tank The Fraser Institute, puts this argument as follows:

“Let’s look at it from a different point of view...let’s look at it from the point of view of the people in Bangladesh who are starving to death; the people in China who are starving to death; and the only thing that they have to offer to anybody, that is worth anything, is their low-cost labour, and, in effect, what they are saying to the world is, they have this big flag that says ‘Come over and hire us! We will work for 10 cents an hour, because 10 cents an hour will buy us the rice that we need not to starve’ and ‘Come and rescue us from our circumstance’. And so when Nike comes in, they are regarded by everybody in the community as an enormous godsend. ...’ (Walker43, 2004, cited in Achbar, Abbott & Bakan, 2004)

According to this argument, the sweatshops benefit both parties – the corporations on the one hand obviously through decreased costs of labour, and, less obvious to critics, the workers benefit on the other through the employment and the wages this provides. Walker (2004, cited in Achbar, Abbott & Bakan, 2004) goes on to insist that such corporate practices have long-term effects in raising the wages in the host country, that they then become “plump and healthy and wealthy”; and that in these cases corporations will then move on to “the next desperate lot”. If the corporations paid these people a higher wage, it is argued, they would have to hire less of them.

As with other things, Friedman argues that the sole protection needed for the worker is the existence of competition and ’the Invisible Hand’ - “the most reliable and effective protection for most workers is provided by the existence of many employers” (Friedman & Friedman, 1990, p. 246).

The true value of a worker's labour will necessarily be paid because employers will be motivated by the need to attract good workers in competition with other employers. Any attempt to go beyond this

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43 Michael Walker, speaking in an interview for the film, is president of the Fraser Institute, a Canada-based organisation which describes itself as ‘an independent public policy organisation’ which advocates ‘competitive market solutions for public policy problems’, www.fraserinstitute.ca
process is seen as a distortion of the market mechanism.

**14.2 The 'Market' Price, Unions and Minimum Wages**

As with his discussion of consumers, Friedman (1976/2007; 2002; & Friedman, 1990) envisions a world governed by the 'laws' of supply and demand, with all of the assumptions which go with that. Friedman envisions employees and employers as equal players in negotiations for wages and conditions who through these negotiations come to a 'market' price.

Adam Smith (1776/1952) himself had none of Friedman's illusions:

> “The workmen desire to get as much, the masters to give as little as possible...It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. The masters, being fewer in number, can combine much more easily...In all such disputes the masters can hold out much longer...In the long run the workman may be as necessary to his master as his master is to him, but the necessity is not so immediate” (Smith, 1776/1952, p. 28).

Smith (1776/1952) argues that the employer can always last longer using his existing capital than the employee can without a steady income; and therefore the immediacy of need will thus force employees to accept lower conditions in the interest of speedier employment.

Friedman's own critique of trade unions and minimum wages rests on the same assumptions about 'supply and demand' and prices as discussed in Chapter 11 of this thesis; including perfect competition, price competition, the 'law of variable proportions', etc (Friedman, 1976/2007). As discussed, the model of 'perfect competition' is made questionable at the very least by concentration of employers, and in any case the concentration of resources of the employer can already undermine this process. Stilwell (2006) argues that a market system in such cases rewards power, and that trade unions, while argued to be market interference by Friedman (Freidman, 1976/2007; Friedman & Friedman, 1990), are, for the most part, the only method by which employees can effectively exercise power against the huge resources of corporations; and even in these cases the power balance may favour employers. As mentioned previously, John Stuart Mill regarded trade unions not as an interference in the free market but as “the necessary instrumentality of that free market; the instrumental means of enabling the sellers of labour to take due care of their own interest under a system of competition” (Mill, 1871/2006, p. 932). Where there is any concentration of market power on the employer side, Friedman's theory actually can be shown to predict that workers will receive less than their 'market' rate of pay - unless they organise, that is, form their own contrary concentration of market power: a trade union (Keen, 2001).

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44 Smith referred to employers as 'masters' (Lux, 1990)

45 The trade union acts as a 'monopsony' or single seller. This will mean that the wage decided on will be some where between a range where employers are exploiting workers and one in which workers (through their own concentrated market power) command wages above the 'market' price. (Keen, 2001)
above the 'natural' market rate – they can be essential in setting that market rate.

The fact that employers purchase labour not for consumption in and of itself but for use in the production of consumer products for sale to end consumers also means that labour behaves fundamentally differently from other goods. Employers will always purchase as much labour as is required to produce products profitably to sell to consumers. A minimum wage (or increased wage in general) will only therefore have a negative effect on employment if it decreases the demand for consumer products or makes their production unprofitable. Friedman simply assumes that this is the case but this assumption is highly contentious.

In his seminal work *The General Theory of Employment, Interest and Money*, John Maynard Keynes (1936/1964) pointed out the fact consumers and workers are frequently *the same people* – that is that, in aggregate, the very people working to produce products are also the people who buy those products. An increase in wages may therefore be likely to be spent on consumer products, and this may actually *increase* the demand for these products, and perhaps, therefore for the labour required to produce them – decreasing unemployment. This will be particularly true of the lowest paid in society (those who benefit from the minimum wage), who may have a lower propensity to save their income than the higher paid. Conversely, a *decrease* in wages – or rather a removal in regulation to allow wages to be lowered (Friedman's market solution to high unemployment) - seems unlikely to increase the overall demand for products and therefore the impetus to hire more workers – indeed, it seems more likely to have the opposite effect; and therefore to exacerbate, rather than curb, high unemployment.

The discussion of how prices are determined in the chapter 'Who Chooses?' is also relevant here. If firms are, as in Friedman, price takers, then any increase in wages will be necessarily incorporated into the sales price of products and therefore increase their price; so that any effects on unemployment will depend on the elasticity of products, the size of the wage increase, and the extent to which this is offset by increases in. However, the strategically determined pricing strategies described in the aforementioned chapter imply a more complex relationship between the price of labour and the price of final goods. Kalecki (1971), for instance, shows how in a world of strategically determined 'markup' prices, increases in wages may simply do what advocates of wages assume it will do: redistribute income from profits to wages, with a reduction in the mark up of price over cost (in order to maintain demand) rather than in increase in price (reducing demand). The idea is lent empirical support by Fichtenbaum (2009), who in a study of the U.S. manufacturing sector 1949-2006 found that declining union density was correlated with a decline in the share of income going to production workers.

Historically, the record simply does not support the idea that higher real wages or the existence of a
minimum wage create joblessness, or indeed that deregulation improves employment. Take, for instance, the minimum wage. When one adjusts for inflation, the United States has seen a steady decline in the real value of the minimum wage since the 1970s (Economic Report of the President, 2009; Batra, 2005). In 2004, the minimum wage was at $5.15; where in 1968 it was worth $8 at 2004 prices (Batra, 2005). From a Friedman point of view, one would predict that the decreased real minimum wage, along with the deregulation which had occurred since the 1980s, would produce a reduction in the unemployment rate over that period.

However, this is not what happened. In the 1960s, unemployment averaged 4.78% and was 3.6% in 1968 (Economic Report of the President, 2009) with that $8 real minimum wage (Batra, 2005). Contrast this with the decade 1996-2005, arguably the most prosperous in the Friedman era, where 5.01% was the average unemployment, and 2004, with a $5.15 real minimum wage (Batra, 2005), was a year with 5.5% unemployment (Economic Report of the President, 2009). The results should be clear: a period producing a lower real minimum wage with reduced regulation actually had a slightly higher unemployment rate than the more regulated 1960s where the real minimum wage was higher. Meanwhile, those earning minimum wage have seen their purchasing power decline, with none of the consolation Friedman offers of increased opportunities for work.

This can also be applied to the relation between wages and data more generally. Consider, for instance, Figure 14.1, which compares yearly growth in average real hourly wages for nonsupervisory workers in the private sector with unemployment in the United States from 1965-2009. For Friedman's theory to hold, one would expect periods of high unemployment to be preceded by periods of high growth in real hourly wages; and for drops in the rate of growth to be necessary for a drop in unemployment. However, this is in no way supported by the data. Despite (or perhaps because of?) the fact that real wages actually declined 1973-1974, unemployment rose from 4.9% in 1973 to 5.6% in 1974 and then 8.5% in 1975. The recovery in unemployment 1976-1979 is preceded by recovery in the rate of real wage growth, while the resumption of worsening unemployment 1980-83 is preceded by sharp drops in real wages. Recovery in the rate of real wage growth again precedes the recovery in unemployment after 1983, and again the worsening employment situation of the early 1990's is preceded by a worsening rate of real wage growth. The recovery of this is preceded by stabilisation of real wage growth. Growth of real wages in the late 1990's and stabilisation for most of the 2000's coincides with stabilisation of unemployment, but ultimately at worse levels than those experienced in the late 1960's and early 1970's. The major spike in unemployment caused by the global financial crisis in 2009 is clearly unrelated to wage demands, which declined in 2008. Employment and wages, it would seem, behave in a way which is almost the opposite of that predicted by the 'laws' of supply and demand – high wages clearly are not a major cause of unemployment and in fact Keynes' theory that they may decrease
unemployment appears to be supported by this evidence.

Figure 14.1 Unemployment and the yearly growth rate of real hourly wages for production and nonsupervisory workers in private nonagricultural businesses, 1965-2009.

The issue of information asymmetry raised in "The Informed Choice?" can also be applied here. Employees, like consumers, are often ill-informed about, and ill-prepared to make, decisions regarding their wellbeing in employment. Felstiner, Durkin & Segilman (1989), for instance, allege that workers often are not aware of work hazards which threaten their health. This is likely to be true, for instance, of the hundreds of thousands of workers who either have or are likely to die from asbestos-related illness (Hills, 2005; McKenna, 1996; Punch, 1998; Shaw, 2005; Wishloff, 2003); or indeed for many of the some 6000 workers who die on the job each year in the U.S. or the 100,000 estimated to die from industrial diseases (Brown, 2002). Regulation is needed to protect these people.

14.3 Realities of Sweatshop Labour.

There are further implications of derived demand when it is placed in the context of a global labour market. If indeed it is the behaviour of consumers, and their demand for products, which determines the demand for labour, then the behaviour of consumers becomes an important factor in determining employment. This is further complicated by the fact that products are consumed, not only from the domestic trade, but from producers in other countries. While, then, as is often argued, consumers may benefit from inexpensive products on the one hand; if a country becomes a net importer of goods then it would seem that this would further worsen the problem of insufficient labour demand because that demand is then transferred elsewhere.

Furthermore, the differences in the value of money in different parts of the world also effect the
extent to which the cost of labour becomes important in stimulating demand from consumers. Take
the example of the tendency of textile industries to produce their products using cheap 'sweatshop'
labour in poorer parts of the world. As was outlined in the above quote from Michael Walker of the
Fraser Institute, the excessively low wages - often barely enough to survive - are defended on the
grounds that they are necessary to stimulate job production in these countries, and that raising them
would not only raise costs to consumers but then in turn reduce their demand for the products and
thus the demand for jobs producing them (Bakan, 2004; DeRegil, 2006; Klein, 2000; Korten,
1995; Lal, 2006).

Whether this bears out in reality, however, is a different matter. The National Labour Committee,
an organisation which attempts to improve the lot of labourers in developing countries by
exposition of the practices of the corporations profiting from this labour, found copies of company
documents related to the ‘sweatshop' labour employed (through contractors) by Nike during one
investigation. The documents broke down the several functions of production of Nike textiles in
time units of ten thousandths of a second. Taking the wage of the workers and calculating it against
the time taken to make the goods, the amount paid for the labour needed to make the shirt was
calculated to be 8 cents, taking 6.6 minutes to make. This same shirt was sold in the U.S. for
$22.99 (Bakan, 2004).

Even assuming that all labour prices are incorporated into final costs, for this labour cost to in any
way effect the demand for such a shirt it would have to be significant enough to affect whether a
consumer would buy the shirt. At around 0.35 percent of unit cost, it seems unlikely that reducing
the cost of such labour would increase demand for such shirts. If the labour cost were reduced to
zero - that is, the workers worked for free - the maximum saving for a U.S. consumer on such a shirt
would be 8 cents - reducing its price to $22.91. Conversely, if the labour cost were doubled, to 16
cents (which, when translated to a wage, may be enough to pay workers a reasonable living wage
and stimulate the economy of the country where the workers are located), the additional cost to the
consumer would be 8 cents. If it were trebled, the additional cost to the consumer would be 16
cents, and the labour cost would contribute a little over 1 percent of the unit cost to the consumer.
That any of these scenarios would be enough to either stimulate or stunt demand for Nike shirts in
the United States – thus reducing demand for labour - seems unlikely.

In contrast, basket ball star Michael Jordan was paid $20 million dollars for his endorsement in a
marketing campaign in 1992 – more than the combined annual pay of all the workers which made
Nike shoes (Korten, 1995). Of course, Jordan himself contributed not at all to the actual production
of the shoe. As DeRegil (2006) argues, such companies could easily pay manufacturing workers a
more substantial living wage and still be paying very small amounts of money in absolute terms; but
the drive to minimise costs, without regard to ethics, prevents them from doing so.

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Frustratingly, the reality is that sweatshops frequently provide few of the benefits claimed of them by free market advocates. The governments of developing countries have been drawn into stiff competition with one another to provide the incentives for corporations to move production to their country – tax breaks, deregulation, and a ‘race to the bottom’ for the acceptance of lower and lower wages (Bakan, 2004; DeRegil, 2006; Sklair, 2002, Wichterich; 2000), which “has a direct impact on the generation of more inequality and of more social and environmental decay, by contributing to the widening gap between rich and boor both in rich and poor countries” – with workers in wealthy countries having to accept lower wages to offset wage competition from offshore; and low-wage earners in developing countries competing with one another to offer the best incentives (DeRegil, 2006, p. 3). The ability of workers to demand better wages and conditions is also severely undermined by anti-union behaviour by such governments, which includes use of the military to break up strikes (Bakan, 2004; Korten, 1995, Wichterich, 2000). Sklair (2002, p. 92) also counters the job-creation argument in pointing out that “the growth of new industry jobs in the third world has hardly kept pace with the loss of jobs in traditional indigenous industries, and TNCs have directly caused the loss of at least some of these indigenous jobs by forcing domestic competitors out of business”.

The long-term wage-raising and economy-stimulating effect of sweatshops is also highly dubious. Klein (2004, cited in Achbar, Abbott & Bakan, 2004) points out that “the workers rarely make enough money to buy three meals a day, let alone stimulate a local economy”. Not content with merely taking advantage of lower costs of living in developing countries, corporations frequently pay their workers from this part of the world wages below basic subsistence levels in their single minded determination to reduce costs (Bakan, 2004; DeRegil, 2006; Lassere, 2003; Wichterich, 2000). Wal-Mart, for instance, was recently reported to have been paying its garment workers in China 16.5 cents per hour, well below the 31 cents per hour legal minimum wage (which can already be seen to be a ‘hunger wage’) (DeRegil, 2006, p.7). These workers also have no prospects for promotion, as the more skilled managers and technicians tend to be expatriates, and there is little done to improve the skills and marketability of workers – in fact, many are simply ‘used up’, physically debilitated, by about age 25 (Sklair, 2002; Wichterich, 2000), and so when they do leave to pursue “the next desperate lot” because of better incentives, the original host economy has never experienced being “plump and healthy and wealthy” to any degree, and has not been helped to any meaningful degree by the presence of sweatshops (Sklair, 2002; Wichterich, 2000).

Conditions in ‘sweatshops’ are also appalling. Physically abusive punishments (including beatings, and plastering of mouths for talking too much), pay deductions for ‘mistakes’ such as when a needle breaks, restrictions on toilet breaks and water intake, sickness from chemical dust intake, forced overtime (on already long hours of 12 per day), the fear of a fire in places with no emergency exits.
Joseph McIvor ‘Seeing the ‘Invisible Hand’

(the death of 32 women in 1996 in a third world textile factory giving credence to this), and the threat of being fired if the results of forced pregnancy tests are positive, are some of the harsh realities of working in third world textile factories making clothes for multibillion dollar companies such as Wal-Mart and Nike (Bakan, 2004; Korten, 1995; Wichterich, 2000). These workers do not appear to have greatly benefited from the existence of other employers.

Part IV has demonstrated Friedman's notion that competition is all that is needed to protect consumers and workers, and that government regulation and provision is almost everywhere harmful, to be fallacious. The performance of the 'Invisible Hand' has been far from satisfactory in this regard, and it seems difficult to imagine that the situation would not have been even worse without the existence of some regulation. Where Part IV has focused on 'microeconomic' issues, however, Part V turns the attention to Friedman's claims about 'macroeconomic' issues including stabilisation of the economy and the prevention of economic crisis.
PART V: THE HELICOPTER
DROP OF MONEY: FRIEDMAN'S
MACROECONOMICS.
15 Foundations and Implications of the Theory

15.1 A Monetary Rule

Beginning in the 1950s, Friedman began to publish a series of articles speaking out against Keynesian fiscal policy and asserting the primacy of money and monetary policy in stabilising the economy. Beginning with his *The Quantity Theory of Money: A Restatement* (Friedman, 1959), and continuing most importantly with his sprawling seminal work (co-authored with Anna Schwartz) *A Monetary History of the United States* (Friedman & Schwartz, 1963) and then later *The Optimum Quantity of Money* (Friedman, 1969/2005), among others, Friedman made the case for turning away from the Keynesian emphasis on fine-tuning the economy with fiscal policy and the pursuit of full employment in favour of a nondiscretionary, rule-based expansion in the money supply with the sole intent of limiting inflation (Friedman, 2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963). Using a revisionist history which attempted to show that the original impetus for Keynesian interference had been based on an erroneous interpretation of events; Friedman was, in effect, attempting to give the greatest feasible role to the free market in the determination of the workings of the economy.

Friedman’s assertion was that excessive inflation or deflation was caused, not by flaws in the workings of the free market, but by misuse of the discretionary power of organisations such as the U.S. Federal Reserve to control the supply of money (Friedman, 2002; Friedman & Schwartz, 1963; Friedman & Friedman, 1990). Instead of a discretionary Federal Reserve system, he would propose a rule-based system whereby increases in the supply of money would occur at some set rate (Friedman, 2002).

15.2 The Quantity Theory and the Helicopter

Friedman’s position was based on a revival of the pre-Keynesian Quantity Theory of Money. This posits that, assuming that the velocity of circulation (i.e. the rate at which money circulates and is distributed throughout the economy) is constant (and this is indeed assumed – though in reality it can tend to vary (Kydland & Prescott, 1990; Stilwell, 2006)), changes in the money supply and changes in prices will move together at any given rate of economic production in an economy, such that an increase in the money supply over and above an increase in goods and services produced will always raise prices. An expansionary money policy will therefore necessarily cause excessive inflation, as will expansionary fiscal policy financed in any part by increases in government created fiat money (Friedman, 1963; Friedman, 1969/2006; Stilwell, 2006).46

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46 Friedman’s objections to expansionary fiscal policy financed solely by taxation are different: they are seen as crowding out private expenditure and causing an inefficient distribution of resources.
In *The Optimum Quantity of Money* (1969/2005), Friedman attempts to show the logic in this by conjuring a vision of a society which begins with a given amount and distribution of money, and a given level of savings in each person's case. The people use money primarily as a means of exchange, and also save it as a reserve for future emergencies. The society then receives a scattering of money dropped from a helicopter. Because people have a higher nominal income than they did previously, and because the amount that they saved on average had been 'optimal' for them previously, they will simply try to spend more; but this process will ultimately be frustrated as the economy returns to 'equilibrium' – because if other people have the extra money then everything will cancel out – prices increase in the same proportion as the increase in money, so there is no gain in real income. Even if the helicopter drop was unevenly distributed, distributional effects will only be temporary because """"After picking up the cash, each individual is in a position that he could have attained prior to the arrival of the helicopter. But he preferred the position he had attained prior to the arrival of the helicopter. Nothing has occurred to change the ultimate alternatives open to him."" (Friedman, 1969/2005, p. 6) – implying that everyone has already chosen the amount they wish to earn and that the distribution from the winners from the helicopter drop will soon be transferred back so that the money is distributed as before. Nominal prices thus increase with no gain or loss.

If the helicopter drop becomes more regular, however, then this will cause people to expect nominal prices to rise, which reduces the value of savings - if, as in the parable, the quantity of money rises at a constant rate of 10 percent per year, then this creates a yearly cost of holding cash equal to that amount. People will begin to behave differently as a result -

""""When it costs ten cents per dollar per year to hold an extra dollar of cash, there will be greater incentive...to substitute other productive resources for cash. This will mean both a reduction in the real flow of services from the given productive resources and a change in the structure of production, since different productive activities may differ in cash-intensity, just as they differ in labor- or land-intensity.....when the community has adjusted to it, each individual separately is worse off.....he is poorer because the representative individual now has a reserve for emergency equal to (a lower real income than previously)...(and) he has a lower real income because productive resources have been substituted for cash balances, raising the price of consumption services relative to the cost of productive services"""" (Friedman, 1969/2006, p. 14)

More lucid explanations are given in Friedman's more populist works. While admitting that other factors can play a temporary role in the rise of prices of individual items (oil, for instance), Friedman's contention is that the supply of money ultimately governs the level of inflation (or deflation) in the economy (Friedman & Friedman, 1990). Further, Friedman contends that the supply of money is governed by the control of the 'printing press'. This is to say, that the money supply is controlled by (government) central banks, exogenously to the workings of market players rather than endogenously within that free market, such that a slower expansion of the monetary base.
(printing money) will lead to less inflation (or a deflation if it is maintained during a panic); and a faster one will always increase the rate of inflation.

15.3 The Great Depression: A Redirection of Blame

Perhaps the most potent aspect of Friedman's monetarist claims have been those regarding the nature and causes of the Great Depression 1929-1933. Friedman's claim was not, as Rayack (1987) appears to imply, that the Depression's severity might be deemphasised. Instead, Friedman's assertion was that the Depression was not caused, as had been believed, by inadequate regulation and excessive speculation during the 1920's, but by the creation of the Federal Reserve System – its failure to save banks from runs, and its failure to sufficiently expand the money supply so as to offset the Depression (Friedman, 2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963).

The assertion is crucial to Friedman's rejection of government intervention in, and regulation of, the economy to increase stability - and his assertion that markets should be left largely unregulated. This claim was made when Capitalism and Freedom was first published in 1962 (Friedman, 2002); but the full case would be made in his sprawling monetarist collaboration with Anna Schwartz, entitled Monetary History of the United States 1867-1960 (Friedman & Schwartz, 1963), in a chapter entitled 'The Great Contraction'. The argument rested on a number of key assertions:

• that the existence and incompetence of the Federal Reserve was the key difference between this and other previous crises

• that the destabilising effect of the bank runs of the period would have been much less if not for faith in the Federal Reserve System

• that the extent of the contraction in economic activity was caused primarily by a decrease in the money stock.

• that this decrease in the money stock could in turn have been prevented by the Federal Reserve bank by, in essence, printing money

• that the Depression would have been very much milder had the Federal Reserve been compelled by a monetary rule to ensure an increase of the total money stock at some predetermined rate (thereby necessarily preventing any persistent decline in the money stock)\(^{47}\)

• following from all this, that the money stock in general is controlled by the Federal Reserve and its power over the printing press, and that, in a free economy, deflation can always be

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\(^{47}\) It is assumed that Friedman means that the money supply over all is targeted through varying ratios of base (fiat) to credit money, as it is the only way that his argument can be even remotely internally consistent. If he simply means that base money should be increased at a predetermined rate then his assertion that the Federal Reserve could have prevented the depression by injecting base money into the system at a higher rate would contradict this.
Despite some criticisms (the most compelling of which will be discussed later), the claim has gained much standing among many – particularly U.S. Federal Reserve governor and now chair Ben Bernanke, who at a 2002 conference to honour Friedman, closed his speech by saying: “I would like to say to Milton and Anna: Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again” (Bernanke, 2002a). Less than two weeks later, Bernanke would further spell out sentiments regarding the primacy of the power of the Federal Reserve to prevent depressions before the National Economists' Club, stating that he was confident that the Federal Reserve system “has sufficient policy instruments to ensure that any deflation that might occur would be both mild and brief” (Bernanke, 2002b). He went on to remind people that

“the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in existence, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation” (Bernanke, 2002b).

He goes on to recommend, in the case of deflation, a series of ways of injecting 'fiat' (government created) money into the economy, including a money-financed tax cut “essentially equivalent to Milton Friedman's famous 'helicopter drop' of money” (Bernanke, 2002b), which he contends will cure deflation in the event that it occurs. Bernanke characterises Friedman's explanation of the Depression as having “become the leading and most persuasive explanation of the worst economic disaster in American history, the onset of the Great Depression” (Bernanke, 2002a).

On this issue, Friedman has several policy recommendations which reflect his attempt to place as little responsibility as possible in the hands of government and give the free market maximum reign. One of these, as briefly described earlier, is the adoption of a rule-based system of expansion of the money supply; curbing the discretion of central bankers to determine the needed money supply. Friedman proposes that the central body be compelled to ensure that the money stock increases at some set rate (Friedman, 1983; Friedman, 2002;), using base money (the proverbial helicopter drop) as the instrument (Friedman, 1982).

Another important one is to abandon the pursuit of full employment and an emphasis on curbing inflation; which includes a definition of a 'natural rate of unemployment' as simply any rate of unemployment at which inflation is non accelerating (however high that may be). The latter seems to be almost an almost purely value driven theory, giving primacy to low inflation over low unemployment. Further, and perhaps most crucially – that the prevention of economic crises by
vigilant regulation and fiscal policy should be abandoned; that the market be left free to its own devices, and that the reserve system can avert crises – if and when they threaten – simply by running the veritable printing press.

While some have bluntly pointed to the failure and abandonment of 'monetarism' \textit{per se}, Stilwell (2006) rightly points out that the current systems in place – including so-called 'modern' monetary policy – share important continuities with monetarist theory, including an emphasis on inflation targeting and an abandonment of the use of fiscal policy to lower unemployment. That is, until the recent economic crisis.
16 Can the State of the Economy Really Be Controlled by the rate at which a helicopter drops money on it? Some alternative theories

16.1 The Endogenous Money Stock

Perhaps the most compelling argument refuting Friedman's conception of macroeconomics and the causes of inflation and deflation has come from a group who share Friedman's emphasis on the role of money, but refute out of hand Friedman's conception of how money is created. The Post-Keynesian theorists assert that, in countries with developed credit systems, the money supply is determined not by the decisions of central bankers to print money or not, but by the lending decisions of financial institutions and the willingness of private citizens and businesses to borrow (Jarsulic, 1989; Kaldor, 1982; Keen, 2001; 2009a; 2009b; Lavoie, 1984; Moore, 1979; 1983; 1988; 1989; 1994; Palley, 1993; 1997; Wray, 1993). Central banks, far from being the drivers of the money supply, are at best reactive agents to private decisions.

This theory of endogenous money requires a rethinking of the traditional 'multiplier' model. According to the traditional theory, banks wait for deposits of money to enter their accounts. They then (in the U.S., where there is 10% minimum reserve requirement) lend out roughly 90% of this. This lent money (or a proportion of it) in turn gets deposited in another account, and then 90% of this is lent, and so on; so that the total amount of money exceeds by several times the initial fiat (Federal Reserve created) money deposit (Friedman & Friedman, 1990; Kaldor, 1982; Keen, 2001; 2009a; 2009b; Moore, 1979; 1988; 1989). The central bank, then; through a combination of its control over the printing press and the control of a discounted rate of lending to banks (the 'interest rates' so often referred to in policy discussion), is therefore the driver of the amount of money – credit or 'fiat' – in the economy at any one time. When it prints less money or increases the discount rate, this will necessarily slow the increase in the supply of money and reduce inflation; in turn, when faced with a potential deflation, it can simply lower the discount rate or print more money; and through this 'multiplier' effect the deflation will be stopped and crisis averted (Friedman, 2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963). Friedman in particular emphasised the use of base money rather than interest rates to target money supply (Friedman, 1982).

Post Keynesians argue, however, that this presents a distorted view of money creation. They argue that, in fact, lending decisions are first made endogenously by financial institutions (in response to perceived opportunities) and borrowers, and that central banks, in the interest of preventing a credit crunch in the short-term, accommodate these lending and borrowing decisions with base money. The causality, then, is reversed – credit money creation in the market economy fuels the creation of base or 'fiat' money, not the other way around (Jarsulic, 1989; Kaldor, 1982; Keen, 2001; 2009a; 2009b; Lavoie, 1984; Moore, 1979; 1983; 1988; 1989; 1994; Palley, 1997).
Essentially, banks have an incentive to draw down their reserves below the reserve requirements (whatever they may be, and assuming they exist) to meet the demand for credit through off balance sheet activities or loopholes in the system. At this point they now need to look for money with which to restock their reserves. If this happens in just a few banks then they may be able to just borrow from each other, but if it becomes endemic in the system (as it does) then, in order to avoid a destructive contraction in lending (a “credit crunch”), the central banks will need to add new money to the system to top up the reserves (Kaldor, 1982; Keen, 2001; 2009a; 2009b; Lavoie, 1984; Moore, 1979; 1983; 1988; 1989; 1994; Palley, 1997).

In a study of business cycles which looked at monetary aggregates from the mid-1950s to 1989, Kydland & Prescott (1990) found fairly solid empirical support for the idea of an endogenous money supply in the U.S. According to them, increases in fiat money were consistently preceded by changes in the larger money stock (i.e. including credit money) – “if anything, the monetary base lags the cycle slightly….M2, the more comprehensive measure of the money stock, showed some evidence that it leads the cycle by a couple quarters” (Kydland & Prescott, 1990, p. 16-17).

Friedman’s monetary policy, then, is impossible to apply properly. If the monetary authorities accommodate the needs of credit, then the ‘rule’ cannot be applied – the money supply will expand at a rate which varies according to the activities of debtors and creditors in the market system, not at a set rate as proposed by Friedman. If they attempt to expand the monetary base at some set rate regardless of the demands of the financial system, they will create a credit crunch which results in a severe monetary contraction – an advent which Friedman has insisted it is the monetary authorities’ responsibility to prevent.

Immediately, this has some important policy implications. The importance of money in the economy is, as in Friedman, paramount. However, while Friedman asserts that the Federal Reserve can control money by its control over the veritable printing press and should let the free market have otherwise free reign in their lending practices; the endogeneity of the monetary system implies that the only real way for the government to limit the money supply is with direct controls over credit markets and lending practices.


Friedman’s explanation of the Great Depression is further called into question. The modern Post Keynesian theories on the causes of depressions is based largely on the work of Hyman Minsky (1977), but this in turn originates in part in the work of Irving Fisher (1933). Fisher had been an investor and well respected economist who early on in the progress of the Great Depression had predicted the self-stabilisation of the system before it turned to disaster. Fisher was duly shocked by the severity with which it would ultimately strike and lost a fortune in the process (Keen, 2001).
Unlike many of his contemporaries, however, Fisher was sufficiently reflective on the process to break out of the neoclassical, self-equilibrating theoretical paradigm in which he had been indoctrinated; concluding that the neoclassical theories which at that time dominated economics painted an absurdly erroneous picture of the economy bearing little or no resemblance to a real world. In the real world, far from tending always toward perfect equilibrium, the economy’s natural state was disequilibrium, as it was prone to several disturbances mostly caused by the fallibility of human thinking. While most of the time there would be relatively stable oscillation around equilibrium, the system was prone to disturbances that could potentially destabilise the system (Fisher, 1933).

Fisher theorised of what he called a ‘Debt Deflation Theory of Great Depressions’ (Fisher, 1933), where the principal causes of a Depression are “over-indebtedness to start with and deflation following soon after” (Fisher, 1933, p. 341, emphasis in original). Essentially, an overexpansion of credit and debt increases the fragility of the system and greatly exacerbates the effect of other disturbances in equilibrium such as over-production, excessive speculation, over-investment, and the like – the contribution of these other disturbances are seen as “important; but they would have far less serious results were they not conducted with borrowed money” (Fisher, 1933, p. 341). When there is excessive indebtedness, a scramble to repay excessive debts leads to ‘distress selling’ at greatly reduced prices in order repay the debts; this in turn causes a monetary contraction as deposits are used to pay debts and the demand for credit is reduced, causing a reduction in the money multiplier; and banks may also be forced to accept less than complete repayment of loans. There is in turn a further decrease in prices as demand is reduced, increasing the real indebtedness (in terms of purchasing power) of many borrowers even as their loans are paid down and interest rates are reduced – “the very effort of individuals to lessen their burden of debts increases it, because of the mass effect of the stampede to liquidate in swelling each dollar owed……The more the debtors pay, the more they owe” (Fisher, 1933, p. 344, emphasis in original). The contraction in demand effects business and business profits, causing bankruptcies and a reduction in output, trade, employment and, ultimately, nominal wages; which feeds back into the demand contraction loop and causes further loss in confidence and contraction of lending and borrowing; with further contraction in the money supply and demand; and so on in a downward spiral.

Interestingly considering his theories’ later use in Post-Keynesian explanations of the Great Depression, Fisher’s final analysis does bear resemblance to Friedman’s in that he indicates his opinion that the Federal Reserve could have prevented the worst effects of the depression:

“it would have been (easy), at any time, to have stopped it earlier. In fact….recovery was apparently well-started by the Federal Reserve open-market purchases, which revived prices and business from May to September 1932…..It would have been still easier to have prevented the depression almost altogether. In fact, in my opinion,
this would have been done had Governor Strong of the Federal Reserve Bank of New York lived, or had his policies been embraced by other banks and the Federal Reserve Board and pursued consistently after his death. In that case, there would have been nothing worse than the first crash. We would have had the debt disease, but not the dollar disease – the bad cold but not the pneumonia” (Fisher, 1933, p. 347).

However, Friedman’s view that control by the Federal Reserve of the money supply should be the sole means of regulating the market appears not to be supported by the diagnosis of debt as a ‘disease’. Fisher would later recommend that commercial banks be forced to maintain 100% reserves on deposits, lending money out of proceeds from fees charged to depositors and profits from interest payments (Fisher, 1935). Fisher’s ideas on the Depression largely languished for many years after publication, until the Post-Keynesian economist Hyman Minsky picked them up years later (Keen, 2001).

Minsky’s (1977) ‘Financial Instability Hypothesis’ also drew heavily upon the work of John Maynard Keynes, whose theories had gained prominence after the Great Depression. Keynes’ (1936/1964) seminal work *The General Theory of Employment, Interest and Money* had pointed to a number of flaws in the neoclassical theories of the capitalist system. These included the theory – supported by Friedman (2002; Friedman & Friedman, 1990) - that wage reductions and the elimination of minimum wages were an effective way of reducing unemployment. As discussed in chapter 14, Keynes (1936/1964) instead argued that while wage reductions might reduce the unit price of products, because wage earners and consumers are essentially the same people, wage reductions could potentially exacerbate unemployment by reducing both the ability of wage earners to buy products and their general propensity to spend money on them. But Minsky (1977) was particularly interested in Keynes’ emphasis on the importance of uncertainty in determining expectations.

Minsky highlighted the fact that Keynesian theory had, in an attempt to reconcile it with Neoclassical economic theory, been bowdlerised of elements which had been crucial to Keynes’ original analysis since the publication of *General Theory*; particularly with regard to the role of uncertainty and expectations about the future. Keynes’ theory was one of “analysing the economic behaviour of the present under the influence of changing ideas about the future….which depends on the interaction of supply and demand” (Keynes, 1936/1964, p. vii) (and uncertainty with these). Expectations substantially affected decisions whether to invest or hold cash and savings (the ‘liquidity preference’) – while the neoclassical economists insisted that the rate of interest would determine this, Keynes (1936/1964) had insisted that this was determined more by (uncertain) expectations about future yield from such investments.

Keynes (1936/1964) also emphasised the role of these expectations in the excessive volatility of the

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48 See Keen (2001) for a detailed discussion of Keynes’ bastardisation in this way.
stock market, where “day-to-day fluctuations in the profits of existing investments… tend to have an altogether excessive, and even absurd, influence on the market” (Keynes, 1936/1964, p. 153-154). Moreover, the separation of ownership and management – whereby shareholders may have only a passing knowledge of the operations of the business they had invested in - meant that these expectations were all the more uncertain; and that the most knowledgeable professional investors, rather than providing greater clarity to the market with their superior knowledge of the long-term prospects of companies, instead concerned themselves primarily with estimates of the future temperament of other investors in determining the market price of shares:

“not with what an investment is really worth to a man who buys it ‘for keeps’, but with what the market will value it at, under the influence of mass psychology, three months or a year hence….For it is not sensible to pay 25 for an investment of which you believe the prospective yield to justify a value of 30, if you also believe that the market will value it at 20 three months hence…the actual, private object of the most skilled investment to-day is ‘to beat the gun’, as the Americans so well express it, to outwit the crowd, and to pass the bad, or depreciating, half-crown to the other fellow” (Keynes, 1936/1964, p. 154-155).

It was thus that Keynes (1936/1964) distinguished between ‘enterprise’ investment – of the type which supported business with a view to profit from its operations – and ‘speculative’ investment, designed only to profit from the prospect of enough other people buying the same stock as to substantially raise its price.

All of these decisions were made under expectations of future profits which were inherently uncertain. While investors must make decisions based on facts which are known, the most important facts may be ones which are impossible to know – “The outstanding fact is the extreme precariousness of the basis of knowledge on which our estimates of prospective yield have to be made” (Keynes, 1936/1964, p. 149). In a reply to criticism of his work, published the year after The General Theory, Keynes (1937) takes pains to express the nature of uncertainty. By ‘uncertainty’, Keynes does not simply mean cases where all potential outcomes are known and it is simply a matter of choosing between them – roulette, for instance, while a risky gamble, is a choice between a finite number of possibilities; and indeed its probability is calculable. ‘Uncertainty’, instead, is a choice between an infinite number of possibilities, about which only guesses can really be made:

“The sense in which I am using the term is that in which the prospect of a European war is uncertain, or the price of copper and the rate of interest twenty years hence, or the obsolescence of a new invention, or the position of private wealth owners in the social system in 1970. About these matters there is no scientific basis on which to form any calculable probability whatever. We simply do not know” (Keynes, 1937, p. 214).

The expectations upon which investment decisions are based are highly uncertain, and the decision making process used to formulate these expectations is deemed by Keynes (1937) to be highly dubious. According to Keynes (1937), the present state of things is given far too much weight in decision making, while not enough is given to a careful examination of the past. Further, “we
assume that the *existing* state of opinion as expressed in prices and the character of existing output is based on a *correct* summing up of future prospects, so that we can accept it as such unless and until something new and relevant comes into the picture” (Keynes, 1937, p. 214) – this despite the distortions of incomplete knowledge and speculative investment. Further, with doubts as to their own knowledge and judgment, investors will tend to more or less conform to the opinion of others in the market, especially of the majority, which Keynes (1937, p. 214) calls “conventional judgment”.

Crucial to Keynes (1936/1964; 1937), then, was the effect of this uncertainty, and the dubious methods by which investors seek to cope with it, on undermining any semblance of self-stabilisation in the market. With expectations of an uncertain future built on dubious and highly fragile grounds, a sudden drop in profits in one market may, rather than simply resulting in a minor adjustment in prices to equilibrate the market, lead to a drop both in investment in that market and in the purchase by companies servicing that market of investment goods and capital assets, as pessimism about future profits sets in. Others, then, perceiving this, may then further withdraw or fail to make investment as pessimism spreads. This pessimism then begets further pessimism as aggregate demand decreases and the liquidity preference increases (i.e., people begin to hold more cash and invest less), and prices are pushed further down. This feedback loop may continue as the pessimistic perspective becomes more and more rational in a falling market – “disillusion may suddenly impose a new conventional basis of valuation” (Keynes, 1937, p. 215). A general slump ensues.

In these cases Keynes (1936/1964) advocated expansive government (deficit) spending on social programs and services, tax cuts, infrastructure and direct employment of people by government (rather than simply printing money and giving it to financial institutions). Furthermore, government needed to act as a vigilant regulator preventing the worst excesses of economic behaviour with laws to combat them.

Minsky’s work combines Keynes’ emphasis on expectations, uncertainty, and the role of government with Fisher’s emphasis on the credit system and over-indebtedness, as well as Post-Keynesian theories of the endogenous money supply, to produce his ‘financial instability hypothesis’ (Minsky, 1977; 1982; 1995a; 1995b). Essentially, Minsky postulates that crises will be caused when euphoric expectations about future profits result in excessive debt financing of increasingly risky ventures, so that when a number of these expectations inevitably fail to be realised, a deleveraging process and debt deflation, the type of which Fisher (1933) theorised, ensues. According to Minsky, the memory of major financial crises (of the type experienced in the depression) leads to a period of cautious investment - “the memory of the great Depression led households, businesses and financial institutions to prize their liquidity….conservatism ruled in finance” (Minsky, 1982, p. 6). This period of moderation leads to consistent success of business
ventures (because investors are unwilling to invest in riskier ones) and low unemployment, while borrowing and investment are highly conservative. Economic growth is strong but not extreme. There is, in Minsky’s words, a period of “financial tranquility” (Minsky, 1977, p. 9). However, as the memory of crisis fades and economic stability continues, investors and speculators begin to think their assessment of risks and uncertainty too conservative. They begin to lift their expectations of future earnings; and with this their aversion to borrowing is also reduced – higher profits appear and asset prices to legitimate greater borrowing (Minsky, 1977).

For a time their expectations – and their higher borrowings - are validated by the increased profits and asset prices. In this optimistic climate, finance is sought for more and more speculative ventures and there is an increase in leveraging, while banks share the optimism of speculators and are more than happy to finance such ventures. The stable profit margins of the ‘real economy’ of production of goods and services are devalued in relation to the euphoric speculation of asset and share appreciation, which are propelled by constant refinancing. The credit market – and thus the debt to equity ratio – expand in a kind of market euphoria. Ultimately, this kind of euphoria gives rise to what Minsky calls ‘Ponzi finance’, in which the interest rates of a loan for an investment exceed the anticipated cash receipts from normal business operations, but the anticipated market price appreciation of the asset (be it shares or other assets) is expected to make up for this (Minsky, 1977). Market interest rates rise (even without increases in the discount rate by the central banks) in response to decreased liquidity, as well as to stimulate demand for more liquid (and therefore lower margin) financial instruments, but this does little to dissuade investors as asset price appreciation rates are anticipated to continue to exceed this.

As interest rates and levels of leveraging continue to rise, so does the level of systemic risk; and conservatively financed ventures develop into speculative and even Ponzi ones – the over-indebtedness about which Fisher (1933) postulated becomes entrenched. The high level of indebtedness mean that margins for error are low – “even minor declines in profits and wages can lead to increases in nonperforming assets in the portfolios of financial institutions…even minor increases in interest rates can lead to increases in nonperforming assets in the portfolios of financial institutions…even minor increases in (money) wages can lead to pressures on profit flows and therefore to an increase in nonperforming assets” (Minsky, 1995a, p. 198).

Ultimately, the heavily indebted positions lead to sale of assets in order to repay debts. This can be enough to slow the breakneck pace of asset price increases on which the sustainability of debt levels depend. Ponzi financiers can no longer sell their assets at prices which exceed their debts and the

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49 Charles Ponzi was a 1920s financier who acquired investment without generating any revenue from actual business ventures. Instead he concocted fantasy assets, including real estate which did not exist; but was able to pay interest to investors with the money from new investors. When the rate of increase of new investments could no longer support this, the scheme collapsed (Keen, 2001; Minsky, 1977; Lordon, 2007)
cash flows generated by these assets are insufficient to meet interest payments, meaning that banks lose money on these loans. Initially, banks respond by increasing interest rates to compensate, exacerbating the issue. Panic sets in and the beginnings of the distress selling and debt-deflation scenario posited by Fisher (1933) ensue.

Minsky believed that concerted action by both ‘big government’ (by deficit spending to stimulate the economy) and the central bank (by injecting liquidity into the system) could avert the worse depths of crises (again combining Keynes and Fisher). In particular, Minsky (1982) favoured resource and infrastructure building by government over support of ‘consumption’. However, Minsky also believed that if the financial ‘bailout’ actions were not accompanied by vigilant regulation, this would limit the ability of governments to avert future crises (Minsky, 1986/2008; Polley, 2008). This is partly because the ‘bailouts’ limit the costs to speculators of their previous excesses, and so they will more readily return to them as the markets regain strength, so that the ‘tranquil’ period is briefer. It might also be observed that, with deleveraging incomplete, the increasingly brief post-crisis ‘tranquil’ period and the euphoric period after might both start at increasing levels of indebtedness and a more volatile situation.

Others – both those explicitly employing Post-Keynesian theories of endogenous money and those who appear to have come to endogenous money in their assessment of the facts – have more strongly emphasised the fact that the private credit system’s hegemony over the bulk of the money supply, and the extent of the credit market, can severely limit the effectiveness of monetary policy in a crisis. They argue that, in addition to the zero limit on the discount rate, injections of base money will pale in comparison to the collapse of the money multiplier as deleveraging occurs (i.e. lending and borrowing are reduced and debts are paid down), and that the cash injections may simply be put into reserves and used to offset liabilities (Foster & Magdoff, 2008; Keen, 2009a, 2009b; Krugman, 2007; 2008; 2009; Palley, 1993).

While Minsky's influence over government policy has been limited, the reach of Friedman's monetarist policies has been extraordinarily wide ranging, and it would be imprudent to attempt to cover it all here. In the following chapters, a brief attempt will be made to draw on key points in history to illustrate the overall trend, both evaluating monetarist interpretations of history, and evaluating the effects of monetarist policy. As with the rest of this thesis, the emphasis is on the United States and, to a lesser extent, Britain, with a special exception made for Chile because it involved the first and arguably the most complete adoption of Friedmanite monetarist policies. For greater discussion of economic crises in Asia, Latin America and the rest of the world, see Kindleberger & Aliber (2005), Klein (2007) and Krugman (2009).

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50 All figures in the below discussion refer to the United States.
17 The Great Depression

17.1 Introduction: The Depression and Friedman's Revisionist History.

The Great Depression 1929-1933 was the most severe economic contraction in the capitalist history of the developed world (Ferguson, 2008; Friedman & Friedman, 1990; Keen, 2001). By 1933, the U.S. faced 25% unemployment (Friedman, 1990; Friedman & Schwartz, 1963; Jones, 2008; Rayack, 1987), and for the decade of the 1930s it averaged 18.2% (Rayack, 1987). Housing foreclosures proliferated - according to Ferguson (2008, p. 242), “in 1932 and 1933 there were over a half million foreclosures. By 1933, over a thousand mortgages were being foreclosed every day”. Commodity prices were reduced by almost 10% per year while stock prices plummeted 90% and output in the U.S. fell 30% (Keen, 2001). Real income over the period fell on average by 36 percent over the four year period (Friedman & Schwartz, 1963). Poverty and hunger reigned (Rayack, 1987).

As mentioned, Friedman places the blame for this crisis not on the faults of the free market system but on both the existence and incompetence of the Federal Reserve. Proximately, Friedman claims that a series of 'runs' on banks – whereby depositors withdrew all of their money from accounts - caused a series of bank failures and in turn a decline in the money stock which caused the depression. However, Friedman argues that the Federal Reserve was to blame because it failed to provide banks with sufficient base money as to offset these runs; and to therefore prevent a decline in the stock of money; and that if the Federal Reserve had not existed then a system whereby concerted action was taken to restrict payment of deposits (used previously in 1907) would have prevented the bank failures which caused the Depression (Friedman, 2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963). These claims are now discussed in the context of the Depression.

17.2 Behaviour of Money and the Policies of the Federal Reserve 1914-1933

Monetary History of the United States (Friedman & Schwartz, 1963), despite issues of interpretation, is if nothing else a prolific piece of empirical research. However, the wealth of data presented in the work can also be used to present a different picture of the potential effectiveness of Federal Reserve action in stopping the Depression than the one presented by Friedman & Schwartz (1963), particularly when combined with other data not included. The data presented by Friedman & Schwartz (1963) can, in fact, be used to demonstrate that the U.S. was on more a credit money than a fiat money system in the years leading up to and during the depression, and that the ability of

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51 This is true at time of writing. The full effects of the current crisis remain to be seen.
52 The analysis I present here uses data interpreted from charts and tables on ‘high powered’ (base) money, the money stock, and discount rates and credit outstanding of the Federal Reserve Banks from Friedman & Schwartz (1963).
the Federal Reserve bank to limit the severity of the Depression (such that it could be called a 'garden variety' recession) is, at the very least, highly contentious.

The Federal Reserve system was created in 1914, so it seems appropriate to begin the analysis here. Friedman & Schwartz (1963) break their analysis of this period up until the official end of the 1929-1933 depression into periods 1914-21; 1921-1929, and 1929-1933 respectively. For the 1914-21 period, base money starts at around $3.5 billion with a total money stock of around $15.9 billion – a ratio of 4.5 to one. The two numbers largely move together 1914-1917 but begin to converge slightly as base money increases at a slightly higher rate than the money stock in 1918. By 1919, however, there are the beginnings of a clear divergence between base money and the money stock, where the ratio between the two is increased and the rate of base money growth does not keep pace with the growth in the money supply. The base peaks for the period in 1920 at around 7.3 billion with a total money stock of 34.8 billion – a ratio of about 4.8 to one (from Friedman & Schwartz, 1963).

The discount rate shows some limited influence over the relative expansion and contraction of credit money in relation to money and the money stock as a whole during the period. Rapid interest rate drops in late 1914-1915 do appear to precede a growth of the money stock, but interest rates at 4% in 1915 preside over a relatively consistent ratio of money to base money, while the beginnings of the divergence between the two begins early in 1916, well before interest rates drop to 3% toward the end of that year, which results in no real increase in the money stock. The beginnings of the brief period of convergence (decrease in the ratio) in late 1917 also precede an increase of the rate back to 4%, and, while the money stock does decrease after successive increases in the rate (up to 7% and leaving it there for several months in 1920), base money decreases at a higher rate, and the deposit-reserve ratio continues a steady increase, with if anything less deviation from the trend than in previous years, ending the period at 11.2 to one (ibid).

The trend of the money stock increasing its ratio to base money continues in the 1921-1929 period. This is true even during periods of business contractions identified by Friedman & Schwartz (1963). What is noticeable about the period 1921-1929 is that the base money remains relatively stagnant, fluctuating up and down in the 6-7 billion range, while the money stock, other than a drop over 1921, shows a consistent trend toward increase. By the end of 1929, the money stock is at $45.9 billion (having dropped from around 48 billion), while base money is at around 7 billion – a ratio of 6.6 to one. The deposit-reserve ratio is at around 13 to one. (ibid).
Figure 17.1 Money Stock 53 (yearly) 1914-1933, $Billions

Source: Friedman & Schwartz, 1963

Figure 17.2 Base Money (yearly) 1914-1933 $Billions

Source: Friedman & Schwartz, 1963

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53 As defined by Friedman and Schwartz (1963)
Figure 17.3. % Yearly Growth Rates of Base Money and Money Stock (M2 as per Friedman and Schwartz) 1914-1933

Source: Friedman & Schwartz, 1963

Figure 17.4 Money Multiplier: Ratio of Money Stock to Base Money 1914-1933

Source: Friedman & Schwartz, 1963
Successive decreases in the discount rate – from 7% down to 5% - do appear to precede a halt in the decline of both base and total money in 1922, but the decline in both forms of money does continue well after the identified period of ‘business contraction’, and ends well before the next (ibid). However, the beginnings of a steep increase in the money stock in late 1923 – pulling well away from the stagnant base money – precedes a further decrease in the discount rate down to 3% in 1924.

The relation between base money and the money stock begins to change, however, in mid-1930. Prior to this, the two money levels had tended to move at different rates, but in generally the same direction. During this period, base money began to rise as the money stock fell rapidly. In January of 1929, base money is at just over $7.2 billion while the money stock was at $46 billion; by March 1933 base money has risen to 8.4 billion while the money stock has plummeted to 30 billion or so to a ratio of 3.6. The deposit-reserve ratio also fell from around 13 in 1929 and much of 1930 to 8.4 in 1933 (ibid). The money multiplier had collapsed (see Figure 17.4).

Friedman & Schwartz (1963) claim that policies adopted by New York Federal Reserve governor Benjamin Strong, who acted as a sort of leader of the Federal Reserve system, in the 1920s were highly effective in promoting stability, and that had he been alive the Depression would have been averted. They assert that Federal Reserve policy was contractionary during the depression in a way it hadn't during the 1920s.

Assessing this requires a comparison between the behaviour of the Federal Reserve during the depression and in previous contractions during the 1920s. The 1920-21 contraction shows a decline in Federal Reserve credit outstanding from around 3 billion to around 2 billion, the 1923-24 contraction a decline from about 1.3 billion to around 0.9 billion, the 1926-27 contraction a decline from around 1.2 to 1.0 billion. The 1920-1921 period shows relative stagnation in securities held and even a slight decrease, 1923-24 period shows increases in securities held from around 0.2-0.5 billion, the 1926-27 one from around 0.3-0.5 billion. Bills discounted rose briefly in 1920 before declining from 2.5 billion to around 1.7 billion, they again rose briefly during the 1923-24 contraction before declining from around 0.9 billion to around 0.3 billion, while the 1926-27 period from around 0.6-0.4 billion. Bills bought in the 1920-21 contraction declined from around 0.5 billion to less than 0.1 billion, in the 1923-24 period they declined from around 0.25 to less than 0.1 billion, while remaining relatively stable in the 1926-27 period (from Friedman & Schwartz, 1963). Interest rates during the contraction 1920-21 actually rose from just under 5% to 7% in 1920 and stayed there for several months before later returning to the initial level toward the end of the period; the 1923-24 contraction saw interest rates hold at around 5% for most of the period before dropping to just over 3% toward the end of the contraction, while the 1926-27 contraction saw interest rates hold at 4% for most of the period before a very slight drop toward its end (from
Figure 17.5. Bank Reserves, $ Billions, 1914-1933

Source: Friedman & Schwartz, 1914-1933

Figure 17.6. Bank Reserves as % of Money Stock. 1914-1933

Source: Friedman & Schwartz, 1914-1933
None of these culminated in a depression of the type seen 1929-1933. Yet Federal Reserve policy during the Depression does not appear to be contractionary relative to these periods in the way that one would expect from the analysis put forward by Friedman (2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963). From the 1929 stock market crash to the first banking crisis in 1930 as identified by Friedman & Schwartz (1963), Federal Reserve credit decreased from 1.5 to around 1 billion, then rose slightly after this before returning to this level before the second banking crisis in 1931 and actually rose between then and the end of the depression. Securities held rose from about 0.25 – 0.5 billion between the stock market crash and the first banking crisis, continuing a less rapid and more faltering rise before a slight decline after the second banking crisis until June 1931 when it resumes its pace, approaching 1 billion by early-mid 1932 and then accelerating toward 2 billion by the beginning of the final banking crisis in early 1933. Bills discounted dropped from around 1 billion at the stock market crash to 1/4 billion at the onset of the first banking crisis, remained relatively stable before the second banking crisis before they began to actually rise in mid 1931 and approached their 1929 level at their peak in early 1932 before declining again, while bills bought remained relatively stable before rising mid 1931 and following a similar pattern to bills discounted (from Friedman & Schwartz, 1963).

Further, the discount rate shows a rapid reduction immediately following the 1929 crash – from 6% in September to just over 4% by December 1929, and was under 2% by year’s end 1930 and approaching 1% by mid-1931 – both unprecedented low levels of interest. In late 1931, interest rates do increase, but despite the sharpness of the increase, the level is at only 3.5% - a level comparable to the lows of pre-1929 discount rates. Again, this appears to have had little effect on the decline in the money stock – while Friedman & Schwartz (1963) attach substantial importance to this event, there is no sudden dip nor an arrest in improvement in the money stock, only a continuing decline. Indeed, the only visible improvement is a slight one month increase in January of 1931, after rates had been stagnant at 2.5% for several months, and the further rate reductions over the year appear to have had little effect. In any case, the rate was brought back to 3% in February and 2.5% in June 1932 where it remained for the remainder of the depression (Friedman & Schwartz, 1963).

This can also be shown in the data on base money growth rates (see Figure 17.3 above). In the 1920-21 crisis the Fed 'allowed' the base money to go from growing just over 12% in 1920 to actually decreasing 19% in 1921. In the 1923-24 contraction, base money growth remained stable at 4%, while the 1926-27 contraction base money went from decreasing 0.95% to increasing 1.27%. Contrast this with the Depression, where in the first two years base money went from decreasing 1.97% to increasing 2.11%, and then increased 8.56% in 1931. Given that the base money is what the Fed has the most direct control over, if anything this should demonstrate a superior response
Figure 17.7 Private Debt, $ Billions 1920-1935

Source: Tabulated data given by personal communication with Steve Keen, 2009, derived from data from US Census Bureau and Federal Reserve Bank Flow of Funds, as published graphically in Keen, 2009a.

Figure 17.8. Private Debt to GDP Ratio, %, 1920-1935

Tabulated data given by personal communication with Steve Keen, 2009, derived from data from US Census Bureau and Federal Reserve Bank Flow of Funds, as published graphically in Keen, 2009a.
compared to previous crises. Thus it can be seen that the policy response to the initial crisis was similar to or better than the reaction to previous crises in the 1920s.

What is notable about the data presented by Friedman from the Debt Deflation and endogenous money perspective is that deflation of wholesale and resale prices had already well and truly taken hold by the banking crises – the most dramatic of course being in stock markets, but wholesale prices had begun a steady decline as well (Friedman & Schwartz, 1963) – increasing the burden of debt and thus the impetus for de-leveraging. By year's end 1930 de-leveraging had also begun in earnest (Keen, 2009a). It is also important to note that reserves remained relatively constant in absolute terms over the period despite the decline in deposits and the over all money stock, increasing their proportion of the money stock over all from around 7% to 11% over the course of the crisis (see Friedman & Schwartz, 1963, and Figures 17.5-17.6). This shows the premium placed on liquidity during the period, and it seems not unreasonable to conclude that extra reserves provided might have been simply added to bank reserves in the scramble for liquidity.

The level of private indebtedness adds an additional variable to money behaviour. As Figure 17.7 shows, private debt went from $106 billion to $162 billion in just the period 1920 to 1929 – an increase of 53%. By 1931 private debt was already down to $148 billion, and $128 billion by year's end 1933. The proportion of debt to GDP during the de-leveraging period, however, increased from 156% 1929 to 234% 1932 (see Figure 17.8), as the de-leveraging caused a massive contraction in output which outran the contraction in debt – demonstrating the Fisher hypothesis of a debt deflation whereby the more borrowers pay, the more they owe.

17.3 Assessing The Culpability of the Federal Reserve

Taken together, the data presented appear to show an expansion of the credit contribution to the money stock during the period leading up to the depression which occurred largely irrespective of monetary policy, followed by a contraction in the money supply which occurred in spite of an increase in base money. Previous Federal Reserve policy appeared to have prevented contractions from reaching crisis point (though in retrospect this may have been coincidental, or indeed a placebo effect through psychological boosts in confidence), but the contraction in the money to base money ratio which characterised the Great Depression was never present in the crises previously handled by the Federal Reserve. In the 20th century, only the pre-Fed 1907 crisis showed a contraction of this kind (Friedman & Schwartz, 1963). Regardless of monetary policy, the Great Depression was never going to be an ordinary recession.

The Minskyan analysis – of a period of stability creating excessive risk taking and indebtedness, leading to an endogenous debt-deflation of the type Fisher (1933) had theorised – may better
explain the Depression. The apparent success of the Federal Reserve in moderating the business cycle in the 1920s accompanied rapid economic growth, and the optimistic financial system would appear to have increased its risk and decreased liquidity in the credit-driven speculative milieu. Both were stimulated by an optimism about the future of the economy and a growing belief that “a new era had arrived, that the business cycle was dead, dispatched by a vigilant Federal Reserve” (Friedman & Friedman, 1990, p. 78).

In the 1927-1929 period, this milieu reached fever pitch. 1927 broke the record for the year with the highest number of shares traded on the New York stock exchange at 576,990,875 – in 1928, 920, 555,032 million shares were traded (Galbraith, 1975/2002). Then in just three months in the summer of 1929 – June, July, and August - the *Times* industrial stock price index recorded a 110 point gain – already higher than the 86.5 point gain for all of 1928. By this time, credit-driven speculative gains in share prices had begun to outstrip gains in profits and production (ibid) – industrial production had actually begun its decline in around June. Broker's loans increased at a breakneck pace – around $400 million per month. Average interest rates charged for call loans increased from around 4 - 5% in 1926 to close to 10% in 1929 (Evans, Hasan & Tallman, 2004) and ultimately reached as high as 15% (Galbraith, 1975/2002), far exceeding any increase in discount rates. Ferguson (2008) paints the following picture of the credit-driven speculative boom:

“Euphoria encouraged a rush of new initial public offerings (IPOs); stock worth $6 billion was issued in 1929, one sixth of it during September. There was a proliferation of new financial institutions known as investment trusts, designed to capitalise on the stock market boom.....At the same time, many small investors....relied on leverage to increase their stock market exposure, using broker's loans (which were often supplied by corporations rather than banks) to buy stocks on margin, thus paying only a fraction of the purchase price with their own money.....flows of hot money between financial markets served to magnify and transmit shocks” (Ferguson, 2008, p. 161)

As in the Minsky analysis, speculators often eschewed the desire for real profits from business ventures in favour of capital gains from trading on a rising market, as the prices of stocks which had paid no dividend, and securities which provided little cash flow in comparison to the real loans they were based on, became popular and soared in price (Galbraith, 1975/2002). The extension of stocks and bonds “required a rosy view of the future” (Galbraith, 1975/2002). In essence, the Ponzi finance of the Financial Instability Hypothesis became characteristic of the period.

The 1928-29 credit-driven speculation occurred despite an increase in the discount rate from around 3.5 to 4 and then 5% in 1928 and a sharp decrease in securities held by the Federal Reserve System over the period (Friedman & Schwartz, 1963). Fed policy was not the cause of the boom - as Galbraith (1975/2002, p. 39) has noted, “there were times before and there have been long periods since when credit was plentiful and cheap – far cheaper than in 1927-1929 – and when speculation was negligible”.

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It seems inevitable that the bull market – which Friedman has admitted to have been an “unsustainable speculative bubble” (Friedman & Friedman, 1990, p. 79) – would eventually come to an end. It may have in March of 1929, after speculation as to the nature of a series of secretive Federal Reserve meetings culminated in a rapid contraction of share prices and increase in trading. But then representatives of the Board came forward pledging to avert any crisis with injections of liquidity as necessary (Galbraith, 1975/2002). The boom revived after this time and was allowed to continue. After an increase of the discount rate from 5 to 6 percent in August 1929, “the market weakened only for a day” (Galbraith, 1975/2002, p. 67) before reviving again, despite the fact that actual industrial production had been declining for several months prior (Evans, Hasan & Tallman, 2004; Kindleberger & Aliber, 2005).

When the stock market bubble finally did burst September-October, resulting in unprecedented falls in stocks, coalitions of bankers initially attempted to revive the prices; but could not overcome the panic that had set in and ultimately resigned themselves to the crash (Galbraith, 1975/2002). In turn, the Federal Reserve acted largely as it had done in the past, when it had found that its attempts to increase base money had been enough to offset contractions and result in a halt of the contraction in the money supply. It rapidly decreased its discount rate and increased purchases of securities (from Friedman & Schwartz, 1963).

But this time it did not work. The money stock decreased even as base money was increased. Bills discounted dropped even as interest rates were reduced. The money multiplier collapsed. The Federal Reserve maneuvered in a number of directions, but was unable to prevent the monetary collapse using its past strategies. When the Fed began its more aggressive large scale bond purchases in 1932, the money stock and the money multiplier continued to decline before the money stock leveled off as the program was abandoned, though the money multiplier continued to drop (see Friedman & Schwartz, 1963), and the later purchases also show a continuing drop in the money stock and the multiplier. Despite Friedman & Schwartz’ (1963) protestations to the contrary, there is no real evidence in the data that these purchases had any effect.

The difference between this and other crises was not Federal Reserve policy. It was the size and rapidity of the debt-driven boom and the depths of its decline and deflation. While Friedman & Schwartz (1963) have contended that the money stock did not increase significantly in 1929, indebtedness did (Keen, 2009a), and in any case the money stock and money multiplier had increased fairly steadily up until then. The credit system collapsed (Kindleberger & Aliber, 2005) and debt became toxic as prices declined in the distress selling rampage. As Fisher (1933) theorised, the downward spiral of prices meant that the value of debt increased even as its absolute level decreased - the private Debt-GDP ratio began at 175% in late 1929 but peaked at nearly 240% before the depression's end, despite absolute debt declining from over $160 million in 1929 to under
$130 billion (Keen, 2009a).

Given all of this, it would seem that for Friedman to assert that by simply injecting even more fiat money into the system the crisis could have been largely avoided seems, at best, highly speculative. For this to work, it would necessitate a revival of the money multiplier, which would in turn require the panic-stricken liquidators of debt to borrow money all over again despite declining prices. It seems doubtful that by simply buying more securities the Federal Reserve could have facilitated this in the face of the panic that prevailed. Moreover, reviving borrowing without accompanying regulation is likely to have revived the speculative boom to a higher level – one which have might have even further reduced the potential effectiveness of open market operations in the event of another financial crisis. In any case, the certainty of Friedman's claims given the evidence provided is surely insufficient to be the basis for a laissez-faire policy largely devoid of protective regulations and institutions, particularly given the consequences.

17.4 The Endogenous Failsafe Hypothesis.

As stated, Friedman has made the assertion that a system of withdrawal restrictions – which involved banks conspiring to restrict the convertibility of deposits into cash in order to reduce the severity of bank runs– would have been implemented in the Great Depression if not for the existence of the Federal Reserve system, and that this would have been effective in preventing its worst effects. According to Friedman:

“Had the Federal Reserve system never been established...there is little doubt that the same measures would have been taken as in 1907 – a restriction of payments.....by preventing the drain of reserves from good banks, restriction would almost certainly have prevented the subsequent series of bank failures in 1931, 1932, and 1933, just as restriction in 1907 quickly ended bank failures then....the panic over, confidence restored, economic recovery would very likely have begun in 1931, just as it had in 1908” (Friedman & Friedman, 1990, p. 82)

Friedman goes on to assert that the Federal Reserve system prevented this from occurring because banks were confident of being able to borrow from the Reserve system to meet liquidity needs and that the existence of the system fostered a mistaken belief that in general such drastic measures would not be needed (Friedman, 2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963). This is crucial to Friedman's claim that the Depression was caused by government intervention, not just a lack of it.

The only evidence given to support this is that this restriction of payments was used in 1907 and may have reduced the severity of that crisis, and that this happened prior to the creation of the Federal Reserve system (Friedman, 2002; Friedman & Friedman, 1990; Friedman & Schwartz, 1963). From this it is inferred that it was not implemented, though it would have been effective, because the Federal Reserve system existed.

It is perturbing that Friedman is so certain in his analysis because this is history at its most
speculative. For the sake of argument, let it be assumed that Friedman is right in his analysis that the restriction of payments was effective in reducing the severity of the 1907 crisis. This does not change the fact that this crisis was substantially different from the Great Depression in ways which go well beyond the Federal Reserve system. The 1907 crisis, for instance, occurred after a period of "relatively stable economic growth" (Friedman & Schwartz, 1963, p. 152); while the Great Depression followed the bursting of an "unsustainable speculative bubble" (Friedman & Friedman, 1990, p. 79). At the onset of the 1907 crisis, base money was at around $2.8 billion to a money stock of around $11.7 billion – a ratio of about 4.2 to one, while in October 1929 base money was at $7.1 billion to a money stock of $48.2 billion – a ratio of 6.8 to one. Moreover, the 1907 deposit-reserve ratio was around 9-1 while the deposit-currency ratio was at 6-1; by October 1929 the deposit-reserve ratio was at just under 13-1 while the deposit-currency ratio was over 11-1 (Friedman & Schwartz, 1963). The volatility, vulnerability and level of indebtedness of 1907 are simply not comparable with that of 1929, and this is reflected in the fact that the debt liquidation which characterised the early phases of the Depression was not a feature of Friedman & Schwartz’ (1963) analysis of the 1907 crisis, the latter apparently more directly caused by concern over the ability of banks to pay out deposits.

If Friedman's contention that such a suspension of payments would have been effective had it been implemented in preventing the Depression is contentious, his certainty that it would have been implemented in the first place may be even more so. To assert that bankers would spontaneously form an effective coalition to restrict payments and support liquidity – a move which Friedman has admitted had dire side effects (Friedman & Friedman, 1990) – and then stick to it long enough to ride out the depression simply because they had done so in the past does not seem like something which one can have "little doubt" about as Friedman did (Friedman & Friedman, 1990, p. 82). The fast abandonment of organised support of the stock market by bankers portrayed by Galbraith (1975/2002) does not lend itself to this idea. Nor, indeed, does the failure of a plan to save the Bank of the United States whose failure Friedman saw as crucial (Friedman & Friedman, 1990). Epstein & Ferguson (1984) have also described the widespread opposition from banks worried about profits which was levied against the Federal Reserve in the wake of its 1932 large scale attempts to expand the monetary base, and this also makes apparent a reluctance to make any sacrifice in the name of concerted action. Again, while it may have happened, there is nothing to suggest the certainty which Friedman expresses.
17.5 Conclusions

It is not the position of this thesis to dismiss entirely the possibility that more aggressively expansionist monetary policy may have, for the time being at least, averted the worst effects of the Great Depression; and it is certainly not the position of this thesis that the Federal Reserve behaved exactly correctly. However, it is hoped that the evidence as presented is sufficiently convincing that at the very least no one can say with confidence that “we now know, as a few knew then, that the depression was not produced by a failure of private enterprise, but rather by a failure of government” (Friedman & Friedman, 1990, p. 71), and it is contended that the scenario presented – of the impotence of monetary policy in the face of an endogenous credit crisis - seems more likely. Moreover, even had monetary policy been thus effective, it could only have been so in such a way as to further exacerbate the volatile indebtedness which precipitated the Depression and perhaps created conditions for an even worse contraction. Further, it should be clear that monetary policy is at best an unreliable instrument for stabilising a deflation. Direct regulation aimed at preventing the volatile conditions from developing in the first place, despite disadvantages, would certainly be more reliable – prevention being better than the cure which Friedman advocates.

17.6 Aftermath

The Great Depression shook faith in the free market and the efficacy of monetary policy in producing stability. A new consensus emerged that the experiment in free market economics had failed and that it needed to be replaced with a more humane (and complex) form of human and economic arrangement. Regulation was increased, and in the late 1930s President Franklin Delano Roosevelt introduced a 'New Deal' of social and welfare reforms – including social security, public housing, public education and a host of direct employment programs - to boost the economy, reduce unemployment, and combat inequality. Keynesian policies of using a combination of vigilant regulation and discretionary fiscal policy to stabilise the economy and promote full employment dominated from the 1940s to the early 1970s (Jones, 2008; Kaldor, 1982; Klein, 2007; Stilwell, 2006).

The period has been described as a “long boom in the major capitalist economies....the period from the late 1940s to the early 1970s was one of sustained economic in the major capitalist countries, with full or near-full employment and generally low rates of inflation” (Stilwell, 2006, p. 302). Whether Keynesian policies can take credit for this period of stability is up for debate, and any attribution of credit might equally require attribution of blame for later failures (Stilwell, 2006); though Jones (2008) points out that even the failures of the latest times of the Keynesian period pale in comparison with those of the relatively 'laissez-faire' policies before it. It is also notable that this period was decidedly more stable than the century prior to the depression (Minsky & Vaughan,
In any case, Friedman's defence of the free market was explicitly a reaction against Keynesianism and he fought hard for its demise. However, his first chance to demonstrate the superiority of his macroeconomic policies would not come in the developed United States but in developing Latin America.
18 Chile

18.1 Friedman's 'Economic Miracle'

The first real instance of the adoption by a country of Friedman's monetarist policies (and one of the most complete) was Chile in the 1970s. Friedman's Chicago School had enjoyed a presence in Chile through a partnership with Chile's Catholic University, and Chilean students of that university studied economics under Friedman himself at the Chicago School. While these theories were considered extreme in most corners of Chilean society (as in much of the rest of the world at that time), Catholic University economists who had studied under Friedman and his colleagues would act as the economic architects of the U.S. government backed Pinochet military junta, who violently overthrew the democratically elected leftist Allende government in 1973 (Klein 2007; Munoz, 2008; Rayack, 1987).

No attempt will here be made to apportion any blame, as others have done (see Klein, 2007), to Friedman for the brutally oppressive nature of the Pinochet regime. However, the role of Friedman and his theories in the economic outcomes which occurred under the regime is largely uncontroversial. While Friedman's protestation that he was not “running the Chilean economy from my office in Chicago” (Friedman & Friedman, 1998, p. 400) is duly noted, as stated, the economic team advising the junta was made up primarily of economists indoctrinated in the ways of the Chicago school, and Friedman himself personally gave economic advice to Pinochet in a visit and later letter in 1975. The policies which were implemented were typical of Friedmanite/monetarist thought – massive cuts in government expenditure, widespread deregulation and privatisation, suppression of union power, and a drastic reduction in the rate of increase in the money supply - but, without the moderation of a functioning democracy, they were implemented with unprecedented completeness and rapidity (Barber, 1995; Klein, 2007; Rayack, 1987).

Friedman has described the results of Chile's experiments with Friedman's economic theories as “an economic miracle” (Friedman, 1982, cited in Friedman & Friedman, 1998, p. 407). In a Newsweek column written in 1982, 9 years after the coup, Friedman talked about how during this period “the economy boomed, growing an average of about 8 percent a year from 1976 to 1980”, and alleged that “real wages and employment rose rapidly and unemployment fell” (ibid). Other comments on markers of 'progress' are not so much measures of wellbeing as simply measures of implementation of neoliberal ideas: he celebrates removal of trade regulations and the privatisation of state enterprise and the education system (ibid). He later goes on to give credit to the free market for improvements of 1995 figures over 1973 figures in inflation, real income, infant mortality and life expectancy (Friedman & Friedman, 1998). Friedman counts Chile as an example of the successful workings of the 'Invisible Hand'. These claims are, at best, highly contentious, at worst, simply
spurious.

18.2 Allende's Radical Left

It is important to note that Friedman's use of 1973 as a base year of comparison to prove the efficacy of Friedman's extreme capitalism over other options is problematic: it compares one extreme with another. 1973 was the third year of government for Salvatore Allende, who had won the elections of 1970 with 36.8% of the vote in a three party split (Fourcade-Gourinchas & Babb, 2002; Friedman & Friedman, 1998; Library of Congress, 1994; Munoz, 2008), beating out the right-wing National Party and the more moderate Christian Democrats. Allende's supporters were disenfranchised with what they perceived as the slow pace of social progress under the Christian Democrats, and Allende had won on a platform of socialism and nationalisation. Unfortunately, hyperinflation (into the hundreds of percent) soon became a pervasive feature of the economy, and, from the outside at least, the program appeared to be creating a climate of economic turmoil (Fourcade-Gourinchas & Babb, 2002; Friedman & Friedman, 1998; Library of Congress, 1994; Munoz, 2008).

Klein (2007) seems partly to be an apologist for Allende's government and is quick to point the finger at efforts by interests in the U.S., including both corporations and the federal government, as well as right-wing interests within Chile, to undermine the Allende program. However, even former Socialist party member Heraldo Munoz, while acknowledging the effects of such efforts and insisting that fears of the threat from them were “grounded in reality, not fantasy”, placed principal blame for the economic turmoil of the period on “the ruling coalition's increasing radicalization and the blatant mismanagement of the economy” (Munoz, 2008, p. 34). Munoz (2008) explains that Allende’s program had initially targeted only very large businesses for nationalisation with an aim for large state-run enterprises to coexist with private property. However, the socialist movement became increasingly radicalised, and soon even smaller businesses were being violently seized and nationalised (ibid). By 1973, inflation was at 508% (Rayack, 1987). Interestingly, however, in spite of the hyperinflation, mid-term elections in 1973 actually saw an increase in the Allende government's lead (Fourcade-Gourinchas & Babb, 2002; Klein, 2007; Library of Congress, 1994; Munoz, 2008), leading Fourcade-Gourinchas & Babb (2002, p. 544) to conclude that “Allende's economic program was more popular than ever with the masses”. This may lead one to question whether the inflation statistics were truly indicative of an economy which was worse off for the majority, and indeed unemployment remained low (Rayack, 1987): though this is, at best, speculation, particularly given the minority status of the government. On the available evidence, Allende's government, while producing early gains (Library of Congress, 1994), soon proved to be an economic disaster.
18.3 Less than Miraculous

Given the apparent incompetence of the Allende government, it seems in any case a testament to the ineffectiveness of Friedman's ideas that things initially were made worse in many ways. Inflation was curbed to some degree – from 508% in 1973 to 376% in 1974 (Rayack, 1987) – but this was still more than double the 163.4% level of 1972. Furthermore, 1974 saw unemployment nearly double on 1973 levels to 9.2% (Rayack, 1987).

While this type of immediate economic regression might give some pause, Friedman, on his visit to Pinochet in March 1975, instead insisted that Pinochet was not implementing his ideas to their fullest, and assured him that once he did a short period of recession lasting only months would precede a rapid improvement in economic conditions. Friedman's prescribed ideas of rapidly privatising the public sphere and ridding the country of social protections and government industry he called economic 'shock treatment', as if he were a doctor delivering medicine. Even the notoriously brutal Pinochet's own reservations would not sway him. He would record his notes from the time in his memoirs:

“He (Pinochet) was sympathetically attracted to the idea of a shock treatment but was clearly distressed at the possible temporary unemployment it might cause” (Friedman & Friedman, 1998, p. 399)

The results of shock treatment were less than miraculous. Inflation, Friedman's bugbear, had been predicted by Friedman to dwindle to 10% by 1976, but persisted at 174% that year and was not under 10% until 1981, before rebounding to 20.7% in 1982 (Rayack, 1987). By 1989, it was at 30.2%. In 1975 unemployment hit 14.5% - more than triple 1973 levels – and, contrary to Friedman's predictions (and his later implications), never fully recovered under the junta. In the decade following the coup, between 1974 and 1984, unemployment remained in double digits for all years except 1981 (when it was 9%), which was followed immediately by the peak rate of 20.3%. During the initial period of 'shock therapy' 1975-79, unemployment averaged 13.4%, and actually increased further in the years following, averaging 14.3% 1980-1984 (Library of Congress, 1994), while in the pre-Pinochet 1970s it had been relatively stable in the 3-6% range (Rayack, 1987).

The aforementioned figures only show the official rate – Munoz (2008) and Rayack (1987) both point out that a significant proportion of these were 'employed' by the government doing menial work (such as street sweeping) for barely subsistence wages – essentially a work-for-unemployment-benefits regime; so that the real estimate for 1975 already nears 20%, and this analysis is supported by Klein (2007), who puts the 1982 level at 30%. The Library of Congress also published these figures as an alternative measure on unemployment, causing the 1975-79 and 1980-84 averages to rise to 17.6% and 22.3%, respectively. Furthermore, in a climate now without important government social services, the real cost of that unemployment would be even higher than...
under the more supportive social systems of previous regimes, while as Barber (1995, p. 1944), put it, “the distribution of income had moved regressively”.

18.4 Things are worse than they seem...

Friedman's claims in 1982 that “employment rose rapidly and unemployment fell” (Friedman, 1982, cited in Friedman & Friedman, 1998, p. 407) appear in this context as an abject falsehood, if not an outright lie. But in fact, the performance of his policies is even worse than it appears from a comparison with the wildly radical and incompetent Allende. When compared with the more moderate governments of the previous decade, the 17 years or so of the Pinochet regime looks as extremist as that of Allende. These previous regimes presided over a mix of reforms from both the right and left, increasing the sphere of private enterprise while increasing rights for workers and maintaining a strong welfare state (Library of Congress, 1994; Munoz, 2008). By the time Pinochet took power,

“Chileans enjoyed a high level of education (illiteracy was less than 10 percent by 1970)...Chilean universities were among the best in the Americas; there was an efficient transportation infrastructure; the Central Bank, the Internal Revenue Service, and the General Comptroller's Office, among others, were all solid state institutions.” (Munoz, 2008, p. 308)

Inflation was high, in the 30-35% range (Library of Congress, 1994), but more importantly real wages grew despite inflation (Rayack, 1987) and while Friedman contends that under the Pinochet regime they “rose rapidly” (Friedman, 1982, cited in Friedman & Friedman, 1998, p. 407), in fact they never fully recovered to levels reached in 1970 (Library of Congress, 1994; Rayack, 1987). Unemployment, meanwhile, averaged only 6.4% for the 1960-69 period (Library of Congress, 1994). In 1970, 20% of Chileans lived under the poverty line, while by Pinochet's abdication in 1990 the figure was 40% (Munoz, 2008). Munoz (2008) also points out that measures such as life expectancy and infant mortality had been improving for decades before the Pinochet regime: hardly something which Friedman's policies can be given credit for.

Clearly here Friedman fails his own test of the predictive power of his theories – in a country which followed his advice virtually to the letter, unemployment didn't recover during that first decade, and inflation fell much more slowly than he had predicted. While GDP growth was ostensibly strong (though some have questioned even this (Munoz, 2008)), clearly the economic reality for the population was that proportionally less people were able to find work to benefit from it, and those who did found the benefits of decreased inflation eroded by wage adjustments and the removal of social programs – the benefits concentrated in the hands of a few. The Chilean 'miracle' might therefore be more accurately described as a prolonged depression for much of the population.

Nor can Friedman and his extreme brand of capitalism be given the credit he tries to take for the
later successes of democratically elected government. One of the first actions of the first post-
Pinochet government, newly elected and under the presidency of Particio Aylwin in 1989, was a
move to the left: a bill which restricted the reasons for which employers could dismiss employees,
restricted the ability of employers to use lockouts in industrial action, and increased compensation
needed to be paid to employees made redundant (Library of Congress, 1994). Indeed the
Concertacion de Partidos por la Democracia, as the coalition party elected in that first government
was called, was an alliance of the centrist Christian Democrats with leftist parties including the
Socialist Party (but excluding the Communist Party) (Munoz, 2008). By 1993, inflation had been
reduced from 32 percent in 1989 to 12 percent in 1993, gdp growth was exceeding 7 percent
annually, real wages were finally exceeding 1970 levels having grown some 15 percent, while
unemployment was brought down to its lowest levels since the beginning of the Pinochet regime
(Munoz, 2008). Indeed, the Concertacion continued to enjoy relative economic success while
instituting a range of state-sponsored social programs and equity-inclined regulatory reforms into
the 2000's (Cypher, 2004; Munoz, 2008). This more moderate regime has vastly outperformed its
extremist counterpart.

In one of Friedman's most controlled laboratories, his macroeconomic policies failed to perform as
he predicted they would Worse, they hardly if at all outperformed even one of the most extreme
leftist programs, while clearly and miserably failing in relation to more moderate alternatives.
Crucially, one might ask the question of how Chile would have performed had Allende been allowed
to be voted out in an election and replaced with an economically moderate government by more
democratic means – and, if in that event he was not voted out, one might wonder why.
19 Stagflation and the Rise of Monetarism

19.1 The Apparent Void...

After a long and prosperous period under Keynesian policy, the mid-1970s saw the advent of 'stagflation' – a period of simultaneously rising inflation and unemployment - in the United States and Britain. By 1980, inflation was at 13.6% while unemployment was 7.1% in the United States (Jones, 2008). While the intensity of growth stagnation was not comparable to the disaster of the Depression period, it was enough to shake faith in Keynesian theory, which had until then (as reinterpreted by conventional economists) appeared to stipulate that inflation and unemployment could not simultaneously be high, such that a rise in one would generally produce a fall in the other (Friedman & Friedman, 1990; Friedman & Roberts, 2006; Jones, 2008; Stilwell, 2006).

Into the apparent void of theory stepped Friedman and monetarism (Peck, 2008; Rayack, 1987; Stilwell, 2006). His prescriptions for the economy influenced to a large extent the agendas of Margaret Thatcher's Prime Ministership in Great Britain (Hanson & Chen, 2004; Kaldor, 1982; Klein, 2007; Stilwell, 2006) and, even more so, Ronald Reagan's Presidency in the United States (Friedman & Friedman 1998; Friedman & Taylor, 2001; Hanson & Chen, 2004; Klein, 2007; Rayack, 1987). The policies advocated were typical of Friedman's theories – deregulate the economy, reduce union power, reduce government spending on social programs - and, for the most part, these were followed (Friedman & Friedman, 1998; Hanson & Chen, 2004; Klein, 2007; Rayack, 1987), beginning a long period of deregulation which has lasted up until now (Hanson & Chen, 2004; Klein, 2007).

Thatcher's union opposition, in particular, was such that she treated them as enemies with whom she was at war (Klein, 2007) and may be observed to have purposely sought to create sufficient unemployment as to break union power and tip the scales in favour of employers (Kaldor, 1982). Such measures, Friedman reasoned, would reduce unemployment by reducing barriers to accepting lower wages and conditions, and thus reduce costs to business; as well as increasing incentive to work by the removal of the social safety nets (Friedman & Friedman, 1990). This was also the period where the 'natural rate of unemployment' theory was accepted and the commitment by government to full employment was abandoned (Stilwell, 2006).

19.2 Applying the Monetary Rule

Friedman also recommended a reduction in the rate of growth rate of the money supply, to be guided by a money growth rule, which was followed, at least in intention, by the monetary authorities in Great Britain and the U.S. (Hakes & Rose, 1993; Kaldor, 1982; Keen, 2001; Rayack,
1987). Friedman blamed excessive increase of the money supply caused by fiat money-financed government spending for the 'great inflation' of the 1970s (Friedman & Friedman, 1990) and reasoned that a reduction in the rate of increase of the money supply would curb the inflation of the period.

Interestingly, Friedman completely deemphasised the role played by the price of oil in creating inflation during the period (Friedman & Friedman, 1990). In 1973 the Organisation of Petroleum Exporting Countries, with a virtual monopoly on the supply of oil, elected to restrict output to increase prices from $2.59 per barrel to $10 (Batra, 2005). Because it plays such an important role in energy used for transportation and production as well as being a component part of many products, an increase in this one commodity can have a substantial spillover effect for the rest of the economy; so that its contribution to inflation should not be underestimated (Batra, 2005; Jones, 2008).

In any case, the money targets were, for the most part, ruthlessly pursued, with central banks in both countries increasing interest rates and slowing the injection of fiat money. Though the money targets were never able to be met – in Britain inflation actually doubled in the first year to 22% and the growth rate of their chosen measure of the money stock\(^\text{54}\) rose from 11 to 18% (Kaldor, 1982) - the immediate result of this monetary tightening, combined with the above described Friedmanite fiscal and regulatory policies, was a more immediate plunge into the worst recession since the great depression – a 'cure', one might argue, that was in some ways worse than the disease. In 1982, unemployment reached 9.7% in the U.S., and as in Chile (though, tempered by democracy, to a lesser extent) the reduction of social programs made the burden of unemployment even worse than it might have been with such measures still in place.

Eventually, however, the high inflation was broken, and in 1982 the Fed chairman Paul Volcker (who had first implemented Friedman’s policies) engaged in monetary and easing allowed GDP growth to resume in the U.S. Friedman would predict several times – often with specific time periods in mind - that this monetary easing would cause an explosion in inflation, or in some cases a resumed recession, in the early-mid 1980s, but this never came to pass (Rayack, 1987). Unemployment, however, now abandoned as a policy target of government (Stilwell, 2006), remained in the high ranges experienced in the 1970s for several years (Jones, 2008) – which in some ways may demonstrate a failure to really overcome the 'stag' element of 'stagflation' by policy.

19.3 Anti-Monetarist?

While Friedman seems happy to credit the tightening of monetary policy in the 1970s with breaking the inflation of the period (Friedman & Friedman, 1998), he has distanced himself from its more

\(^{54}\) In the UK, the M3 measure, a broader measure of money than the M2 favoured in the U.S., was used (Kaldor, 1982).
dire effects by denying that a 'monetarist' policy was followed (Friedman, 1982; 1983; 1984), even going so far as to call the policy execution “anti-monetarist” (Friedman, 1984, p. 397). Friedman's main evidence for this was the volatile fluctuation in the money supply – which was even greater during the Volcker era than before (Friedman, 1983; 1984). The test of a 'monetarist' policy, Friedman contends, is a stable growth in the supply of money – this is an “essential criterion” for determining whether a policy is monetarist (Friedman, 1984, p. 397).

However, as Keen (2001) has pointed out, the fact that the central banks could not meet their monetary targets does not so much demonstrate that the policy was not monetarist, as it does that the money supply is endogenous and largely outside of the control of the central bank. Friedman is here attempting to create a situation where a policy is judged by its effects rather than by the means by which it attempts to achieve these effects. To say that a policy is not monetarist unless there is stable money growth is rather like an archer claiming that they can't be judged to have fired an arrow unless it hits the bull’s-eye. It is here contended that a policy is monetarist if it aims to be monetarist, and on these grounds the policies of the era must be judged monetarist. The failure of monetarist policy to control the money supply demonstrates, as the Post-Keynesians have claimed, that these countries are on a credit, and not a fiat money system, and that monetary policy is severely constricted in efficacy by the endogenous nature of this credit system. Morris (2009) paints a picture of the events as such:

“Somehow, free-market monetarists hadn't guessed that if the Fed cracked down on conventional money stock, profit-seeking banks would create new financial techniques to avoid the restrictions. Which they promptly did – spinning out high-yielding money market mutual funds, interest-bearing checking accounts, electronic sweeps to marshal corporate cash, and much more. The transcripts of (Federal Open Market Committee) meetings through most of 1980 betray an air of semi comic desperation as the members try to discern which numbers they should count as the money supply” (Morris, 2009, p. 25).

Figure 19.1 shows the yearly growth rates of the U.S. money stock and base money for the period 1967-1986. Interestingly, the major increases in the growth rate of the money stock are not preceded by major increases in base money – showing that there is little evidence for the idea that excessive expansion of base money was the cause of increases in the money stock. Further, the major decreases in the rate of growth of the money stock – in 1972-1974 and 1976-1978 – are in fact immediately preceded by minor increases in the rate of base money growth. These decreases in money stock growth rates utterly dwarf the decrease in the growth rate after the 1980 'Volcker shock'. Again, the record does not support Friedman's assertions that the origins of the 1970s

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55 In his defence, Friedman (1983), in a rare call for more regulation, does call for stricter oversight of reserves to increase the control of the Fed over the money supply, but contends that the Fed was quite capable of controlling it even without this regulation.

56 Volcker, by no means a ‘true believer’ in monetarist theory, had predicted the outcome of missing targets (Morris, 2009).
inflation lay in excessive base money creation.

Figure 19.1 % Yearly Growth Rates of Money Stock (M2) and Base Money 1967-1986


19.4 The Minsky Alternative

Contrary to Friedman, Minsky (1981) places blame for the inflationary pressures of the period not on an excessively regulated economy and government spending financed by fiat money creation, but on an endogenous expansion of the money supply through risky financial innovation and a failure of regulation to reign this in. Minsky (1981) traces the origins of the stagflation period to 1966, when a 'credit crunch' caused by failures after risky financial innovation was abated by successful state intervention through the injection of liquidity by the Federal Reserve. Unfortunately, the intervention and prevention of widespread failures of financial institutions validated the financial risk-taking which had led to the crisis in the first place. Soon financial risk-taking – and thus increased lending and borrowing – would cause a resumption of inflationary pressures, and further financial disturbances, more moderate in nature – in 1969-70, 1974-75, and 1980 – would lead to more 'lender of last resort' bailout operations by the Fed in order to avoid a deflation. Regulation fell behind the financial innovations – by their bailouts the Fed gave them their tacit endorsement, and the assets which might otherwise have been deemed bad continue to inflate in price. Deficit spending by the government, far from being a bane to the economy, sustains business profits in times of economic hardship and prevents the fuelling of pessimistic expectations – altogether preventing a deep depression (Minsky, 1981).

Minsky was not heeded: Friedman had positioned himself well and his ideology had by now begun to take root. The Reagan government cut spending and social programs, as well as regulation, while
nonetheless increasing the government deficit through tax cuts and increased military spending (Rayack, 1987). However, Minsky predicted that, with deregulation and a failure to enact new regulations to deal with innovations, combined with a reduced role for government spending, the next recession could be deeper and more disastrous than any which had come since the great depression...
20 The Age of Friedman – And the Subprime Crisis

20.1 Friedman, Greenspan, Bernanke.

In January of 2006, after Alan Greenspan retired from chairmanship of the Federal Reserve, Milton Friedman wrote the following in the Wall Street Journal:

“Over the course of a long friendship, Alan Greenspan and I have generally found ourselves in accord on monetary theory and policy, with one major exception. I have long favored the use of strict rules to control the amount of money created. Alan says I am wrong and that discretion is preferable, indeed essential. Now that his 18-year stint as chairman of the Fed is finished, I must confess that his performance has persuaded me that he is right - in his own case.” (Friedman, 2006, p. a14)

In this passage Friedman gives his express approval for the way Alan Greenspan ran the Fed and the economy – even making an exception for his usual insistence on dismantling a discretionary monetary body and replacing it with a monetary rule. Later, in an interview given shortly before his 94th birthday, he asserted that the policies of Greenspan and Bernanke had, using the short-term interest rate as a tool for controlling the money supply, approximated his rule for steady money growth – though he did remark that he was “puzzled by why they insist on using the interest rate rather than the quantity of money.” (Friedman & Roberts, 2006). He credited this policy with creating an unprecedented period of stability and low inflation.

Given this, as well as Bernanke's avowed belief in the Friedman view of preventing deflation, it seems rational to presume Friedman's approval for actions taken during the period (at least on monetary policy), and conclude that Friedman's ideas in large part ruled Federal Reserve policy over the period from the beginning of Greenspan's reign until the present day. This in addition to the general political hegemony of Friedman's ideas in economics since the 1980's – a period which saw a general reduction in regulation and funding cuts for regulators (Hanson & Chen, 2004; Henry, 2008; Klein, 2007; Morris, 2009; Peck, 2008; Phillips, 2008).

20.2 Financial Crises and the liberal use of the Helicopter

By the beginning of Greenspan's reign as Fed chairman in 1987, Friedman's ideas had become well entrenched (Morris, 2009), though the presence of a functioning democracy had prevented the kind of widespread 'shock treatment' which had occurred in Chile (Klein, 2007) – an early Reagan attack on Social Security, for instance, had to be abandoned in the face of widespread condemnation (Rayack, 1987). However, the destabilising effects of not only deregulation but failure to regulate new innovations would be felt by Greenspan only a few weeks into his term (Batra, 2005; Ferguson, 2008; Morris, 2009).

The Savings and Loans Crisis of the 1980s had its origins in deregulation undertaken by the Reagan administration in its first term (Morris, 2009; Phillips, 2008). Savings and Loan associations (S&Ls)
Joseph McIvor ‘Seeing the ‘Invisible Hand’

had begun as a conservative form of mortgage lending organisation, which were insured by government guarantee but tightly regulated. Mutually owned by depositors, the institutions were insured by government for deposits of up to $40,000 for a premium of just 0.08% of total deposits (Ferguson, 2008). In return for this insurance they faced stringent regulations on their lending practices, including restricting loans so that an S&L could only lend to home buyers within 50 miles (around 80km) of its head office, and after a new 1966 regulation they were restricted to a maximum 5.5 percent payment on their deposit rates (Ferguson, 2008). However, the Reagan administration deregulated the institutions in 1981 – now they could invest in whatever they wanted to, however risky – including junk bonds, commercial property, stocks, even issuing credit cards (Ferguson, 2008; Phillips, 2008), while their insurance from the government was not only maintained but increased from $40,000 to $100,000 (Ferguson, 2008).

The deregulation not only inherently increased the risk of the institutions but also culminated in a series of fraudulent schemes in which even large Wall Street institutional investors were caught up (Morris, 2009). In addition, the emergence of highly profitable Leveraged Buyouts (LBOs – debt financed buyouts, usually of sections of large corporations who had over-diversified) as well as financial innovations such as Collateralised Mortgage Obligations (CMOs) and the use of derivatives to 'insure' investment portfolios, would also change the financial landscape of the 1980s (Morris, 2009). The combination of these factors facilitated a debt-financed speculative boom (Morris, 2009; Phillips, 2008).

The Minskyan markers were there – including an institutionalisation of Ponzi finance through 'payment in kind' (PIK) bonds, in which creditors were simply given more bonds if the debtor missed a payment (Morris, 2009). Morris (2009, p. 28-29) remarks of this that “Wall Streeters joked about the 'death spiral' – repeated missed payments triggered more and more PIK issuances until the debt load spun into infinity”. S&Ls also expanded their debts to unsustainable levels while promoting a building boom which far outstripped demand (Ferguson, 2008; Morris, 2009). Meanwhile, 'portfolio insurance' ensured that a false sense of security prevailed (Morris, 2009).

By 1987, stock prices had risen to unsustainable levels, and in October of that year the stock market crashed (Batra, 2005; Ferguson, 2008; Morris, 2009). Greenspan – only two months into his tenure – acted quickly to drop interest rates and inject liquidity into the system to create new debt (Batra, 2005; Ferguson, 2008; Morris, 2009) – a Friedmanite 'helicopter drop' of money. In addition, pressure was applied on the banks to ensure that the new money would be used for lending and not simply tucked away in reserves (Morris, 2009). Greenspan's fast action worked, and by week's end markets stabilised (Batra, 2005; Ferguson, 2008; Morris, 2009).

Crisis was, for the time being, averted, but the bailout was not accompanied by extra regulation to
maintain stability – the deregulatory tide only continued (Batra, 2005; Ferguson, 2008; Morris, 2009; Phillips, 2008) – as did the debt explosion (Keen, 2009a; Phillips, 2008). Successive financial crises – the Citibank crisis of 1989-90, the Junk Bonds crisis of the 1990s, the 1994 U.S. Bonds crash, the long-term Capital Management (LTCM) crisis of 1998, the bursting of the so-called 'dotcom bubble' in the early 2000s – were generally met with monetary easing and government sponsored or orchestrated rescue packages of many of the institutions involved, but, for the most part, no new financial regulation (Batra, 2005; Morris, 2009; Phillips, 2008; Soros, 2008) – indeed, financial wizard George Soros has been led to remark that since financial deregulation had begun in the 1980s “there has barely been three years without a serious incident” (Soros, 2008, p. 7).

Despite the apparent financial instability – and more dire circumstances emerging in newly deregulated Asian and Latin American countries (see Batra, 2005; Klein, 2007; Krugman, 2009; Sapir, 2008) – Greenspan and the proponents of the free market were untroubled (Baker, 2008; Batra, 2005; Ferguson, 2008; Krugman, 2009; Morris, 2009; Phillips, 2008). Warnings of ‘irrational exuberance’ by Greenspan in the mid-1990s were apparently ignored by everyone, including Greenspan himself. The recessions that occurred were relatively mild, and inflation, which Greenspan apparently saw as his primary responsibility, was ostensibly kept low (Batra, 2005; Friedman, 2006; Friedman & Roberts, 2006; Krugman, 2009; Morris, 2009; Phillips, 2008). All seemed well, so much so that in 2003, Chicago economist Robert Lucas declared in a speech to the American Economic Association that the “central problem of depression prevention has been solved, for all practical purposes” (quoted in Krugman, 2009, p. 9), and by 2004, Ben Bernanke was speaking of 'The Great Moderation' (Krugman, 2009).

**20.3 Inflation Tamed?**

As to the 'low' levels of inflation, as Phillips (2009) has shown, the claims made in this regard are dubious at best. In late 1990s, Greenspan successfully lobbied to change the rules of how the consumer price index is reported, complaining that the system as it was overstated inflation because it didn't take into account changing tastes. The previous system had used the market prices of a fixed 'basket of goods' to determine the rate at which prices were increasing. However, the new system adjusted the goods used in the 'basket' – and the weighting given to them – according to the assumption that substitution of goods represented a change in which goods were important to consumers. Items going up in price would be given less weight in the measurement – reducing the measured level of inflation, while items going down were given more weight, also reducing the measured level of inflation (Phillips, 2008).

Critics have pointed out that this represents an adaptation to downward mobility and a reduction in standards of living (Phillips, 2008). As Stroupe (2006, cited in Phillips, 2008, p. 84) has pointed out,
a trend of consumers switching from higher priced goods to lower priced ones should be a marker of inflation being high, but the adjustments of the system distort this. This is exacerbated by the fact that, rather than housing costs being measured, the measure used for the housing contribution is 'owner's equivalent rent', or the amount that a homeowner could get if they chose to rent their homes rather than live in them. Phillips illustrates the ridiculousness of such a measure and the extent of its abstraction from the economic reality of home ownership:

“let us suppose the Smiths had bought a house they had previously rented for $2000 a month, and that their new monthly total of mortgage, insurance and property taxes is $3000. The effect on the CPI: zero, no increase. Now suppose they had always owned and their property tax bill just went up 40%. Effect on the CPI? Nil. Now suppose they bought in 2005 under an 'exotic' mortgage, and the monthly payment has just reset from 4.5 to 7.5 percent. What would be the effect of those circumstances on the CPI? Again nil. None of these would affect owner's equivalent rent, even though in the real world, they were out of pocket mightily” (Phillips, 2008, p. 86-87)

In any case, regardless of relative merits, for victory to have been claimed over inflation, it seems important to compare like with like – and the record is not favourable. An enterprising California journalist named John Williams took it upon himself to calculate the CPI using the old criteria. The data shows that by this measure the Fed in the 2000's would have been presiding over inflation of 5 to 7 percent rather than the 2 to 4 percent claimed under the adjusted system (Phillips, 2008).

Moreover, the stability of money supply growth which Friedman (& Roberts, 2006) attributed to the period simply never happened. Figure 20.1 shows growth rates in the money supply and base money from the end of 1988 (after Greenspan had settled into the Fed Chairmanship) to 2007. A striking element of this picture is not only the erratic nature of each figure in its own right, but in their relation to each other. Base money shows no real tendency to influence the money stock in the way that one would expect from the Friedman analysis. While Friedman had previously recommended a steady money supply growth of around 3-5%, the below chart shows money growth fluctuating between ranges of 0.5% and just over 10% per year between 1988 (after Greenspan's first year) and 2007. The monetary base – Friedman's chosen tool for money supply control – fluctuates even more wildly, reaching over 15% growth in 1999 and then actually growing negatively for the 2000 period. Contrast this with the so-called 'anti-monetarist' and stagflationary era, when base money fluctuated only between 5.18% and 9.76% (see Figure 19.1). Interestingly, the decline in 2000 did not precede a reduction in the rate of growth of the money supply the following year – on the contrary, growth jumped from 6% to over 10%.
More importantly, however, none of these free market true believers – Friedman included - saw any problem with the fact that each bailout, with the immediate consequences averted and no regulation to curb it, resulted in an almost immediate resumption of the progression toward higher and higher indebtedness and riskier financial behaviour (Keen, 2009a; Phillips, 2008) - “each apparent recovery after a debt-induced crisis was really a re-ignition of the fundamentally Ponzi lending that had caused the preceding crisis – but with a change in the sector that took on the debt” (Keen, 2009a, p. 9). In absolute terms, non-government debt had risen from $5544 billion in 1984 to $12606 billion in 1994 and $37852 billion in 2006 (Phillips, 2008). By the mid-1990s, the level of private indebtedness relative to GDP had already increased to a level higher than at the onset of the Great Depression: by 2007, it had skyrocketed to 275%, as against 156% at the end of 1929, and even more than the some 234% reached during the depths of the debt deflation of the Great Depression (Keen, 2009).

This is also reflected in the growth of the finance sector relative to the ‘real economy’ it is supposed to be financing (Baker, 2008; Davies, 2004; Foster & Magdoff, 2008; Korten, 2009; Morris, 2009; Phillips, 2008). In 1980, profits from the financial sector represented 16% of all U.S. profits – the same as it had been in 1960 - and made less than half of the profits made in the largest sector, manufacturing. By 1990, after only 10 years of Friedmanite policies, this proportion had ballooned to 24%, and reached as high as 36% during the 2000s, while the some $479 billion in profits it made in 2006 well and truly eclipsed the $304 billion made in manufacturing (from the Economic Report
of the President, 2009). In the 1980s, global financial assets roughly equaled global GDP – by 2005, global financial assets were around 3.7 times as high as global GDP, while the notional value of the derivatives market was around 10 times global GDP (Morris, 2009). The financial firms themselves were also increasingly leveraged – particularly after 2004 when restrictions on this were removed after lobbying by then Goldman Sachs CEO and recent Bush Administration Treasury Secretary Henry Paulson. At the height of the boom, some firms were leveraged at 30 to 1 (Powell, 2008). Nonfinancial corporations, in turn, became increasingly dependant on debt (Davies, 2004) and all incentives were toward short-term profit maximisation (Baker, 2008; Davies, 2004).

The sector which really took on the debt which financed the 2000's boom, however, was housing. Mortgage debt almost doubled between 2001 and 2007 – from around $7.5 trillion to $14.6 trillion (Economic Report of the President, 2009), while the market value of homes grew by over 50%, despite a rapid increase in supply (Economic Review of the President, 2009; Morris, 2009). Robert Shiller (cited in Morris, 2009, p. 65-66), a specialist in the history of housing booms, has described the housing bubble which occurred in the early-mid 2000's as the largest in history.

Meanwhile, nothing fundamentally had occurred in the U.S. which had increased the ability of American consumers to service debt. Average real wages stagnated so that they were no better in the 2000s than in the early 1970s, and the average figure may obscure an even worse scenario given the increasing inequality of income, such that while in 1980 CEOs averaged 42 times the average wage for a production worker, in 2003 this number was 301 times (Batra, 2005), and the share of total income of the 10 percent of the population earning the most money increased from 35% to 49% - with 60% of this gain going to the top tenth of one percent of income earners (Morris, 2009). Discretionary income in households actually decreased in the face of rising costs – a single income household averaged over $19000 in discretionary income in 1970 while the dual income family of the early 2000s had only $18000 (Phillips, 2008). The insecurity of employment tenure had also increased, such that while in 1970 the chance of a household experiencing a 50% or more drop in income was indefinably minimal, by 2002 the risk had grown to 1 in 5 (Phillips, 2008). Nor were there any particular demographic changes which would generate such a boom (Morris, 2009). If anything, American households in general were a bigger credit risk in the 2000s than they had been in recent history, even as their debt burden increased (Phillips, 2008).

Thus it seems not unreasonable to concur with Morris' (2009, p. 67) observation that “the 2000s real estate bubble may be one of those rare beasts conjured into the world solely by financiers”. The key to this conjuration was the expansion of credit to those who were perhaps least able to service the debts incurred, and the name given to this type of lending was to become synonymous with the crisis itself: subprime. Poor neighbourhoods were saturated with advertising and aggressive sales pitches from brokers, while the term 'NINJA' loan – for No Income No Job or Assets – entered into
the everyday vernacular of financiers. Prospective borrowers were enticed with loans with low 'teaser' rates which reset to double or triple the initial rate after two to five years – the difference between the two rates was added on to the principal (loan amount on which interest is paid) during that time: as has shown previously to be the case with other consumer products where negative information is omitted, the resetting was frequently left out of discussions. Some loans were initially paid interest-only, with no amortisation of the principal. Ultimately, usurious interest rates and outrageous administration fees were charged in order to compensate for the riskiness of making these loans – ironically thereby increasing the risk of default (Baker, 2008; Ferguson, 2008; Morris, 2009; Phillips, 2008).

Instinctively, one might look at this and wonder why the 'Invisible Hand' of self-interest didn't curb the enthusiasm of financiers for making such risky loans in this way. After the ensuing crisis had made itself apparent, Alan Greenspan certainly did (Greenspan, 2008, Testimony of Alan Greenspan, 2008). Surely they knew that low income borrowers on very high interest rates would frequently default on loans? However, the perception of this risk was reduced in two related ways. First was the use of financial innovation, in particular a brand of risk hedging known as 'securitisation'. Essentially, this involved packaging several – often thousands - of loans together to create new products with names such as 'Collateralised Debt Obligations' (CDOs) and 'Collateralised Loan Obligations', then dividing these products into shares which could be sold to investors. This in turn had two important effects. One was the obvious risk hedging effect – rather than investing in one loan which may or may not default; investors were holding a share of a bundle of many loans, so that each default would have a reduced effect on the total income generated by the product. Moreover, this allowed high-interest, high yielding subprime and 'NINJA' loans to be packaged with less risky 'prime' loans to further reduce the total risk of the product, and many such products were given triple A ratings by credit rating agencies (Ferguson, 2008; Morris, 2009; Phillips, 2008).

The other effect was that it allowed the issuers of the loans to profit from them while defraying the risks to investors who may be thousands of kilometres away – among the investors in CDOs were the Norwegian municipalities of Hemnes, Hattjeldal, Narvik and Rana (Ferguson, 2008) - and blissfully unaware of the true content of the loans they were buying. Rather than risking their capital to earn profits from interest as traditional money lenders do, they simply collected administration fees and profited from the sales of the loans without keeping any of the actual loans – and thus the (apparent) risk – on their own books. Money lending, in the words of Morris (2009, p. 60), became virtually “costless”.

The second way in which the perception of risk was reduced was through the use of classic
'Ponzi' logic. Even if borrowers defaulted, the argument went, it wouldn't matter because the appreciation in the price of the house used for collateral on the loan would mean that in the event that the borrower could not meet payment obligations the house could be sold at a higher price or the mortgage could be refinanced with no loss. Of course, to sustain the increases in housing prices would require even further increases in borrowing, but this was exactly what financiers selling mortgage backed securities intended to happen (Baker, 2008; Ferguson, 2008; Morris, 2009; Phillips, 2008). It wasn't just directed at the poor either - speculation by people buying houses only to sell them in one or two years' time was encouraged (Morris, 2009). By 2005, subprime lending was at $625 billion annually, more than four times the $145 billion level in 2001 (Morris, 2009).

Of course, this is not to dismiss the problem of other elements of finance. While wages stagnated, for instance, credit card debt in 2007 was 180% of what it was in 1999 (Powell, 2008), and the $915 billion investor's market for this is also largely securitised (Morris, 2009). The derivatives market – another alleged risk hedging device with a large variety of instruments – had a gross value of $683 trillion in June of 2008 (Bank of International Settlements, 2009; Keen, 2009a). However, these have not been the principal drivers of the current crisis – though they could now exacerbate its effects.

### 20.5 Collapse

By 2006, the Ponzi scheme was threatened by a combination of relative monetary tightening (interest rates now approaching 5%) and gross oversupply. This was exacerbated by the beginnings of the consequences of the predatory lending which had characterised the lead up to the housing boom. Many found that they had borrowed beyond their means, and worse, interest rates on adjustable rate mortgages began to reset at higher rates, so that many found themselves unable to service their loans. Seven percent of securitised loans issued in the second half of 2006 were 60 days overdue within 6 months (compared with three percent of those issued in early 2005) (Economic Report of the President, 2009). New mortgage borrowings had peaked in 2005, and a year later had declined by 45 percent (Phillips, 2008).

In one month of 2007 – July – the number of foreclosures was twice that for the whole of the previous year (Phillips, 2008) - by first quarter 2008, foreclosures were running at an annual rate of 2.8 million (Baker, 2008). The Case-Shiller Index showed house prices peak in the second quarter of 2006, after which they began to decline at an increasing rate (Standard and Poor, 2009). The decline in housing prices fed back on loan defaults further as borrowers found that they now had negative equity in their homes (Baker, 2008; Economic Report of the President, 2009; Phillips, 2008). Further, the increases in foreclosures effectively meant that supply was effectively increased,
exacerbating price pressures (Baker, 2008).

By mid-2007, with the unanticipated high rates of defaults and subsequent losses, the value of mortgage backed securities had begun to plummet (Economic Report of the President, 2009; Morris, 2009; Phillips, 2008). Stock markets now began to react. The Dow Jones peaked at 13,901 in October of 2007, by November 2008 it had crashed to 8,614.55 – a 38% reduction - eroding all increases since 1998 (Economic Report of the President, 2009).

As of writing, the latest figures show U.S. unemployment at 9.5% - the highest since the recession of the 1980s and more than double the rate of 2007 (Bureau of Labor Statistics, 2009) and this figure may understate the impact of unemployment given the phenomenon of 'underemployment'. The U6 measure of underemployment – which takes in to account the fact that many may have some work but insufficient hours to really make a living, while also not excluding those who want work but have given up looking - is at June 2009 16.8% - up from 10.3% at the same time the previous year (ibid). Several large institutions; including not only financial institutions such as Bear Sterns and Lehman Brothers but General Motors; have failed, been bankrupt or forced to accept buyouts; and the acceptance of large government loans has been endemic among financial institutions. The latest figures of the Case-Shiller index show that as of first quarter 2009 house prices had dropped by 32% from their second quarter 2006 peak (Standard & Poors, 2009). Eichengreen & O'Rourke (2009), who are tracking the progress of the crisis on a range of economic measures, have shown that the current crisis is tracking or doing worse than the progress of the Great Depression. As of writing on July 10 2009 the Dow is at 8109.79 (dj.com, 2009), down around 42% from 2007 levels. According to Friedman's theory, however, this can all be resolved if the U.S. Federal Reserve can just print some more money....

20.6 The Helicopter Solution (and the behaviour of money)

I will not go into great detail about the fiscal stimulus plans and new regulatory measures which are evolving as this is being written. What will be emphasised, instead, is whether the Friedman theory – that using Federal Reserve operations to increase base money (the proverbial helicopter drop of money) is the only means necessary to the prevention of the crisis worsening – holds.

Ben Bernanke concurred with Friedman's blaming the Federal Reserve for not providing banks with sufficient liquidity and thus causing the Great Depression. He appears to be ensuring that the same will not be said of him. Interest rates are now in the 0-0.25% range, and since 2007, the Federal Reserve has participated in an unprecedented raise in base money – literally more than doubling it from around $823 billion in 2007 to $1651 billion in 2008 and $1680 billion as of end of June 2009 (Economic Report of the President, 2009, Federal Reserve, 2009a).
Figure 20.2 Base Money $Billions. 1987-June 2009.


Figure 20.3 Base Money Yearly Growth % 1988-2008

Figure 20.4 Money Stock (M2) in $Billions, 1987-June 2009


Figure 20.5 Bank Reserves, $Billions, 1987-June 2009

This has so far been enough to prevent a decline in the total Money Stock (see Figure 20.4). However, in order to create inflation and prevent the potential deflation of a credit crunch (and in particular to reflate the deflated housing prices which have been a driver of the crisis), this money needs to be lent out, and through the mechanism of the money multiplier create an additional several trillion dollars in debt and credit money (Keen, 2009a, 2009b). Only then will a reflation be possible. The theory of endogenous money, in contrast, predicts that this new money will simply be added to bank reserves if it is beyond what the system desires, and if it does this then it is effectively sitting in bank vaults not being spent and thus having little effect on inflation.

It is the latter which is happening. Rather than being lent out, as in the traditional money multiplier model, the extra base money is simply being added to bank reserves. Bank reserves are now more than 18 times what they were in 2007, having risen from $42.5 billion in 2007 to $821 billion in 2008 (see Figure 20.5). Having represented less than 1% of the money stock since 1999 and around 1-2% for the decade before, bank reserves now sit at around 10% of the money stock (see Figure 20.6). Further, most of this is now excess reserves, which having stayed at around $1-2 billion for the past two decades at around 2-4% of total reserves, are now at $750 billion and represent over 90% of total reserves (see Figures 20.7 and 20.8). As in the Depression, the money multiplier ratio has collapsed – the money stock is now down from around 9 times base money to around 5 times (see Figure 20.9).

Unfortunately, this scenario seems likely to continue, and a base money and credit-driven recovery seems increasingly unlikely. The extreme saturation of lending in the lead up to the crisis – whereby every possible avenue was explored for expanding the number of mortgage holders - would seem to preclude any further expansion of lending such as to reflate asset prices. As Keen (2008, p. 1) has rightly pointed out, there are no “sub-sub prime” borrowers. Further, while the understatement of inflation outlined above may mean that in realistic terms consumer prices may be saved from deflation in the short-term, the rapid and continuing deflation in the asset prices – in particular real estate and stocks - which have underwritten the credit system increase the likelihood of the continued distress selling and debt liquidation characteristic of a debt deflation. They will therefore greatly decrease the likelihood of an increase in credit money of several trillion dollars to reflate the economy (in spite of the Fed's efforts), as both borrowers and lenders become more reluctant to generate increasingly risky debt. Of course, as outlined above, the lack of borrowing and lending will tend to exacerbate price declines as well as business contractions as lending to real-economy business enterprises decreases, which will in turn further exacerbate declines in borrowing and lending, and so on.
Figure 20.6 Bank Reserves as a % of Money Stock (M2) 1987-June 2009.


Figure 20.7 Excess Bank Reserves, $Billions, 1987-June 2009.

Figure 20.8 Excess Reserves as % of Total Reserves, 1987-June 2009


Figure 20.9 Money Multiplier – Ratio of Money Stock (M2) to Base Money 1987-June 2009

20.7 The Minsky Moment?

Minsky's name and ideas have found their way into a number of treatments of the current crisis (e.g. Keen, 2009a, 2009b; Lahart, 2007; Lordon, 2007; McCulley, 2009; Morris, 2009; Phillips, 2008; The Economist, 2009; Whalen, 2007) (though few have discussed the debt deflation element of the Minskyan analysis). It is not without some merit that Pollin (2008, p. 5) has declared that “we are all Minskites now”.

Indeed, it seems as if the Minskyan markers are present. Despite the frequent calamity of the 1987-2007 period, it clearly seemed to some that the Federal Reserve had tamed the business cycle. In addition to the above mentioned comments regarding ‘the great moderation’, Wall Streeters of the 2000s had come to talk of the ‘Greenspan Put’ - “No matter what goes wrong, the Fed will rescue you by creating enough cheap money to buy you out of your troubles” (Morris, 2009, p. 65). These sentiments are eerily reminiscent of Friedman's (1990, p. 78) comments on the general sentiment before the Great Depression – that “a new era had arrived, that the business cycle was dead, dispatched by a vigilant Federal Reserve”. The 'tranquility', though perhaps more fragile (and less truly 'tranquil') than he had imagined, increased the system's proneness to instability.

Unfortunately, the period of cautious finance was long past by the beginning of the current credit crunch, and indeed the speculative and ‘Ponzi’ finance which developed particularly in the 1980s never really died down as the 'Greenspan put' had been successful in preventing financial calamity (or so it appeared). However, in using exclusively monetary means to prevent debt deflation – without accompanying regulation or sufficient consequences for the perpetrators of the near-crises he treated – Greenspan helped to validate the speculative and Ponzi finance of the period. Ultimately, of course, Ponzi finance must collapse, and it has done so spectacularly, while no 'Bernanke put' seems likely to revive it again. A credit crunch has ensued.

Happily, Minsky theorised that a combination of deficit government spending with fiscal stimulus and monetary policy would almost always prevent a debt deflation. In addition to the monetary easing, the Obama administration is planning Keynesian stimulus measures in the order of $1 trillion. As Eichengreen & O'Rourke (2009) have theorised, the major difference so far between this crisis and the Great Depression has been the policy response. Unfortunately, as Keen (2009a) has pointed out, Minsky himself may not have foreseen the extent to which Ponzi finance would be saved from itself and be allowed to worsen. It took 4 decades for the private debt to GDP ratio to go from 50% to 150%; then roughly half of that to go from 150% to 275% (see Figure 20.10). Minsky may yet be proved wrong on this point.

57 In financial terms a 'put' is an option which allows its holder to sell a particular asset to a third party at a fixed price, no matter what (Morris, 2009)
Figure 20.10 Private Debt to GDP Ratio, %, 1935-2007

![Graph showing the Private Debt to GDP Ratio from 1935 to 2007.](image)

Source: Tabulated data given by personal communication with Steve Keen, 2009, derived from data from US Census Bureau and Federal Reserve Bank Flow of Funds, as published graphically in Keen, 2009a.

### 20.8 Conclusions

Given the differences between the still-evolving policy response (the use of Keynesian fiscal stimulus, re-regulation, etc) and those of previous crises, it seems too early to at this stage for this thesis make definitive predictions about the ultimate outcome of the crisis. However, it does not seem too early to set terms for the interpretation of outcomes, and some attempt at this can be made here.

First, the obvious comment that can be made is that if indeed this becomes a prolonged debt deflation and an economic crisis of comparable magnitude to the Great Depression, then there can be no respite for Friedman's macroeconomic theory. The Federal Reserve has been monetarist over the course of the build up to the crisis and is now aggressively pursuing money expansion, and the removal of regulation which Friedman preached has been progressing steadily since the 1980s. Friedman's assertion that the cause of crisis is government and that crisis will be averted when regulation is reduced and government discretion replaced with monetary rules must be rejected on its clear empirical invalidity.

Secondly, there can be no vindication of Friedman's theories even if the crisis does not deteriorate further to an even more severe recession. The fact that these policies have already brought the world to the brink in this way – and that the instances of the highest rates of unemployment in the U.S. since the Great Depression have occurred since 1980 - is already a clear indication of the inherent instability of the free market and an impetus for further regulation. If Friedman's theories are to be tested on their predictive ability as he advocates, then great weight should be given to Friedman's optimism shortly before his death and Greenspan's (2008) comment that “those of us who have
looked to the self-interest of lending institutions to protect shareholder's equity (myself especially) are in a state of shocked disbelief”. Further, any recovery, should it occur, will need to give credit to fiscal and regulatory measures, so that attribution to monetary policy will be difficult at best.

Furthermore, on the issue of inflation, the record shows that the influence of base money expansion has been greatly exaggerated. While Chile's inflation may have been caused by excessive fiat money creation, in a country like the United States with a much more highly developed credit system, the comparative influence of the monetary base is greatly reduced.
PART VI: CURRENT REALITY AND ALTERNATIVE THEORY

58 In this section, I rely principally on information already revealed and referenced in earlier sections of the thesis, hence the reduced frequency of referencing.
21 Judging Friedman: Assumptions, Predictions and Reality.

21.1 The F-Twist.

This thesis has attempted to contrast Friedman's assertions with what it has described as 'empirical reality'. To some, however – and to Friedman in particular – the concept of 'reality' as used in this thesis is questionable. In particular, Friedman might object that many of the criticisms made here are of 'assumptions' which he has made in formulating his theory that unregulated markets, populated by unrelenting seekers of self-interest, will be led by the 'Invisible Hand' to maximise the overall wellbeing of society. The noneconomist, or indeed anyone reading this who is not familiar with Friedman's work may wonder why this is grounds for objection: surely if the assumptions on which the theory depends are demonstrably false, then this necessarily renders the theory false.

However, Friedman is famous for arguing in his essay *The Methodology of Positive Economics* (1953) that, in fact, a theory cannot be judged by the realism of its assumptions. Friedman argues that the realism of assumptions is largely immaterial to the judgement of theoretical validity, and that instead theories should be judged on the conformance of their 'predictions' with observable events. In an even stronger statement, Friedman even goes on to argue that:

“Truly important and significant hypotheses will be found to have ‘assumptions’ that are wildly inaccurate descriptive representations of reality and, in general, the more significant the theory, the more unrealistic the assumptions (in this sense). The reason is simple. A hypothesis is important if it ‘explains’ much by little, that is, if it extracts the common and crucial elements from the mass of complex and detailed circumstances surrounding the phenomena to be explained and permits valid predictions on the basis of them alone. To be important, therefore, a hypothesis must be descriptively false in its assumptions; it takes account of, and accounts for, none of the many other attendant circumstances, since its very success shows them to be irrelevant for the phenomena to be explained.” (Friedman, 1953, p. 14-15)

Not only do unrealistic assumptions not make for an invalid theory, but in fact here Friedman expounds the virtue of unrealistic assumptions and actually appears to assert that theories are enhanced by the lack of realism in their assumptions (Friedman, 1953). Friedman is therefore expounding two (normative) virtues of what theories should do – firstly, simplify reality, and secondly, make accurate predictions. As long as a theory meets these conditions, it is both valuable and valid – the realism of its assumptions don't matter.

In his 1963 critique of the work (discussing a paper on the same topic presented by Nagel (1963) to the 75th annual Meeting of the American Economics Association), neoclassical economist Paul Samuelson (1963, p. 232), while expressing his hope that he was “misinterpreting (Friedman's) intention”, summarises the implications of the idea: “A theory is vindicable if (some of) its consequences are empirically valid to a useful degree of approximation; the (empirical) unrealism of the theory 'itself', or of its 'assumptions', is quite irrelevant to its validity and worth” (Samuelson,
Joseph McIvor ‘Seeing the ‘Invisible Hand’

1963, p. 232). This (and the aforementioned stronger version of the theory) Samuelson calls ‘The F-Twist’, refraining from using Friedman's full name on the basis that the claim seems so absurd (Samuelson even jokes about it – see p. 333) that it seems necessary to give Friedman the benefit of the doubt. Friedman has not responded to critiques and discussions of interpretation (see Friedman & Friedman, 1998), however he more or less acknowledges that he has broadly been interpreted correctly when he affirms his agreement with Mayer's comment that his essay on 'The Methodology of Positive Economics' is “broadly consistent with the methodology that most economists now affirm, at least in principle”(Mayer, 1993, p. 213, cited in Friedman in Friedman, 1998, p. 214).

Samuelson's (1963, 232) insight above – that when Friedman talks about the unimportance of unrealistic assumptions and the primacy of prediction he is also talking about the unimportance of the “unrealism of the theory itself” - is also born out very clearly in the essay and worth pointing out. This is illustrated when Friedman asserts that theories which for instance, postulate that the relative density of leaves around a tree is such that they are “positioned as if each leaf deliberately sought to maximize the amount of sunlight it receives, given the position of its neighbors, as if it knew the physical laws determining the amount of sunlight that would be received in various positions and could move rapidly or instantaneously from any one position to any other desired and unoccupied position” (Friedman, 1953, p. 19), or that an expert billiard player “makes his shots as if he knew the complicated mathematical formulas that would give the optimum directions of travel, could estimate accurately by eye the angles, etc., describing the location of the balls, could make lightning calculations from the formulas, and could then make the balls travel in the direction indicated by the formulas” (ibid, p. 21), are correct simply because they (to what Friedman would deem a reasonable degree) allow for accurate prediction of outcomes. To explain such phenomena in this way goes to the content of the theory itself and not simply its assumptions.

For a number of the points made in this thesis, the argument made by Friedman (1953) in this regard is inconsequential. Part II, for instance, concerns the misrepresentation and misappropriation of the Political Economic thought of Smith and Mill and the incongruence of their positions and theories with Friedman's – there is no question here of predictions or assumptions. In other cases Friedman has made very clear predictions which have been falsified by history – his predictions about the stabilisation of unemployment following implementation of his recommendations in Chile, for instance (see Chapter 18), or his faith in the ability of monetary policy to ensure that recessions could not be severe (Chapter 20).

However, Friedman may (were he in a position to do so) argue that other points made in this thesis, crucial to showing that in fact the 'Invisible Hand' as he conceives it does not maximise the aggregate welfare of society, are in fact concerned with 'assumptions' and therefore themselves inconsequential. This may be true in particular of the information asymmetries discussed in Chapter...
10, or the rejection of the idea of organisations having perfect information regarding the long-term profitability of the firm (and this being a protective mechanism for other stakeholders) contained in Chapter 12. If these are indeed 'assumptions', then by Friedman's standard falsifying them does not necessarily falsify the 'Invisible Hand' theory provided that the 'Invisible Hand' theory still makes valid 'predictions'. Therefore, it seems necessary over all to address this question of the relevance of 'assumptions', and whether the abovementioned discussions of Friedman's 'assumptions' contribute to falsifying his overall thesis of the 'Invisible Hand' working to maximise societal welfare.

21.2 Classifying Assumptions.

In order to assess the validity of the notion that assumptions are unimportant, it seems necessary to define what is meant by the term 'assumptions'. In this the typology proposed by Musgrave (1981) with elaboration from Maki (2000) is used as a starting point. Musgrave (1981) proposed three types of assumptions: heuristic, negligibility and domain assumptions. Maki (2000) redefines Musgrave's (1981) idea of 'negligibility' to distinguish between those which are of 'negligible' consequence and those which are 'detectability' assumptions; and also further distills Musgrave's (1981) idea of 'domain' assumptions into 'domain' and 'applicability' assumptions. The following introduces these classifications – five in total – before a later discussion of their relevance to Friedman.

Firstly are 'heuristic' assumptions. 'Heuristic' assumptions are made in the initial phase of the formulation of theories or in their explanation, with a view to relaxing them before the theory can be considered whole or valid. These may seen in explanations which begin with statements to the fact of 'assume for the moment x', before a revision or explanation of the theory which no longer includes the (false) assumption that x is true and which takes into account the way in which x not being true affects the results to be derived from the theory (Maki, 2000; Musgrave, 1981). They are in this way a 'stepping stone', theories which use them are “scaffolding” (Samuelson, 1963, p. 236) used in the pursuit of a more complete theory with more realistic assumptions, and their potential importance to results is in such instances acknowledged.

Secondly in Musgrave (1981) are 'negligibility' assumptions, which Maki (2000) rightly divides further into 'negligibility' assumptions and 'detectibility' assumptions. 'Negligibility' assumptions Maki defines as “the hypothesis that some factor F that might be expected to affect the phenomenon under investigation actually has an effect upon it small enough to be neglected relative to a given purpose” (Maki, 2000, p. 322, emphasis in original). This, Maki (2000) contends, requires the effect of the factor F to be largely known. 'Detectibility' assumptions, on the other hand, pertain to whether the effects of a factor on the phenomenon under investigation' are detectible (or indeed detected).

59 Maki (2000) adds a further distinction of 'joint negligibility', but the distinction is not deemed useful for this discussion.
Obviously, when no effect from factor \( F \) is 'detectible' then it is impossible to include it in any model or theory except by mere speculation, so a model may 'assume' that it has no effect.

Musgrave (1981) further theorises of what he calls 'domain' assumptions, which Maki (2000) more illustratively calls 'applicability' assumptions (and it is this term by which it will be referred to henceforth) “specify the domain of applicability of (a) theory” (Musgrave, 1981, p.381, emphasis in original), that is, the conditions under which the theory will apply ie 'theory \( x \) will apply only where factor \( F \) applies'. This can only barely be called an 'assumption', and in fact it also implicitly acknowledges that theory \( x \) does not apply where factor \( F \) does not apply. Musgrave (1981) rightly points out that such 'assumptions' imply rather the opposite of a 'negligibility' assumption: factor \( F \) is indeed acknowledged to have a significant effect such that the theory's applicability is dependent upon its presence or otherwise.

Maki (2000) also theorises of 'domain' assumptions, but by this means something equally useful to but rather distinct from the definition offered by Musgrave (1981) (again, it is Maki's definition which will be used here). While applicability assumptions set the limitations of the theory, 'domain' assumptions make a statement about the 'domain' under investigation itself. Maki (2000, p. ) uses the example that the statement that “the theory only applies where (government) budget imbalance is absent” is an applicability assumption which is always either true or false, while “the government has a balanced budget” is a domain assumption which may be true or false at different times.

21.3 Kinds of Assumptions in Friedman

Having outlined provisional classifications for the concept of assumptions, it is now pertinent to assess what kinds of assumptions Friedman is talking about in *The Method of Positive Economics* (1953) and in his theorising of the 'Invisible Hand'. Firstly, it seems clear that, to the extent that things like 'perfect information' are assumed, Friedman is not talking about 'heuristic' assumptions (though Keen (2001) has observed that Friedman's fellow neoclassical economists in the teaching profession are wont to imply to undergraduates that the assumptions being taught are in fact of this type and are dropped when more advanced levels of knowledge are reached. In fact the opposite is true: even more unrealistic assumptions are introduced). Indeed, Friedman's (1953) position would appear to reject the idea that any assumption need be merely 'heuristic' at all so long as its predictions are 'sufficiently' (according to largely undefined criteria) accurate, and in fact even implies that a theory which tentatively states its heuristic assumptions might be improved by not only abandoning any attempt to make corrections for its current assumptions but by regressing into even more wildly unrealistic ones.

Friedman may instead be more likely to assert that his are mere 'negligibility' assumptions which have little effect the phenomena under consideration. Indeed, some of his examples appear to point
to this – the idea that a time taken for a ball dropped from the top of a building can be closely approximated with the formula given for the speed at which an entity falls in a vacuum, for instance, in 'assuming a vacuum', is in effect assuming that elements such as air pressure etc have, by the Musgrave/Maki typology, a 'negligible' effect on the phenomenon in question (Friedman, 1953). Perfect information, he might argue, is thus a reasonable assumption because the extent to which information is imperfect has little effect on the phenomena in question.

Asserting this in regard to his own models of the world does not make it so (more on this later), but Friedman's (1953) argument goes further than this. Friedman is arguing that assumptions are necessarily negligible so long as the theories which make them yield accurate predictions. He even extends this to what have here been called 'domain' and 'applicability' assumptions - “the entirely valid use of 'assumptions' in specifying the circumstances for which a theory holds is frequently, and erroneously, interpreted to mean that the assumption can be used to determine the circumstances for which a theory holds” (Friedman, 1953, p. 19).

In effect what he has saying is that assumptions cannot be used to assess the validity of theories, but instead the extent to which theories make valid predictions 'to a reasonable degree' can be used to assess the validity of assumptions. This leads to a number of problems. Firstly, as Samuelson so poetically puts it, “This leads to Humpty-Dumptiness. Lewis Carroll had Humpty-Dumpty use words any way he wanted to. I have something different in mind: Humpty-Dumpty uses the F-twist to say 'What I choose to call an admissible amount of unrealism and empirical invalidity is the tolerable amount of unrealism” (Samuelson, 1963, p. 236). The theorist is in some ways given carte blanche to determine the reasonableness of their own theory.

The problem also leads to theories which describe circumstances (make assumptions) which do not apply in any real world circumstance or 'domain' being seen as perfectly legitimate for theorising about the real world (Keen, 2001; Musgrave, 1981; Nager, 1963), and it is this type of assumption which Friedman and neoclassical economists make in formulation of their models. Vacuums actually exist, and the conditions of them are known; thus to extrapolate to circumstances which can (because of its existence and the knowledge of it) be judged to be sufficiently similar for a particular purpose seems less unreasonable than if they did not exist and their conditions were not known. Perfect information and competition exist nowhere in reality, in no 'domain', they are simply a fiction created for the purpose of a theory. Hollis and Nell (1975, p. 213) go so far as to contend that these assumptions amount to assuming “the exact opposite of what is the case”. Friedman may in response cite his examples of sentient leaves and hypercalculating billiards players as being exemplary of good theories which make accurate predictions about the real world but which make assumptions which apply in no real 'domain'. But these theories are ultimately useless: they neither accurately describe nor simplify the phenomena described, and nor do they offer any predictive
advantage. It is simultaneously less false and simpler to simply say that leaves cluster according to their proximity to the sun; or that expert billiards players make a high proportion of their shots; and this sacrifices nothing in terms of predictive power.

The specification of a domain which does not exist in the real world creates a further issue of testability. If Friedman (1953) argues that the test of whether a theory is valid is the accuracy of its predictions, then the accuracy of the predictions must be able to be tested if the theory is to be shown to be valid (or, more importantly in this case, invalid). However, a theory which specifies a domain of applicability which does not occur in the real world cannot be tested (Hollis & Nell, 1975; Keen, 2001; Musgrave, 1981; Nager, 1963). Among economists, this unfortunately leads to defending against accusations that their predictions have been falsified on the grounds that the theory has not been tested because the assumptions (perfect competition etc) have not been met (Hollis & Nell, 1975; Keen, 2001). They have not been met because they are unrealistic, but their lack of realism still cannot be judged to invalidate the theory. This implies that assumptions are important, but their falsehood is not (Keen, 2001).

This creates a rather perverse situation where economists like Friedman essentially appear to imply that the test of how to interpret reality is its conformance with a theory which has not been proven because it is untestable (Hollis & Nell, 1975; Keen, 2001) – which appears to be rather the opposite of what a theory is supposed to do. Keen (2001, p. 65) cites the joke that “an economist is someone who, when shown that something works in practice, comments 'Ah, but does it work in theory?'”. Hollis & Nell (1975) are less amused. They rightly contend that that the untestability of neoclassical theories give them the appearance of being impervious to criticism - “Negative results show only that the market is defective....Even if an allegedly perfect and perfectly well-behaved market were constructed, it still could not be used to test the analysis. For the test could still only reveal whether the market was perfect as alleged. A perfect market simply is one which conforms to the model” (Hollis & Nell, 1975, p. 34). This is, they allege, “like saying that verdicts are just only when they are favourable” (Ibid, p. 42).

The implications are clear. For a theory to be truly 'Positive' in terms of being able to explain or predict an empirical reality, there must be some means by which to assess its validity. According to Friedman (1953), this means is not to be found in the realism of its assumptions, but in that of its predictions. For a prediction to be properly tested, however, the circumstances it describes have to occur in the 'real world'. These 'circumstances' are dependent upon its assumptions. Assumptions which have no equivalent in the 'real world' thusly render the prediction unable to be tested; and the theory becomes an untestable assertion only of “what would happen, if”, leaving it empirically “vacuous” (Hollis & Nell, 1975, p. 38, emphasis added). To maintain the correctness of the theory in the face of these facts, and to assert that interpretations of reality must in this way 'assume' the
theory to be correct, is a position stripped of anything which can in this sense be called 'positive'; and so Friedman's (1953) “Methodology of Positive Economics” can in fact be revealed to be a methodology of something quite its opposite and from which Friedman was trying to distinguish himself: Normative Economics.

21.4 More than Assumptions

At this point it must be confessed, with apologies to the reader, that the preceding discussion of assumptions is in some ways and to some extent superfluous to the present purpose. For the 'assumptions' of the theories which Friedman expounds are not really 'assumptions' at all. They are, in Friedman at least, proofs: the very and most important reasons to suppose the truth of the theory that unregulated markets populated by unrelenting seekers of self-interest, moderated only by nondiscretionary fiat intervention in the money supply according to a monetary 'rule', will be led by the 'Invisible Hand' to maximise the over all wellbeing of society.

When Friedman says that “both parties to an economic transaction benefit from it, provided the transaction is bi-laterally voluntary and informed.” (Friedman, 2002, p. 13), or in Price Theory (2007, p. 5), that “since the household always has the alternative of producing directly for itself, it need not enter into any exchange unless it benefits from it”, he is not simply 'assuming' bilateral volition and information, or that the household has the alternative of producing for itself as a part of some theory of mutually beneficial exchange which is unaffected by whether the household actually has such an alternative or not. He is stating empirically that transactions generally are 'bilaterally voluntary and informed', and that such alternatives exist, and for this reason deriving the statement that exchanges are necessarily mutually beneficial. When it is realised that such 'assumptions' are fallacious – that transactions (as discussed in Chapters 10 and 12) are very often neither 'voluntary' (and volition is partly dependent upon information) nor 'mutually informed' and that the idea of households producing all they need for themselves is in fact patently ludicrous (consider the ability of an individual household to produce, for instance, cancer medicine; or indeed even the simplest of things without making a purchase requiring exchange), then the reader is left without a reason to believe that exchanges will necessarily be mutually beneficial. Nor can it be said that it is 'as if' they were true. If it were 'as if' information were perfect, no company would ever go out of business (or lose money at all), no one would make a purchase which they later regretted (let alone one that killed them): asbestos as a product would have been rejected shortly after it was introduced rather than persisting for centuries and causing death to (at least) hundreds of thousands.

For Friedman to call these mere 'assumptions' and to assert that they were inconsequential to the correctness or otherwise of his theories would be patently absurd. It would seem, however, that he knew this: in his Free to Choose there is very little mere 'assuming', perhaps because he is trying to
convince noneconomists not yet indoctrinated by neoclassical theory. He tries to outline, for instance, how the price system creates the incentive for and the actuality of efficiently transferring information between participants (Friedman & Friedman, 1990) – trying to show that his 'assumptions' of transactions being 'mutually informed' are in fact 'realistic'. That they are not – that their discordance with reality is pervasive rather than exceptional - leaves Friedman's theories as little more than empty shells of supposition.
22 Seeing the 'Invisible Hand': Toward An Alternative Political Economy of Developed Democratic Capitalist Systems

22.1 Power, Class and the 'Invisible Hand'.

One of the most crucial errors underlying Friedman's political economy, and that of neoclassical economics in general, is an apparent ignorance of, or unwillingness to acknowledge, the uneven distribution of power inherent in any human society. The 'assumptions' of Friedman and other neoclassical economists – perfect information, perfect competition, and the like – are often in effect attempts to excise questions of power from the discussion of the economy. Friedman appears to imagine a world in which each person is more or less born with an equal amount of market power (in all aspects except possibly for talent), and that it is the way in which they choose to exercise that power which ultimately determines their economic circumstances. In Friedman's imaginary world, with very few conditions, the free market provides 'equality of opportunity' for each person to use that equal amount of economic power through a series of necessarily voluntary, informed and mutually beneficial exchanges. Each person, being of equal power, is able through the market to express their free choice in these exchanges. The distribution of the benefits of the market is thus largely the result of economic choice, not an uneven distribution of market power. Only the state, according to Friedman, has a power to coerce, and the use of this power is in almost all cases deleterious and a distortion of the beneficial workings of the 'Invisible Hand' in producing a freely chosen outcome for all.

In reality; as has, it is hoped, been shown; power in the market is not distributed evenly – there is no 'equality of opportunity' in a free market economy. The market reacts to the choices of each person differently according to their control of wealth, information and other resources; and these sources of power are at no point distributed in evenly. Nor is there any tendency toward evenness of distribution in a laissez faire economy - in fact the reality is often the opposite; at least compared to more mixed-market models. The way in which this power is distributed is at least as important as personal choice in the distribution of market outcomes, good and bad. Power; its distribution and usage; must therefore be central to the political economic analysis of capitalist systems. The discussion of the distribution and usage of power in capitalist systems, in turn, naturally lends itself to discussions of class, and class interests.

Class analysis in political economy has traditionally been associated with Marxist perspectives (Crompton, 2008; Stilwell, 2006). The traditional dichotomy of Capital and Labour in Marxist analysis has been complicated by changes in the character of capitalist economies, including dealing with the so-called 'middle-class'; and theorists formulating analyses of class have attempted to
address this complexity with a more rigorous classification of class. However, some central Marxist features have remained. In particular, this includes the idea that class relationships within capitalism are inherently and necessarily exploitative; and that the process of capitalist production necessarily involves the extraction by capitalists of a 'surplus' of wealth over and above what could duly be expected in an exchange of equal value through their exploitation of, in particular, workers (Crompton, 2008; Hollis & Nell, 1975; Stilwell, 2006). This idea is in direct contrast with the view of Friedman and other neoclassical economists, that profits in a free market are necessarily the effect of fair and free exchanges with no 'surplus' as such.

The position of this thesis is to reject both perspectives. The neoclassical contention that there can be value added by the 'capitalist' (a too-simple distinction which will later be elaborated on) in the marshaling and coordination of resources for production, and that compensation is due for the delay and risk of consumption inherent in capitalist investment, in addition to the labour which the capitalist themselves may engage in within the business, is accepted. Thus the Marxist contention that profit is necessarily a 'surplus', in the sense of 'something for nothing', which is 'extracted' from workers, and that thus they are necessarily exploited, is rejected\(^6\). What constitutes a 'fair' compensation for marshaling of resources, capitalist labour and the risk of capital is difficult if not impossible to quantify objectively, but it may be contended that there are likely to be circumstances in capitalist systems where a just balance between profits and wages is obtained; or even ones where the arrangement is unjustly favourable to the worker (though it is likely that the latter in particular is rare).

This is not to say that such a surplus is not, in practice, (most?) often extracted, or that exploitation does not (or can not) occur, or that indeed the 'market' necessarily prices labour (or anything else) correctly. The Friedman/neoclassical contention that the existence of unregulated markets necessarily both ensures and proves the absence of such a surplus has been a principal target for this thesis (though the term 'surplus' has not been used previously) and is thus similarly rejected. However, unlike in Marx where the surplus comes necessarily from the exploitation of labour, it is here contended that the sources of 'surplus' are multifarious, including among other things such aspects as the externalisation of environmental costs or the exploitation of consumers through faulty, overpriced or otherwise unbenefficial products. The existence, extent and distribution of any 'surplus' is thus not conceived of as being the necessary result of the employee/employer structures of capitalism. It is instead dependent on power derived from a range of sources, including both those created directly by the legal/institutional forms of capitalist societies and those which are more 'organic' and heterogeneous.

\(^6\) If this flat rejection of Marxist theories of value seems brief, it is because countering Marxist theory is simply not a primary focus of this thesis.
Others have theorised of class power struggles within capitalist systems and their implications without reference to capitalist structures which are necessarily exploitative of labour. Kalecki’s (1971) consideration of how the exercise of class power through unions can redistribute wealth away from profits and toward labour has already been discussed. Class power struggles in this vein have also been theorised outside of the traditional labour/capital framework. The ability of firms to extract a ‘surplus’ from consumers through the use of oligopoly market power in determining prices is one such example (Pressman, 2007). A number of authors have also discussed class power struggles between managers and shareholders of varying types (Dallery, 2009; Dumenil & Levy, 2001; Pressman, 2007; Stockhammer, 2004), with this affecting elements such as trade-offs between the distribution of dividends and investment of profits for growth, and the difficulty of a unified definition of ‘profit maximisation’ particularly given the importance of the period of time considered.

Further, while the diffusion of share and property ownership, the prevalence of corporations run by salaried managers rather than owners; and the relative decline of the manufacturing sector employees (and their unions) which traditionally make up the ‘working class’, have led some to question the continuing relevance of class analysis (see Crompton, 2008 and Stilwell, 2006 for further discussion of this phenomenon); continuing inequality in the distribution of wealth, and in particular the stagnant real wages of a large proportion of workers, remains a compelling reason for discussion of class. Real average hourly wages for nonsupervisory workers in the U.S. private sector actually declined from the late 1970’s through the 1980’s until 1996; and remain below the peak level achieved in 1972 (Economic Report of the President, 2010). While increased female participation in the workforce and other moves toward gender equality have seen women’s real median income grow substantially over the last few decades, men saw their real median income decline during the late 1970’s and early 1980’s; and improvements have stalled around the levels achieved in the early 1970’s (U.S. Census Bureau, 2010), which is likely to reflect stagnation in the rate of pay for a given amount of work. Meanwhile, incomes for high earners, particularly executives, have skyrocketed in both relative and absolute terms – for instance in 1971, the 10th highest paid CEO was paid 47 times the average salary, by 1999 the number was 2,381 times (Dumenil & Levy, 2004). While there has been some diffusion of share ownership, the vast majority share holdings remain concentrated in the hands of the wealthy (Dumenil & Levy, 2004).

The gap between the income growth of the very wealthy and that of the majority of workers leads Dumenil & Levy (2004) to retain a conception of an essentially dichotomous capitalist class relationship, with the “uppermost layers” consisting in cohesion between the “ownership-management interface” and a “broader, subordinate tier of the ‘upper salaried classes’”; enjoying a growing gap between it and the “mass of the population” (Dumenil & Levy, 2004, p. 106). Wright
Figure 22.1 Real Median Income of Males and Females in the United States, 1953-2009, 2009 Dollars.

Source: U.S. Census Bureau, 2010

Figure 22.2 Average Real Hourly Wages for production and nonsupervisory workers in nonagricultural private sector businesses, 1964-2009, 1982 Dollars.

Source: Economic Report of the President, 2010
(1997b) however, believes that the 'middle class' is simultaneously part of the capitalist and working classes, and attempts to develop a more complex and detailed discussion of class based on various sources of advantage. Wright (1997b) is particularly interested in the advantage gained by skill level among employees. In other work, he attempts to classify 'classes' along a number of lines beginning with relation to the means of production (owner vs. employee). Among employees, classification is according to relation to authority (level of management) and relation to scarce skills, with highly skilled managerial employees in the most advantageous position; while owners are classified according to the number of employees under them. Formally, this produces 12 classes in all (Wright, 1997a). Dumenil & Levy (2004), however, would insist that skill *per se* is not the key factor in explaining inequality.

However, while these means of stratifying class may prove useful in discussions of inequality of wealth as such, the assignment of individuals to particular classes places some limits on explaining their behaviour dependent on situational factors and their varying (and sometimes conflicting) interests; while also constraining discussion of the multifarious sources of power and 'surplus' (as above defined). If one is interested in more than inequality of wealth, and instead seeks to explain the different ways in which power is exercised and different forms of 'surplus' extracted, then the individual is an inherently limited unit of study. In this, Neo-Weberian class analysis can provide a useful alternative (Hall, 1997).

Weber's (1922/1978) own discussion of class *per se* ultimately retains an individual-based stratification: “class” is defined in terms of “all persons in the same class situation” (ibid, p. 302); and he distinguishes four classes as “a) the working class as a whole....b) the petty bourgeoisie...c) the propertyless intelligentsia and specialists (technicians, various kinds of white-collar employees, civil servants-possibly with considerable social differences depending on the cost of their training)(and) d) the classes privileged through property and education” (ibid, p. 305). However, Hall (1997) points out that Weber's emphasis throughout his work was on market power; and the variable exercise and delimitation of that power in multiple sets of markets; including labour markets, consumer & commodity markets, financial markets, and the like; and even the particular variations of these (for example oil or steel commodity markets). Taken to its ultimate conclusion, this logic can lead to a conception of class in which “Individuals are not *members* of a class; they *engage* in various class *actions* - both individually and collectively....In these acts, individuals may have multiple, overlapping, sometimes contradictory, sometimes reinforcing interests based on their participation in multiple, heterogeneous markets” (Hall, 1997, p. 21). This emphasis on class 'actions' as opposed to class 'membership' provides a useful starting point for developing an alternative typology of class, in which the exercise of power and the position of the individual in the extraction of any 'surplus' is dependent on the particular market situation and the individual's
position within it.

22.2 An Alternative Class Typology

The questions outlined in Chapter 2 discuss the behaviour of market 'players'. In order to better understand this behaviour, it seems pertinent to categorise and demarcate these market 'players' and to postulate their (general) interests and power relative to other 'players'. In Friedman's conception, the 'players' are simply categorised into consumers, firms, and workers, with the state acting as little more than an umpire (to the extent that it participates directly in the market, this is seen as deleterious). These 'players' generally participate in the market 'game' on equal terms with one another and exchanges between the categories (between consumers and firms or firms and workers) necessarily result in mutually beneficial exchanges in a free market setting. Power (in terms of opportunity) is generally conceived as being relatively equal both between categories and between members of the same categories. None of these categories are conceived of as anything approaching a 'class' as such: the members of each category compete ruthlessly with other members of the same category for the same resources; and there is in this sense a lack of the commonality of interests necessary for a 'class'.

Categorisation of these 'players' based in class analysis has rather a different character. Elements of the categorisation of class analysis share commonality with Friedman's and that of neoclassical economists: 'capitalists' are in place of firms, but workers remain as a category and the state remains as an imperfect (though for different reasons) umpire (though recently there some attempt to address divisions within and overlaps between these broad classes). Unlike in Friedman, however, the process of consumption is not traditionally conceived as being a source of categorisation as such. Instead, consumption is conceived as principally being a function of 'class'. Further, while Friedman places preeminent importance on competition between members of the same category, class analyses tend to emphasise the commonality of interests between members of each class. Competition for resources becomes rather the defining feature of relations between classes, and this adversarial nature of inter-class relations is emphasised over the mutually beneficial exchange of Friedman's conception. Crucially, power is seen as decidedly unequal between classes; with power being one of the defining features of class.

Without being explicit about it, much of this thesis has been formulated in a framework which has much in common with class analysis. The thesis has emphasised the limits of the effect of competition between firms; and has emphasised the common interests and behaviours of firms. For instance, 'The Informed Choice' discussed how very often (existing) firms share an interest in the deleterious effects of their products or production processes remaining hidden, or at the very least obfuscated, and particularly within industries will commonly act with a relative uniformity in this
regard. The major players of the U.S. automobile industry acted together in maintaining that safety should not be the province of car makers. The petroleum industry has been almost uniform in attempting to confute the notion of anthropogenic climate change and pharmaceutical companies are consistent in attempting to underplay the negative side affects of their products. Not one of the asbestos-producing companies responded to evidence of the deadly effects of their product by letting the public know about them.

However, the victims of these actions cannot in all cases be assigned a 'class' in the traditional sense described above. A multimillionaire oil industry executive who dies from treatment with an unsafe drug (such as Vioxx) is no less dead than the 'worker' who dies from the same drug. The multimillionaire pharmaceutical industry executive may equally be effected by the negative effects of pesticides understated by chemical industry firms; or eat meat contaminated by the cost-cutting measures of the food production industries. While in some cases they may (due to their wealth effecting elements such as location and health insurance) be less likely to be exposed to some of these risks, the important difference of interest with other members of Dumenil and Levy's (2004) “ownership-management interface” nonetheless remains. It also does so in a way which cannot be explained in terms of 'competition' in the Friedman sense.

Another element often missing from class analyses is the inclusion of institutions and their interests and behaviour as something not totally divorced from, but nonetheless partly separate to, the individuals which make them up. Institutions do more than simply pool the resources of participants and make them more powerful market players. They set limits on how behaviour is expressed, and on the ways in which the pooled resources can be deployed. The chapter 'Who Chooses?' discusses this in terms of the limitations placed on the participants in corporations: the influence of the actual running of a company by shareholders is largely limited to the activity of buying and selling shares (a blunt and imprecise instrument if ever there was one); while in spite of discussions of long versus short-term profit, managers' decision making is limited in any case by their fiduciary duty to maximise some form of shareholder return. In setting these limitations, institutions, and indeed types of institutions, may be conceived as having interests of their own.

A more inclusive conception of 'class' therefore seems necessary in order to classify the market 'players' and to discern the commonalities and differences of interests between them. Hall's (1997) 'Neo-Weberian' conception of class 'action' over class 'membership' allows for this. It can be conceived that in multiple capacities individuals can have the balance of power tipped in either direction. When a car industry executive approves the continued sale of a vehicle they know to have a defect making it unreasonably unsafe without informing the public, they extract a 'surplus' from consumers (in the form of the difference between the ability to sell the product at any price with the added risk unknown, and that price which would be accepted (if any) were the added risk known) in
their capacity as an executive within the context of a particular corporation; as do the shareholders in their capacity as shareholders (though they may not know it). They do so because the asymmetry of information is in their favour provides the company with a source of power over the consumers. However, the executive of another company who buys that vehicle may benefit not at all from the sale, and despite also being an executive of comparable pay will equally have that 'surplus' extracted from them as would any other purchaser, because in this they are acting in their capacity as a consumer and are thus also victims of this information asymmetry. Indeed, even a shareholder of the very same automobile company, while extracting a monetary 'surplus' from all buyers of the product, will have a risk 'surplus' extracted from them should they themselves (unaware of the defect) purchase the vehicle.

The following is an attempt to theorise a typology of 'class' which addresses these issues in a political economic framework and within a context of 21st century developed capitalist societies. As in Hall (1997), classes are defined by interests and activities rather than necessarily by the particular characteristics of the individual. The focus in this case is less explicitly on 'wealth' per se, and indeed class typologies such as Dumenil and Levy's (2004) may be more useful in demarcating behaviour according to wealth and material inequality. In attempting to 'see' the workings of the 'Invisible Hand', the focus is instead on the actual activities undertaken in the pursuit of 'utility' in a more general sense; and, as importantly, on the effects of these activities. There is also an emphasis on difference and conflict not only between classes but within classes, and an attempt to identify the sources of these differences. With by no means any intention of this being a final word on the matter, the typology will begin with divisions between:

• (Publicly Traded) Corporations, and their principal decision makers and beneficiaries, Executives, Directors and Shareholders.
• The processes of Finance, including Credit activities and the Keynesian (1936/1964) distinction between Enterprise Investment (driven by longer term profit returns) and Speculation (driven by asset price appreciation and short-term profit gain), and the operations of Financial Corporations.
• Entrepreneurs and owner-operated firms.
• Economic Agents not directly aligned with Business Interests: Workers (and their Unions), Consumers, and Victims of Externalities.
• The State and the Political Class.

22.3 The Corporation.

The publicly traded, for-profit Corporation has featured prominently in this thesis. The perpetrators of the ills featured in this thesis have most often been acting in the interest of the Corporation as
they define it; attempts by particular privileged individuals to use their position to subvert this (as in the case of Enron, for instance) have not been deemed a principal reason for the failure of Friedman's political economy. Indeed, while Friedman's political economy exonerates behaviour done to benefit corporations, it forbids any subversion of the pursuit of profit within the corporation, be it selfish (deceptive extraction of shareholder funds) or altruistic (pursuit of socially responsible goals unrelated to profitability)\footnote{It is perhaps one of the most disturbing aspects of current jurisprudence that those who steal the money of shareholders are punished exponentially more vehemently under law than those who commit corporate violence against other stakeholders.}. Friedman focuses on competition between corporations and the beneficial effects of this process; his analysis is necessarily individualistic. In formulating Corporations as a 'class', however, the focus must shift to points in common among corporation.

The Corporation, an institution, can be considered a 'class' because Corporations have in common institutionalised interests which are not wholly reducible to those of any humans. Its principal interest is institutionally formulated to be the maximisation of 'profits'. All other interests of the corporation \textit{per se} derive from this interest in profits. The 'moral sentiments' about which Adam Smith theorised are wholly absent from the Corporation.

'Profits' is a term which both leaves substantial ambiguity in terms of its practical application and places extreme limits on allowable behaviour. The term is ambiguous in regard to the timing and usage of the financial return. Class analyses of the relative interests of 'finance' and shareholders as against executives generally assert that the former have an interest in dividends, the latter, in reinvestment of profits for growth (Dallery, 2009; Stockhammer, 2004; Stockhammer, 2004). It also leaves open whether short-term dividend gratification or a lower but more stable return is desired. However, whether it is distributed in dividends or invested in future growth; whether it is milked maximally for the short-term or spread more moderately in the interest of stability; profit is limiting in that it does not allow the corporations' human constituents to use the resources of the Corporation for ends which are not related to ultimate monetary gain to shareholders. In their capacities as private human beings, executives and shareholders, with the choice put to them explicitly, may in many cases choose (in an expression of their choice and interest) to forgo the maximum return (be it in the short or long-term) in the interest of refraining from causing undue harm to their fellow human beings. This, however, would be an interest separate from that of the Corporation, which is institutionally limited in its ability to consider such matters (Bakan, 2004; Hanson & Chen, 2004).

As discussed, shareholders are largely limited to their investment activity (the nature of which discussed further later) in the assertion of their individual, heterogeneous interests.

Arguably one of the sources of Friedman's success may be that his theories generally align with the
(perceived) interests of Corporations. The regulations and government actions which Friedman most opposes – including safety regulation, financial regulation, wage regulation, pollution regulation and provisions by government of things such as health insurance and education – are all provisions which restrict the perceived ability of Corporations to conduct their business with maximum freedom in the pursuit of maximum profits (though in the case of financial regulation this may support longer term stability of profits). These types of regulations are frequently meant to benefit other classes – Workers, Consumers, and Victims of Externalities; at the expense of the Corporation. The regulations which the most powerful corporations in a given market are most likely to support are those which undermine the competition upon which Friedman's theories depends for beneficial effects; only potential new entrants or otherwise less resourced corporations are likely in some cases to support procompetitive government provision. Competition-neutral provisions, and those which force corporations to compete with government, will be nearly universally opposed, except where employment of private corporations in a government program means that some will benefit financially from the ability to acquire contracts. Corporations may also have an interest in supporting regulations which prevent other Classes for combining in the same way that Corporations do (Workers combining into Unions, for instance), and this is indeed one of the few forms of regulation also supported by Friedman (Friedman, 1990). Friedman's program of deregulation and privatisation therefore finds general support among the Corporate class.

Regulations can also be limited in their ability to affect corporate behaviour to the extent that they affect the profit maximisation goal. In deciding whether to take any course of action, including one which contravenes existing regulations, decision makers acting in the interest of a corporation will undertake, formally or informally, a Cost/Benefit analysis for the corporation. These can broadly take two forms. One, performed internally, simply compares the estimated costs to the corporation of a potential course of action (including willful inaction) with its benefits; if the action leads to a net profit over its alternative, then the action will be taken. The costs of an action which prevents or corrects a negative consequence for other stakeholders (such as a product defect or dangerous work process) may be compared with its benefits in terms of avoiding negative publicity and possible regulatory financial punishment. If the benefits in this regard are not deemed to be in excess of the costs, or if the costs are deemed to be insufficiently certain, then the preventative action will not be taken, and the defective product or dangerous work process may remain in place. Obviously, this is also applicable to decisions about wages and prices in a less dramatic sense.

The other, potentially more dangerous form of cost/benefit analysis is one which automobile companies have made famous by using it in their opposition to safety regulation (as was touched on in 'The Informed Choice'). These compare the benefits to 'society' of a particular course of action with the costs to 'society', in a manner which explicitly defines all costs and benefits in monetary
terms. However, the members of 'society' which benefit from the action are different from those whose 'costs' are considered.

Consider below Figures 22.3 and 22.4. During investigation into the Ford Pinto debacle, Dowie (1977) exposed the use of cost/benefit analysis by Ford in lobbying the National Highway Traffic Safety Authority (NHTSA) in opposition to proposed safety regulation. The industry had been successful in lobbying for the acceptance of this kind of negotiation (Dowie, 1977; Lee, 1998), and it has also been used by other companies including General Motors (Bakan, 2004). The figures below concern the infamous 'Grush-Saunby' report, published in opposition to a regulation which would have forced Ford to correct a tendency of a wide range of its vehicles to leak fuel into the passenger compartment in rollover accidents. Essentially, Ford used a monetary value for the estimated number of deaths, injuries, and burnt vehicles which would be saved by fixing the defect (i.e. the 'benefits' of fixing the defect), at a rate of $200,000 for each burn death, $67,000 for each nonfatal burn injury and $700 for each burnt vehicle (numbers accepted by the regulatory body under intense pressure by the automotive industry - Dowie, 1977; Hoffman, 1996; Lee, 1998; Shaw, 2005); and balanced this against the cost of fixing the defect (at a rate of a mere $11 per vehicle). Because the total cost of fixing the defect ($137 million) was greater than the estimated monetary benefits ($49.5 million), Ford proposed that the defect should not be fixed.

There are at least two questionable elements of this. One is that a 'burn death' or a 'burn injury' can adequately be represented in monetary terms. Note the arbitrary nature of the $10,000 assigned to 'victims' pain and suffering' in the breakdown of the $200,000 assigned to the value of a human life in Figure 22.4. The other is the fact that, regardless of the adequacy of the monetary assignations, the parties who benefit are fundamentally different from those who bear the costs. The beneficiaries of the action are Consumers, who would by no means be informed that their vehicle may cause them to burn to death in an otherwise survivable accident, and others who may at the time be in the car having played no part in decisions to purchase it. The one bearing the cost is the massively sourced corporation which has allowed the defect to occur in this first place; and which will benefit not at all from fixing the defect. Also not considered is whether consumers, given the choice, would pay the paltry $11 per vehicle in order to reduce their chance of burning to death within it.

This kind of logic clearly assumes a Friedman/neoclassical view of the world, in which the interests of 'society' are merely the quantifiable sum of the individual interests of those who make up society; and that the profitability of a corporation is a demonstration of the benefits it accrues not only to its shareholders but to consumers, workers and society as a whole. It ignores the fact that one class, the Corporation, is saving costs by imposing risk (and that cost) on another class, the Consumer; that the comparison is not of the costs and benefits to society but of the benefits to potential victims and
the costs to the potential victimiser. By this logic, a robbery might be socially neutral if it simply redistributed wealth from one party (the victim) to another (the robber). Cost/benefit analysis

Figure 22.3 Cost/Benefit Analysis from the 'Grush-Saunby Report': Benefits and Costs Relating to Fuel Leakage Associated with the Static Rollover Test Portion of FMVSS208. From Ford Motor Company internal memorandum: "Fatalities Associated with Crash-Induced Fuel Leakage and Fires."

**BENEFITS**

**Savings**: 180 burn deaths, 180 serious burn injuries, 2,100 burned vehicles.

**Unit Cost**: $200,000 per death, $67,000 per injury, $700 per vehicle.

**Total Benefit**: $49.53 million.

**COSTS**

**Sales**: 11 million cars, 1.5 million light trucks.

**Unit Cost**: $11 per car, $11 per truck.

**Total Cost**: $137.5 million.

Source: Dowie, 1977

Figure 22.4 NHTSA Costing of a Road Death, 1971.

<table>
<thead>
<tr>
<th>COMPONENT</th>
<th>1971 COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Future Productivity Losses</td>
<td>$132,000</td>
</tr>
<tr>
<td>Direct</td>
<td>$132,000</td>
</tr>
<tr>
<td>Indirect</td>
<td>$41,300</td>
</tr>
<tr>
<td>Medical Costs</td>
<td></td>
</tr>
<tr>
<td>Hospital</td>
<td>$700</td>
</tr>
<tr>
<td>other</td>
<td>$425</td>
</tr>
<tr>
<td>Property Damage</td>
<td>$1,500</td>
</tr>
<tr>
<td>Insurance Administration</td>
<td>$4,700</td>
</tr>
<tr>
<td>Legal and Court</td>
<td>$3,000</td>
</tr>
<tr>
<td>Employer Losses</td>
<td>$1,000</td>
</tr>
<tr>
<td>Victim’s Pain and Suffering</td>
<td>$10,000</td>
</tr>
<tr>
<td>Funeral</td>
<td>$900</td>
</tr>
<tr>
<td>Assets (lost consumption)</td>
<td>$5,000</td>
</tr>
<tr>
<td>Miscellaneous Accident Cost</td>
<td>$200</td>
</tr>
</tbody>
</table>
Joseph McIvor ‘Seeing the ‘Invisible Hand’

| TOTAL PER FATALITY | $200,725 |

Source: Dowie, 1977
therefore becomes a tool by which Corporations redefine the judgement of actions in a way which justifies their victimisation of, and extraction of surplus from, other classes.

The Corporation derives its power fundamentally from its massive concentration of resources. It entails the concentration of financial resources of many individuals; individuals with liability limited to the extent of their investment. The fact that it is a very effective kind of profit making enterprise also gives it an unusual capacity to accumulate further material and financial resources in its pursuit of profits. The complexity of the products it produces; requiring as it does the accumulated knowledge of many specialised individuals operating in concert, with that knowledge being used often to the exclusion of others, with 'others' including not only those outside of the organisation or industry but those employed as workers who are not either part of the executive structure or otherwise have not come across or required that knowledge in the performance of their job; also gives the corporation control over crucial informational resources. The Corporation also frequently creates externalities in its production processes, which it does not have to pay for; and this will be particularly true in a world run according to Friedman's theories.

These sources of power are the means by which the Corporation extracts its 'surplus' from other classes. It is important to note that 'surplus' is not here equated with 'profit'. Assuming an absence of protective regulation, to the extent that Consumers buying its products have freely available and genuinely competitive alternatives differentiated on price or quality or, preferably, both; that the power of any one Corporation or any group of Corporations acting tacitly or explicitly in concert is not sufficient to substantially determine the price of the product; that their acquisition of a product is not literally (as in the case of health care) a matter of life and death (or at least relative health and rather ill health); that the symmetry of information is sufficient for the Consumer to make an informed decision; and that the Consumer can otherwise negotiate on equal terms with the Corporation with no surplus of power on either side; then the profit derived from their purchase may not involve a surplus extracted from the Consumer. To the extent that a worker has freely available and genuinely competitive employers among whom to chose which are differentiated on salary or other conditions or both; that the power of any one Corporation or any group of Corporations acting tacitly or explicitly in concert is not sufficient to substantially determine the price of labour in a particular market; that the disutility of their failure to acquire sufficient employment within a given time period is equal to the disutility to the Corporation should it fail to find a suitable candidate within the same time period; that the symmetry of information is sufficient for the Worker to make an informed decision; and that the worker can otherwise negotiate on equal terms with no surplus of power on either side; then the profit derived from their productive activities on behalf of the corporation may not involve a surplus extracted from a given Worker. To the extent that there are no externalities; including to the extent that all of those affected (present and future) by what otherwise
would be externalities are duly compensated according to conditions similar to those set above; and
to the extent that such externalities can indeed be quantifiably compensated; then no surplus is
extracted from noncontractual Victims of Externalities (those who are not buying anything from or
selling anything to the Corporation but may negatively affected by its profit-seeking activities).
Friedman's argument is that, in a free market devoid of protective regulations and government
actions, these conditions are largely met, so that exchanges will be mutually beneficial with a
tendency to the absence of surplus – the only exception being the case of externalities, under which
circumstances he recommends either inaction or the imposition of a tax; neither of which are likely
to have a net advantage over regulation. This thesis has, it is hoped, shown that these conditions are
very (indeed, probably most) often not met; and are unlikely to be so in a freer market: the
Corporation has an advantage over other classes through the sources identified. A free market
devoid of protective regulations and government action will tend to exacerbate, rather than curb, the
inequality of power between the Corporation and other classes, and therefore the surplus which the
Corporation extracts from other classes. Only governments, through their regulation and direct
 provision of services, or institutions of comparable power, are likely to be able to curb the
Corporation's power and reduce the size of its surplus.

22.4 Executives, Directors and Shareholders.
Executives, Directors and Shareholders make up the principal human beneficiaries of the
Corporation's attempts to maximise its profits; with the latter, in theory, the recipients of the profits
which the Corporation acquires. Of these, only Executives exercise regular and direct control over
the means by which profits are pursued; they are the highest level of power exercised in the direct
marshalling of the Corporation's resources. Directors (most frequently including among them those
self same executives) are charged with ensuring that profits are indeed being vigorously pursued and
that the aforementioned means employed are satisfactorily effective in achieving that goal; while
also managing the remuneration of both Executives and themselves.

As discussed, Shareholders themselves exercise little control over the process and are for the most
part restricted to the vague signals of the stock market. They are limited not only in the control
which they may exercise but in the knowledge they are likely to have access to. Indeed, Monks
(2008) has had cause to lament the willful exclusion of Shareholders from the decision making
process, even during annual meetings (the only time executives are legally required to be made
available to shareholders). The fact that they are frequently disparate and transient also limits their
power to give voice to complex desires. The extent of this limitation of power may be partly
determined by their interaction with the processes of Finance, to be discussed later. As the limits
placed upon these beneficiaries and decision makers in choosing priorities other than profits for the
corporation has been discussed above, the point will be little elaborated on here and instead the focus will be on interests.

Executives and Directors are frequently themselves shareholders in the Corporation of their employ, and the use of stock options is now established as an important supplement to executive salaries, as a means of aligning the interests of Executives with those of Shareholders. For the most part, their material interests do vary at least partly in accordance with those of Shareholders. However, they also enjoy a substantial buffer which other shareholders may not. Even without stock options, their salaries remain substantial, and frequently so-called performance 'bonuses' are paid regardless of performance; this apart from the much maligned 'golden parachutes' received in the event of termination.

Executives and Directors also hold the distinction of being two of a very small number of classes capable of frequently extracting a surplus from the Corporation and its Shareholders. They do this at least partly because, being (as they are) at the highest level of decision making, they have the power to determine their own remuneration (though this will at least partly depend on the particular governance measures of the organisation – Faulkender, Kadyzhanova, & Prabhala, 2010). Certainly, the plurality of Executives and Directors and their legal fiduciary duty to Shareholders may put some limits of what they can get away with in this regard, and indeed it seems natural that a proportion of the premium attracted by CEOs in particular is due to the high level of skill required and the high level of responsibility assumed. However, it is argued that given perfect information and greater power to make their own choice about these people who are effectively their employees, shareholders would not pay CEO's as highly as they are currently. Indeed, while corporate profits prior to the crisis beginning 2007-2008 soared, Executive salaries increased at a rate roughly double that of profits (Monks, 2008). Nor can, at an individual level, the consistently high but also highly variable pay of CEO's be consistently correlated with performance; and in fact some studies have found evidence of a negative correlation between the pay of CEO's and their performance (Balnave, Brown, Maconachie & Stone, 2009; Fahlenbrach & Stulz, 2011; Faulkender, Kadyzhanova, & Prabhala, 2010). In recent times, the payment of high salaries and 'bonuses' to Executives of financial corporations who led their companies into a major credit crisis has been one of the most widely recognised examples of this surplus extraction.

However, as touched upon previously, this surplus over Shareholders is not a principal reason for the failure of Friedman's political economy . The surpluses which are extracted by Executives on behalf of the Corporation and in its interests have been far more destructive and pervasive. The very high revenues extracted by Corporations from other classes are the key source of the very high salaries of Executives.
In general, while the money income of the Executives of publicly traded Corporations may differ vastly in absolute terms, their income bracket in proportion to the rest of the money-earning population will remain largely condensed at the top (Dumenil & Levy, 2004). Like the Corporations they serve, their interests will generally align with policies favouring the wealthy: low taxes (at least at the top) and withdrawal of most government services, because, even where such services are available, well-paid Executives are likely to use private providers at a price unaffordable to most in exchange for better service - unless the government holds a monopoly with an egalitarian service distribution, in which case they may be perturbed by their inability to use their enormous wealth to gain more favourable treatment.

Their actual interests in the case of regulations will depend on whether their interaction with the regulation is as an Executive or as something else, such as a Consumer. As Consumers of products other than their own, for instance, they may benefit from consumer protection legislation. As Shareholders and Enterprise Investors, they may benefit in the long-term from financial regulation designed to create stability. As potential Victims of Externalities, they may benefit from regulations designed to mitigate these. On this issue, however, what their interests actually are, and what they perceive them to be are likely to differ greatly. Executives may be more likely to be indoctrinated in conventional neoclassical economics and the theories of Friedman, and may thus be less likely to recognise the benefits of such regulation. Despite the benefits of regulation, therefore, though there may be some exceptions who support regulations (and who may support them as private individuals while lobbying against them in their capacities as Executives), the perceived interests of Executives as private individuals are likely to align with those of the Corporations they represent, and thus they are likely to oppose most forms of regulation.

In their capacities as Executives, their interests in regard to regulation will tend to align with the Corporation in all respects except one: corporate governance. Governance regulations may be designed to mitigate the surpluses which Executives extract, or otherwise limit the authority of the executive. The nonalignment is not in all cases true, however: measures such as stock options increase the potential remuneration of Executives.

While Executives may be mostly united in income bracket and economic ideology, the same cannot be said of Shareholders. The incomes of Shareholders are highly heterogeneous, spanning the gamut of incomes from frontline workers with small superannuation investments (frequently through particular mutual funds) to the very wealthiest capitalists. However, as mentioned, the bulk of actual shares, and therefore power and reward, still remains concentrated in the latter group (Dumenil & Levy, 2004). Wealth in this case is both a source of power and a mitigator of risk: the same investment in money terms may proportionally represent a mere day or week's earnings for a wealthy person, or a lifetime of savings or a year's salary for those of more moderate means. The
power to vote (where there is opportunity) within the Corporation, and to signal it through the sale and purchase of shares, is in no way proportional to the true risk to the material wellbeing of the individual Shareholder: only their money investment. While all have an interest in the profitability of the company, differences in income and risk levels will, among other things, mean that the interest in the nature of that profitability will vary. The nature of their power and interest will partly depend on their relation to the processes of Finance.

22.5 Finance: Credit, Enterprise Investment, and Speculation

'Finance' includes the activities and interests of Financial organisations and, in particular, Financial Corporations; as well as more generally the processes of investment and speculation, and the extension of credit. As well as creating both wealth and risk for those engaging in these processes, the processes of Finance influence the nature of 'profits' sought by Corporations and their use of it, what kinds of businesses are likely to receive capital, and both the levels of and reasons for indebtedness in the economy generally.

First it seems pertinent to distinguish 'Enterprise investment' from 'Speculation'. Following from Keynes (1936/1964), 'Enterprise Investment' will here be defined as buying into an enterprise with a principal view to a share of the profits made from the operations of that enterprise over an extended period of time. 'Enterprise Investment', so defined, is generally made with a view to the long-term, and points to the prioritisation of the sustainability (at some desired level) of profit over the rapid extraction of profits. It necessitates the sustained production of either a physical good or a services product to be sold at a profit over costs.

'Speculation', by contrast, is undertaken with a view to profiting from the future sale of an asset, either through maximum extraction of the asset's profit-producing capabilities before its resale at a price not sufficiently lower as to account for this process, or through the appreciation of the asset's market value (ie the price that others are willing to pay for it) over time, or both. Speculation does not necessitate a profit-making enterprise engaged in 'production' as such; it includes, for instance, speculation on housing markets, currency exchange, commodity markets, etc. The interest of speculators in these cases is, in fact, toward non-production; though the level of speculation, where high, can create incentives for some producers (both Corporations and Private Entrepreneurs) to engage in accelerated production. Production in these cases is only accelerated while the level of Speculation is high, however; there is unlikely to be a net increase in production over the very long-term as there is no actual additional need for the underlying product (in usage terms) being treated as an asset. Soaring housing prices in the U.S. over the 2000's, for instance, created an acceleration in housing production but did not accelerate an underlying need for housing: once the speculative bubble burst production promptly decelerated as the actual demand for housing corrected to the new
oversupply. When these 'corrections' occur, they can be dramatic and destabilising to the extent that the Speculation-driven acceleration of production had gone on before correcting. Moreover, where 'Speculation' occurs in profit-making enterprises, the incentive is for the short-term maximisation and extraction of profits; both to increase the appearance of profitability of the enterprise and thus the demand for it from both enterprise investors and speculators (thus increasing its price), and to extract maximum gain between purchase and sale of share assets.

'Speculators' and 'Enterprise Investors' can be treated as separate 'classes' with competing interests in the way in which profits are pursued: the former require rapid profit growth and/or share appreciation, the latter require a sustainable profit; and this will in turn effect the way in which business is conducted. 'Speculators' also compete with 'Consumers' in certain asset markets (eg housing, commodities), such that Speculation frequently drives prices beyond what they would be were Consumption of the assets in use, and Investment in profitable enterprises making use of the assets, the only drivers of demand.

The relative power and predominance of Speculators and Enterprise Investors in an economy both influences and is influenced by the level of debt in the economy. Where Enterprise Investment dominates, credit levels remain conservative and relatively stable. Credit is extended conservatively to promising or already profitable enterprises or for the purposes of consumption, with debt being serviced by income from business or employment activities. However, under conditions where Speculation become commonplace, debt levels will tend to accelerate, with money borrowed with no intention of servicing it by income as such but through gains realised by short-term asset appreciation - Minsky's (1977) 'Ponzi' finance. These high levels of debt, in turn, increase the interest in Speculation as creditors share an interest with borrowers in rapid asset price appreciation. Minsky's (1977) conception of an economy moving from 'Hedge' through to 'Ponzi' finance can be thought of as a treatment of this issue of the relative increase of Speculation, its effects on debt, and the destabilising effects of this. Economies will be relatively stable to the extent that debt is accepted and credit extended on the basis of expectations of sustained incomes from productive business activities and employment activities (Keen, 2010a, 2010b) – in effect where debt is used to finance Enterprise Investment and Consumption. Once debt is used to finance expected gains from asset price appreciation (Speculation), the effect is destabilising because the rate of asset price appreciation required to meet debt obligations (and make a profit on top) necessitates an ever increasing level of debt relative to incomes. When an upper limit of this is reached, a debt-deflation is the consequence.

The processes of Speculation are compounded by the activities and interests of Financial Corporations. Among Corporations, Financial Corporations (to the extent that they are freed from
regulation) are particularly powerful. They exercise a high degree of control over the money supply through the extension of credit, while playing a major role in directing both credit and equity-driven financing activities. The choices which they make, therefore, affect the capital available to all businesses, as well as over all macroeconomic stability. Unfortunately, systemic incentives in place mean that these choices (in a free market) will tend ultimately toward destabilisation.

These businesses specifically have an interest (not accounting for systemic risk) in the proliferation of debt and in the slow repayment of debt obligations (even the non-repayment of the principal on debts) (Keen, 2010b). Existing debts from other agents count for them as assets (so long as they are not defaulted on), while the level of income earned from interest is maximised the greater the debt and the more slowly it is repaid. To the extent that systemic risk is disregarded (as experience shows it frequently is, particularly, as Minsky (1977) pointed out, after a period of conservative 'tranquility'), Financial Corporations will have an interest in the expansion of debt via debt-financed Speculation when avenues for income-financed debt are exhausted. Financial Corporations are also themselves frequently highly leveraged; and are the principal agents in, and often the very architects of, various forms of Speculative activity. Indeed, much of financial 'innovation' is geared toward increasing the avenues for nonproductive Speculative financial activity. Unless regulated in such a way as to moderate these interests or to force them to account for systemic risk, then, an increase in the importance and power of Financial Corporations will increase the importance of Speculation and Speculators in proportion to Enterprise Investment.

As alluded to previously, a number of class analyses have discussed power struggles between 'Finance' and 'Management' (Executives), with the interests of 'Finance' equated with those of 'Shareholders' (Dallery, 2009; Pressman, 2007; Stockhammer, 2004). These assert that 'Shareholders' will generally be interested in profit maximisation, while Executives and managers “gain little from profit maximisation. Rather, they desire survival, growth, and technical virtuosity” (Pressman, 2007, p. 75). 'Financialisation' is conceived of as an increase in the power of 'shareholders', and that this has created an increased impetus to profit maximisation over growth. This thesis takes rather a different view of the nature of the struggle between what these other authors are describing as 'profit maximisation' and 'accumulation': it is, rather, reconceived of as a struggle between Speculation and Enterprise Investment, with 'financialisation' increasing the power not of 'Shareholders' as a whole but of Financial Corporations and Speculative shareholders over true Enterprise Investors. The evidence given for 'financialisation' and increased priorities of 'profit

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62 It is acknowledged that many Corporations whose core business is something other than finance do profit from financial activities, but here the discussion of 'Financial Corporations' is in regard to whose primary business activities are financial.
maximisation' appears rather to conform to a concept of short-term maximisation. with a substantial increase in the proportion of profits distributed as dividends rather than reinvested since the 1980's, even to the extent that “in many cases firms had to borrow funds in order to distribute dividends” (Dallery, 2009, p. 502). Dallery (2009) also admits that long-term profitability may be dependent upon accumulation in the near term. Nor can Executives be counted upon to share an interest in 'accumulation' as such: to the extent that their tenure at any one corporation is temporary and transient, their interests may be more Speculative, with short-term profit maximisation contributing to high yearly remuneration and fast appreciation of stock options during their (relatively short) tenure.

Indeed, it has been previously noted, and is generally agreed, that Financial Corporations have enjoyed a substantial increase in power and importance since the 1980's in particular (Baker, 2008; Davies, 2004; Dumenil & Levy, 2001; Foster & Magdoff, 2008; Korten, 2009; Morris, 2009; Phillips, 2008). This has led not only to high levels of general macroeconomic instability (partially tempered only by frequent government intervention) and increasingly high levels of private debt, but a general increased pressure on even non-financial firms and Executives to give priority to short-term profit maximisation due to increasingly Speculative and debt-financed Shareholders. This has important implications in regards to the workings of the 'Invisible Hand' on these firms. The checks on corporate malfeasance which Friedman proposes, including such things as a concern about the reputation of the firm, to the extent that they can work at all, are heavily dependent upon a view to the long-term. Curbing Speculative activity in favour of Enterprise Investment, then, is crucial not only to macroeconomic stability but to changing the incentives of Corporations to move away from the short-term extraction of surplus from other classes.

22.6 Private Citizens of Business: Entrepreneurs
Distinguished both from professional managers of businesses which they themselves do not own, and Shareholders distanced from the management of the businesses owned, are 'Entrepreneurs' or owner-managers. As defined here, the businesses of 'Entrepreneurs' will have only one or a very few owners, and the 'owners' will themselves be directly involved in the operation of the business. There is in this way, for those involved in Entrepreneurship, no separation of roles and interests between Shareholders and Executives, nor are these interests narrowly institutionally structured within the confines of the Corporation. Unlike Shareholders and Executives, Entrepreneurs are free to pursue their interests in their full human complexity in direct concert with the operation of their businesses.

While in many cases these interests (at least in regard to regulation) are often likely to align with those Corporations and business generally, greater variation and complexity in expressed desires
and the means undertaken in pursuing them are likely to occur among Entrepreneurs than among those of Corporations. While profits are certainly to be given a high priority, they may not be pursued with the same dogged single-mindedness as in the Corporation: where in the Corporation empathy for non-Shareholders is actively suppressed, Entrepreneurs enjoy freedom of conscience.

Where Corporations will almost universally oppose regulations of products or production processes aimed at protecting the safety of Workers or Consumers, for instance, there seems likely to be greater dissent among Entrepreneurs. Indeed, some Entrepreneurs may see a benefit in being allowed to act in accordance with their concerns for Workers or Consumers while not suffering the competitive disadvantage of doing so: something which regulation provides for.

If this view of Entrepreneurs seems too optimistic, consider the following. Simon & Burns (2009), who in 1993 spent a year virtually living in a Baltimore neighbourhood notable for its open-air illicit drug markets, tell the story of a drug addict who has for some time been abstaining from heroin in an attempt to break free of her addiction. At one point, she weakens, seeking out a drug dealer with the attention of ending her good run. Astoundingly, however, the drug dealer (of all people), having heard of her struggles, refuses to sell to her, instead giving her further encouragement to continue on the path of giving up drugs. That a Corporation would take such an action (if not regulated in such a way as to encourage it to do so), no matter how deleterious the effects of its products, seems unthinkable, yet here is this drug dealer, a purveyor of illicit wares but an Entrepreneur by most consistent definitions, who demonstrates a willingness to take the moral high ground. This is not to say that all or even a majority of Entrepreneurs will or do act in this way or that those that do, do so consistently, only that the potential for such behaviour is greater for Entrepreneurs than for Corporations.

Like Shareholders, Entrepreneurs are likely to vary substantially in individual wealth: the need for capital generally excludes the very poor, but otherwise it may vary from those of rather modest means up to the very wealthy. However, the effect of this is different: a Corporation owned by a plethora of shareholders with modest incomes is still an organisation with substantial resources. For an Entrepreneur, however, the business' wealth is their own: an Entrepreneur of modest means will generally run a business of modest means, and an Entrepreneur who derives the whole or majority of their income from a modest business enterprise will necessarily themselves have a modest income.

While publicly-traded corporations are almost universally large, the small Entrepreneur becomes, in theory, more limited in their ability to extract surplus. Their need for the income from business activities is more urgently pressing, the difference in resources and income between the business and its Workers is likely to be less pronounced, the difference in resources and income between the business and its customers may actually in many cases favour the Consumer, and the complexity of
their products and production processes is unlikely to share the complexity of those of large Corporations. However, at the same time, the need to ensure income may be more urgent and pressing; it may be needed not merely to preserve share price but to meet an upcoming mortgage payment.

Furthermore, the small Entrepreneur may be more likely to have some interests which diverge from that of the Corporation. Small Entrepreneurs may in many cases be the losers in competition with Corporations, with their efficiencies gained through massive concentration of resources. Indeed, the individual's presence in the class of Entrepreneur, as opposed to Worker, may be threatened by Corporations, and so they may seek to restrict the activities of Corporations through the State. Thus while in many cases sharing Corporations' interests in regard to other stakeholders (classes) such as Workers, Entrepreneurs may simultaneously have very much opposing interests to those of the Corporations.

Such businesses will exist in stark contrast with those of the wealthiest Entrepreneurs, who are likely to own very large businesses. Some may be majority owner-managers in otherwise corporatised enterprises, though the extent to which they, in these cases, retain the freedom of conscience here attributed to Entrepreneurs is questionable. For instance, in the infamous *Dodge vs. Ford Motor Company* case of 1919, Henry Ford was successfully sued by shareholders for his philanthropic treatment of employees: despite being the founder of the company he now no longer had the right to sacrifice profits in favour of better treatment of his employees (Bakan, 2004; Banerjee, 2007).

In any case, regardless of wealth, Entrepreneurs will generally share in common that the finance injected into the business by the owners will be more likely to be Enterprise Investment than Speculation. The owner-manager generally seeks a sustainable source of income. A high proportion of Entrepreneur-owned businesses compared to Corporations, or rather a high proportion of resources invested in Entrepreneur-owned business compared to Corporations, seems likely therefore to have a greater chance of promoting stability than the alternative.

### 22.7 Economic Agents not Directly Aligned with Business Interests: Workers and their Unions, Consumers, and Victims of Externalities.

So far the focus has been activities and interests of profit-making businesses and those either owning various proportions of them or substantially controlling them. These are the many faces of what might traditionally have been defined as the ‘capitalist’ class. Now the discussion turns to those private economic agents who do not stand to gain directly, and in fact frequently stand to lose, from the maximum profitability of business enterprises. Here these will be called Workers (non-Executives employed by any enterprise), Consumers of products produced by enterprises, and
Victims of Externalities, who are engaged neither with product exchange nor an employment contract with the particular enterprise but are affected by its activities through the externalities they produce. The definitions to begin with are necessarily broad and greater care to highlight the differences within these classes will be forthcoming.

Firstly, it must be noted that two of these classes do potentially gain something from the profit-seeking activities of business enterprises: to state the obvious, Workers gain employment and the remuneration and self-satisfaction which comes with it; Consumers gain a product which benefits them in some way (though whether that benefit outweighs the negative consequences associated with it will vary). In a developed capitalist system, it cannot be denied that the profit motive is an effective driver of the production of such beneficial products and the employment necessary to undertake such production. However, Friedman's mistake is in presuming that in the attempt not to merely seek reasonable profits but to maximise them, business enterprises will also maximise the overall benefit to these other parties – that the 'Invisible Hand' of the market will lead them to, overall, create the best and most numerous jobs and the best and most numerous products as expressed by businesses, Workers and Consumers in their exchange activities in the market. Instead, it is here contended that, overall, one class maximises their own interests at the expense of others, and that, in a free market, the attempt to maximise profits by business enterprise most often involves the extraction of a surplus from all three of these other classes.

In the case of Victims of Externalities, this surplus is easily seen, indeed the very nature of externalisation involves the extraction of surplus: costs are saved by imposing them on others. It is not contended that business enterprises are the only beneficiaries of such externalisation: certainly, Consumers may partly benefit from the decreased cost of products while Workers may benefit from an increased ability of business to hire as they save costs and produce more products. However, those with the most prescient knowledge of the nature and extent of this externalisation, those with the most direct control over products produced and the processes used to produce them, and therefore those with the greatest responsibility, are business enterprises; and it can be contended that they are also the principal beneficiaries of this externalisation process. The Victims of Externalities are indeed in the weakest position in an unregulated market and are most prone to the extraction of surplus: they neither gain anything by allowing costs to be imposed on them, nor do they have anything to offer in exchange for cessation of the cost imposition except the silencing of their complaints. In some cases, they may also be future generations likely to suffer the consequences of irreversible environmental degradation, completely denied a 'choice' in the matter. There is no chance of a genuine exchange.

This externalisation irredeemably distorts any beneficial effects of the workings of the 'Invisible Hand'. Business enterprises, particularly Corporations, who seek maximisation of profits will not
reduce their externalisation in a pure exchange economy because of the lack of an exchange. However, they are also in the best position to facilitate the reduction of these externalities. 'Externalities' must therefore either be reduced by decree or businesses must be forced to 'internalise' them; and only government action can facilitate this.

The interests of 'Workers', and the extent of any 'surplus' which may be extracted from them, are more complex. 'Workers' provide labour power facilitating the activities of Corporations, Entrepreneurs and the State in exchange for remuneration. In general, 'Workers' have an interest in higher wages per unit of labour, safe working conditions, and rewarding work. However, in cases in which high wages result in less workers being hired, the interest in higher wages becomes questionable and dependent upon things such as the extent of government provisions for the unemployed and the general state of the labour market. More particularly, it could be said that 'Workers' generally have an interest in a higher proportion of total business income being assigned to wages or other improvements in Worker's conditions rather than in profits, as per Kalecki (1971).

'Workers' make up a class which is highly stratified within itself. In terms of wealth, a 'worker' in the employ of a business enterprise can range from the disaffected minimum wage earner to the film star earning an income comparable to that of the Executives of large corporations. 'Surplus' can be extracted from them through the asymmetry of both resources (and resource security) and information which generally favours business enterprises: businesses are in a superior position to know their production processes (including those which may be harmful to workers), may have a better idea of the state of the market, and have a resource base which is likely in many cases to leave them less vulnerable than workers. The extent of the 'surplus', whether it is extracted, and the idea that it may in some unusual cases favour the Worker, is also dependent upon a number of other factors particular to the worker.

As Wright (1997a) theorises, the control over scarce (and desirable) skills seems likely to be an important factor, particularly in the setting of wages and conditions. Here 'skills' must be broadly defined: the 'skills' of film stars, for instance, may involve not only the skill of being able to successfully modify one's behaviour to fit a particular character and mood as envisioned by management (directors, producers, etc), but one's natural physical appearance, age, distinctive voice, personality traits and quirks, among other things. 'Skills' in this sense are simply attributes desirable for the effective undertaking of the activities of the particular enterprise, and the extent of both their scarcity and desirability will determine their effectiveness in negotiations (to the extent that employees are able to negotiate in this way). Generally, the better one's skills, the better position they are in to bargain with their employers.
Wright (1997a) also points out that the level of authority is likely to affect not only the level of remuneration but also the control over one's conditions – though the limitations on this is the reason that non-Executive managers have been included here among 'workers'. Managerial workers are also distinct in the exercise of authority over other workers. Managerial workers may in these capacities simultaneously not only have surplus extracted from them but may directly participate in (and benefit from) the extraction of surplus from other employees. Managerial Workers may also be more likely to identify their interests (however erroneously) as coinciding with those of the business enterprise itself, though this will be highly dependent on individual attitudes and the level of managerial authority.

One important factor, however, not included in Wright's typology of workers is participation in concerted *organisation* with other employees, particularly through trade unions. Just as capitalists may benefit from organisation into Corporations of concentrated resources, the concentrated labour power afforded by trade unions can give workers the ability to reduce, eliminate or even extract their own 'surplus' from business enterprises. Labour or Trade Unions generally represent Workers' interests in negotiation of contractual terms with their employers (be they Corporations, Entrepreneurs or the State) or in advocacy with regard to the regulatory and legal climate. They do this by coordinating the actions of a number of Workers in regard to their labour power, as well as by pooling the resources of Workers for the purposes of professional and coordinated representation. The primary means of exercising power is, as in the Corporation, through the use of concentrated *resources*, in this case labour power, in order to ensure better terms of employment for its constituents. As Friedman points out, the success of this will at times be at the cost of the employment of other workers, but as others such as Kalecki (1971) have also shown it at least as often is simply at the expense of maximal business profits.

It is acknowledged also that leaders of unions do not always act in good faith and that some unions are or have been plagued by corruption or are simply victims of poor or ignorant management – just as Executives may seek to extract surplus from Shareholders, so too the management of unions may at times extract surplus from constituent Workers. Nor do the concerted actions of Unions always represent the exact desires of its constituents. In this unions would seem no different to any other institution. However, the individual members of Unions do appear to have somewhat greater control over (and responsibility in) actions taken in their interests than Shareholders. The size of investment and its price (union fees) is fixed not by the market but by decree, and members are granted an equal vote. Votes are also taken, it would seem, more frequently on particular actions by the interested parties than in Corporations, and constituents more consistently given the opportunity to articulate their perceived interests. Unions also appear to allow for a greater complexity of goals than the narrow profit maximisation of Corporations.
All human economic agents are in some way Consumers, and indeed Consumption is one of the most important guiding ends to which human economic activity is a means (The same cannot be said of institutions: the profit maximising mantra of Corporations is at least partly divorced from an express desire for consumption as such). The class struggle between Consumers and business enterprises can be theorised as a struggle between particular businesses and particular consumers in particular markets, but as with Workers one party can gain both at the expense and to the benefit of the other. As alluded to earlier, the idea that 'capitalists' generally benefit from the general exploitation of consumers is at least partly fallacious: particular business enterprises benefit from extracting surplus from particular consumers of particular products, but the beneficiaries of such business enterprises are themselves consumers of other products. To the extent that a particular group of individuals aligns themselves with 'business' interests generally in advocating deregulation of all production, this must be thought of as at least partly a reflection of a shared Friedman-like ideology rather than a genuine convergence of interests.

The interests of consumers in general will tend to be a greater proportion of revenue allocated to the efficacy and safety of the product compared to profits, and to a low differential between the price charged for the product and the costs of producing it. In a deregulated market, the means by which surplus is extracted from Consumers includes (as mentioned) the asymmetry of information about the product produced and the costs of producing it, which will generally be greater the more complex the product. Corporations in particular are generally in the best position to have knowledge of their products and production processes, and the increasing complexity of products offered means that a surplus is more likely to be extracted. The availability of alternatives may also be a moderator, but it can be in the interest of businesses to act (tacitly or explicitly) in concert to restrict the range of alternatives or to direct them such that the variation of surplus from the multitude of alternatives is minimal. As alluded to previously, the nature of the 'surplus' may be multifarious, including safety premiums, efficacy of the product, costs as related to price, etc.

Consumers exercise power by their knowledge of markets and products, but also more importantly according to their level of income. In Friedman's market, the 'Invisible Hand' is guided by the 'voting' power Consumers exercise with their buying behaviour. The greater the concentration of income in the hands of a few consumers, the greater the proportion of production which will be directed at those few consumers; the smaller the proportion, the scarcer and less profitable, will be directed at satisfying the wants of the majority. The concentration of income directs not only the ability of Consumers to consume what they want, but influences the kinds of consumption available and the nature of production. However, it must be noted that a high price of a good is far from a testament to its efficacy or safety, and high income consumers are far from protected from the extraction of surplus: high income consumers may be no more knowledgeable about their products
than those on low incomes.

In Friedman, the relationship between business enterprise, Consumers, and Workers is theorised as generally cooperative, with competition occurring principally within each group rather than between them. Hollis and Nell (1975), however, contend that the nature of relations between these agents (here called 'classes') should instead be conceived of as a 'battlefield'. Neither conception seems to give sufficient attention to the complexity of these relationships. Friedman is too optimistic: he appears largely ignorant of the pervasiveness of exploitation of Workers, Consumers and Victims of Externalities undertaken by Corporations in particular. Hollis and Nell (1975), however, offer a conception which appears to disregard the lived experience of individuals within exchange economies which often involve both cooperative and adversarial elements, and which appears too cynical about the prospects for cooperative relations. Again the point is emphasised that relationships between business enterprise and Workers and Consumers, while frequently involving exploitation and the extraction of surplus, need not do so, and in many cases do not do so.

22.8 The State and the Political Class.

For Friedman, the power of the State in economic activity is something to be suspicious of. As alluded to previously, Friedman believes that what he has perceived as increasing interference by the State in economic affairs, in a misguided attempt to protect the interests of Workers, Consumers, and various vulnerable individuals in predominantly capitalist societies, has undermined the beneficial effects of the 'Invisible Hand'. Indeed, the State has been a principal target of his most prominent works, and the limitation of the State to a minimal role in protecting non-business classes in particular has been a principal legacy of his political economy.

Critics of Friedman or of Neoclassical theory generally, while dissatisfied about existing states of affairs in this regard, are more optimistic about the ability of the State to restore balance to the relative power of classes. Kalecki (1943) theorised that capitalist opposition to governments taking on the responsibility of ensuring full employment (partly through direct employment programs) was based at least as much on a fear of the loss of a high level of control over employees through a position of disproportional market power as about the decrease of profits per se, or indeed fears of 'fascism'. According to Kalecki (1943, p. 326), “under a regime of permanent full employment, 'the sack' would cease to play its role as a disciplinary measure. The social position of the boss would be undermined and the self assurance and class consciousness of the working class would grow”. Galbraith (1995) sees the state as playing an important role in a 'good society' by providing basic standards of living, while Keynes (1936/1964) and Minsky (1986/2008) see the State as providing not only this but a general stabilising force to the unstable whims of the market.

Pressman (2007) also more generally discusses Post-Keynesian views of the State, where it is seen
as an arbiter able to moderate the 'surpluses' generated by firms' concentrated market power within a capitalist system. Others similarly see the State as a crucial means of curbing the exorbitant power of large Corporations (Bakan, 2004; Korten, 1995). Corporations are granted their privileges by the State; and modifying or threatening to withdraw these privileges in the face of Corporate malfeasance seems a good starting point. Indeed, the State is really the only institution capable of rivaling Corporations in resources and power, though to the extent that Corporations act in concert the ultimate balance is questionable. The State also has the power to modify institutions and interests. Unfortunately, the power which large Corporations in particular themselves exercise over the State is also generally acknowledged.

In discussing the manner in which Corporations exercise power over the State it seems pertinent first to consider the nature of democracy in Developed Democratic Capitalist Systems. As Schumpeter (1950/1976) argues, the actions of the State are not undertaken directly according to the express wishes of voters. A large proportion of State action, including law enforcement, regulation, and provision of social services, is implemented by unelected individuals carrying out policies within predetermined institutional limits; policies and limits in which they have had a limited role in creating. Those engaged in a professional capacity in directly participating in, or attempting to directly participate in, the determination of these policies and institutional limits, as elected representatives or through affiliation to elected Political Parties, make up the Political Class.

The Political Class compete for the right to 'represent' the public in the processes of determining the actions of the State. Voters do not individually choose the policies which accord with their judgement: they choose among limited alternatives those members of the Political Class they believe to be most likely to carry out proportionally more of their desired effects than others. In aggregate, they choose those who have a right to form government and those who may be in a position to check the government's power, but little more (Schumpeter, 1950/1976). In theory (and perhaps original intention), this system would provide in many ways a starkly different distribution of power than that of the economy in a free market system: Corporations, being nonhuman institutions, would be given no say in the creation of government, while inequalities between human agents according to their control over resources would have no bearing on their power to influence the choice of government. Each person, regardless of wealth or position, has only one vote: and, theoretically, has equal say in the system. However, this process is to a large extent undermined by the interests of the Political Class, the competitive nature of the process (and at times the lack of competition), and the disproportional abilities of Corporations in particular as well as others aligned

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It should be noted that this formulation may not be consistent among Post-Keynesians. Minsky (1986/2008), for instance, sees government partly as a means of maintaining and stabilising profits while also filling the employment gaps created by the free market.
with them to satisfy these needs.

The Political Class are not merely servants of the public: to varying degrees, they seek the maintenance of power in the form of varying degrees of hegemony over government policy. As in market relations, the imperfection and asymmetry of information plays an important role. In competing for the votes of the public which facilitate power, they are not judged by the public on their actions as such, but on the perception of these actions or perceptions about what future actions might be taken, including the compliance of these actions with the perceived interests of members of the public. Perception, therefore, matters, and the management of this perception by the Political Class requires finance.

Where there are insufficient restrictions on the provision of finance to the Political Class, the ability to provide finance will vary in proportion to the control of wealth. To the extent that finance becomes important to the Political Class, the egalitarian notion of one vote per person is subverted by the unequal distribution of opportunities for financing the Political Class. In this unequal distribution, as in the market, the Corporation is likely to prevail. Certainly, countervailing power may be partly provided by other organisations combining resources, such as Labour/Trade Unions and other interest groups (including environmental groups), but these are unlikely to compare in economic resources to large, profit-making Corporations. Moreover, while Corporations are restricted in their ability to combine with one another in the market (a form of regulation at least partly supported by Friedman), there is no restriction on their combination in the political sphere: their already potent might in the market can become leviathan-like through combination into industry bodies and sponsorship of 'think-tanks' supportive of the general Corporate agenda. Corporations are, through this finance mechanism, able to dominate one of the principal means by which the Political Class obtains the power to direct the actions of the State.

However, the advantage gained by Corporations through their control of resources is unlikely to be restricted to their control of finance of the Political Class. They may use their enormous resources to manage perception more directly, by sponsoring advocacy groups who attempt to convince the public that they share the interests of the Corporation (though often without making the Corporation's involvement or the fact of their shared interest explicit), and this is likely to be true of such groups espousing the ideals and theories of Milton Friedman. This can even include sponsoring 'science' which provides findings supporting their interests (Gennaro, 2005). Their 'contributions' to employment and GDP are also used to lobby governments with the allegation that these will be threatened by regulations unfavourable to profits. Again, other groups are able to do the same, but not with the same resources of the Corporation.

In this way, the Corporation is able to extract a 'surplus' of political power in relation to all other
classes. Corporations, which being non-persons are not allowed to vote, exercise disproportional influence over the relative ability of different members of the Political Class to compete in the political market place (thus influencing the viable choices available to the public), and through this and other mechanisms influence the actual practice of government. It is thus that the State, the most important means of reducing the surpluses extracted through the market and providing a countervailing force to the power of Corporations, is restricted in its ability to be deployed as such a countervailing force by means of the very power it would otherwise restrict.

It would be too cynical, however, to conclude from this that all is lost; or that the Corporation's hegemony is absolute in this regard. Certainly the Corporation's power is disproportional, but ultimately the Political Class is held at least partly accountable in a plebiscite where votes are distributed equally. The very existence of regulations and government services (however undermined they have been recently) is proof that the power of the Corporation is incomplete. This leaves some hope that the power of the State can be used to counter the power of the profit-seeking Corporation in both the market and political spheres, or perhaps even to reimagine the institutional structures of the Corporation to make it less of a destructive force.

22.9 Reimagining Developed Democratic Capitalist Systems

The above is something less than the comprehensive discussion ultimately required of the topic, and with its discussions of inequalities and interest differences within classes implies a more complex and detailed typology of class than that provided here. However, it does produce a useful starting point to understanding the general naivété of Friedman's political economy. Friedman imagines that unregulated free market capitalism creates a situation in which agents (for the most part) are only able to make themselves better off by making others better off in equal proportion: the market is 'win/win'. The above shows that, in fact, classes are forced into a struggle to make themselves better off by making others worse off, and that the 'Invisible Hand', far from preventing this process, ensures that some are consistently able to do so while others are most frequently the losers in the struggle. Friedman imagines that unregulated free market capitalism is a potent mechanism for distributing power and 'opportunity' with relative equality, the above shows that it does rather the opposite. Friedman imagines that a lack of regulation best facilitates the prevention of deleterious effects, the above shows that deleterious effects of economic action are tied to the exercise of concentrated economic power. More generally, Friedman imagines the absence of a 'surplus' and a tendency toward wealth creation rather than redistribution of wealth, the above shows that unregulated capitalism facilitates the extraction of surplus in every facet of economic activity and that while wealth creation does occur it is also consistently accompanied by redistribution of wealth to those who already have it. The 'class' struggle, its nature and a desire to change it, seems an
important part of political economic experience.

However, the above also shows an inconsistency of class interests apparently absent from analyses based in Marxian theory. Executives, Shareholders and Entrepreneurs are also Consumers and Victims of Externalities. Shareholders may even be Workers, and Workers may be involved in and suffer the consequences of Speculation (particularly in the housing market). If deregulation is sufficiently widespread, all human agents, even those who benefit financially, can ultimately be losers. The result of implementing Friedman's political economy is not only 'win/lose', but 'lose/lose'. Only non-human Corporations - institutions artificially created with only one interest - are consistent 'winners'.

Capitalism is a potent mechanism for tapping into the ingenuity, creativity and industry of people, using the incentive of potential material gain, for the ultimate purpose of improving the general wellbeing of society. It can also be an effective means of creating choices for people in the interests which they are able to pursue and the way in which they are able to pursue them. However, it is fantasy to assert, as Friedman does, that these effects are optimised by the absence of regulation and the maximisation of the private sphere relative to the public one. The 'market failures' identified here are more than mere glitches in an otherwise beneficial system: they represent something fundamentally and systemically wrong with some of the ways in which various parties are allowed to pursue their interests, and indeed with the nature of some of the interests themselves.

In addition to the uneven distribution of power inherent to capitalist systems, one of the most important elements missing from Friedman's work is the complexity of economic reality. With his sweeping political economic vision of an economy allowing the 'Invisible Hand' allowing free reign, he provides a simple and easily summarised answer to the most important questions of political economy. Unfortunately, the true answers to these questions are unlikely to be nearly so simple. The true optimal combination of state and market, the optimal amount and types of economic freedom to allow and support, the best means of directing the pursuit of material gain to the optimal benefit of society as a whole, and the minimisation of negative effects from this pursuit of material gain, are questions with answers which seem unlikely to be so easily summarised as Friedman's 'Invisible Hand'. Nor are they likely to be able to be determined, once and for all: the best that can be hoped for is a close approximation, and even this is likely to change over time.

What this means is that a more fruitful political economy needs to move beyond attempts like those of neoclassical theorists to 'prove' once and for all the superiority of one particular, sweeping set of absolute answers to these questions (often in this case in the face of much of the evidence). Instead, such an alternative political economy needs to embrace the inherent complexity of these questions and take them on an issue by issue basis: it must be dynamic, able to deal with circumstances which
are not always adequately explained by a predetermined set of guiding heuristic principles. This does not preclude the proposition of solutions to economic problems or indeed radical or fundamental changes to the status quo – it only precludes that such solutions be deemed a final answer on the problems they aim to resolve.

In the following chapters, a summary of the historical failings of the 'Invisible Hand' and the rise, fall and rise again of its dominance in political economy is given. In this context, an evaluation of the impersistence of reform and the limits of what regulation can achieve is then made. Then, following from issues raised in both this and the next chapter, an eclectic mix of provisions designed to address both the failures of the 'Invisible Hand' and those of previous attempts to regulate it are proposed. Some are the products of the author's own imagination, derived from a particular diagnosis of the problem (though these are likely to include some which others have thought of and even implemented previously); others are provisions already proposed in the literature. They do not in all cases have the author's unqualified support, nor are they deemed final answers to the problems they aim to resolve: indeed it is likely that much more fundamental changes to the incentives of capitalism and the institutional nature of the Corporation are needed. The question of how best to tame, and harness, the 'Invisible Hand' to ensure it best serves people as a whole is one which must be left continually open.
Reflections: The Workings of the Invisible Hand and a Political-Economic Instability Hypothesis.

23.1 View from History

In *Capitalism, Socialism and Democracy*, Joseph Schumpeter (1950/1976), in essence, predicted that free market capitalism's demise would be facilitated in large part by its very successes in creating prosperity and freedom. Several decades later, history appears to show that something quite the opposite has occurred – that the very successes of the 'creeping socialism' (in reality only modest moves toward a more regulated capitalism) which people like Milton Friedman lamented have enabled them to be undermined. To show this, an analytical summary of the history represented in this thesis will be given to begin with.

Industrialised capitalism began largely without protective regulation and with an unashamedly uneven distribution of opportunity. The transition from feudalism was brutal and exploitative, such that the increased freedoms of choice later theorised by Friedman and other free market advocates was virtually meaningless. Some gained large fortunes by the appropriation of previously public resources, grants of privilege, and the dispossession of large numbers of people; while others were forced out of their previous occupations to work the factories, mines, railroads and other businesses which these privileged and ruthless few developed.

As the excesses of the exploitative system became more widely known, however, and as the common citizens gained increasing power in the political sphere, governments responded by curbing these with both public spending on provision of essential services and with regulations on the actions of business. Most of the latter activities were geared toward regulating the severe working conditions which had become endemic to the harsh system. Both were largely successful in ameliorating some of the worst excesses of the system, such that while the common people had previously been largely excluded from the benefits of industrialised capitalism, they now began to share in its bounties and see their prosperity grow more rapidly than prior to regulation.

By the early 20th century, the previously more labour-oriented regulatory system became increasingly concerned with the regulation of products being produced. Then the onset of the Great Depression appeared to prove even to many of the previous wealthy beneficiaries of capitalism that unfettered greed, and allowing the 'Invisible Hand' to rule un-moderated by the civilising influence of government, would ultimately lead to catastrophe. Through much of the post-depression period, the consensus was that the 'Invisible Hand' needed to be moderated by government regulations and institutions, and there was even talk of making corporations more socially responsible. Taking on the ideas of John Maynard Keynes, the government took on the role of maintaining employment and infrastructure and protecting the populace from the excesses of pure capitalism.
One thing persisted, however: in many parts of the world the Corporation remained a legal person with rights beyond those of flesh and blood people and the mandate to maximise profit. The Executives of these Corporations were constrained, in addition to this legal structure, by the forces of competition and the fickle and Speculative nature of the share market, as well as an overwhelming inter-institutional cultural belief in the idea that the Corporation best served the public by pursuing its profits without regard for that same public. Many used corporate funds to limit and capture the regulatory tide. Moreover, they largely made no consideration of what might be regulated if it were known, and any potentially profitable innovation or process would be employed regardless of its social cost. While behaviours were constrained by regulation when sufficiently exposed and discovered, regulations could never keep up with the innovativeness of Corporations in creating new ways to make money, however destructive. In essence, the common people, Workers and Consumers, and the Corporation remained in a state which was at least as adversarial as it was codependent, and certainly more than it was cooperative or collaborative.

Nonetheless, many experienced unprecedented (and better distributed) increases in economic growth and welfare, as well as relative economic stability. While regulation could not eradicate the malfeasance of Corporations it did at least manage to curb these to a large extent. The regulation created both disfreedom and freedom – while the protections constrained what companies could do, what Consumers could buy, and what work, conditions and pay Workers could offer; it also meant that less bloody-minded Executives were given some respite from the 'race to the bottom' which competition produced and, where regulations existed, were thus more free to choose less destructive processes of production. It meant that Consumers were 'free to choose' in an environment where they could be better informed about products and less likely to be threatened by things which they did not know. It meant that Workers had some freedom from the power inequalities inherent in an unregulated employment relationship, and were also more free of the 'race to the bottom' and the need to offer the most amount of work for the least possible pay and least amenable conditions.

Despite the apparent paradigm shift after the Great Depression, a small group of elites continued to petition for a return to laissez-faire capitalism. A coalition of true believing ideologues and cynical opportunists (with leaders of large Corporations among both groups) armed themselves with the idea that societies benefited most when all players in the market pursued their self-interest and were left free to do so largely without intervention from the State (though in many cases they did not have the same sceptical view of State subsidy as they did of prohibitive regulation), and set out to convince those societies of those views. However, for some time they were unsuccessful, and were restricted by the desires and scepticism of the people in their own democratic countries.

So instead they pushed free markets on the poorer and more vulnerable parts of the world, often complicit in the use of force to do so. Despite the unthinkably brutal oppression that often
accompanied them, these cases were invariably touted as successes by Friedman and his free market coalition (who apparently valued free markets over free people) (Klein, 2007). While Adam Smith envisioned that increases in the wealth of nations could lift the living standards of the poor, the average income data which the free marketers flaunted as evidence of their success obscured the fact that these were skewed by massive increases in wealth for a few while the poorest saw their condition decline.

Finally, a crisis gave Friedman and his ilk the opportunity they needed. Stagflation was apparently unexplainable under the Keynesian orthodoxy, and so Friedman was waiting and ready with his alternatives. He faced a population that had so long been protected by regulation that many had little to no cognisance or experience of why those regulations were enacted in the first place. For many, this may have been the closest they had come to anything like a Great Depression (though the stagflation period pales in comparison); none had worked in the factories of early industrialisation nor had any lived in cities devoid of basic infrastructure, they had perhaps forgotten the road tolls before the institution of seatbelts, or the horror stories of food production before the creation of the FDA and other such regulatory bodies. The regulations and interventions had apparently worked so well that people no longer felt as much need to be protected.

Thus Friedman and his coalition were able to win the day by reinforcing the idea that people didn't need to be protected and telling them that those things which were meant to protect them were in fact hurting them and producing the immediate issue which now concerned them. Further, their freedom to choose what products to buy and what jobs to take was being constricted by an overly paternalistic government. The State now needed to get out of their way and let them pursue their interests in whichever way they saw fit, and to allow more choices to become available. A superficial explanation of stagflation was given, and the Great Depression was explained away with simplistic revisionist history. For those who would think to look that far, even the excesses of early industrialisation were apparently explained away by the assertion that they allowed the increases in living standards that industrialisation produced.

As a result, the State protections and services which had served the public were systematically dismantled. Regulations were removed and regulatory bodies had their funding stripped. Public institutions, infrastructure and services were privatised or removed. Unemployment was to (ostensibly) be lowered with deregulation, not government spending, and opposition to unions and the removal of protections for those that did work would lower the cost to business and allow more to be employed. Curbing inflation would be given pride of place in government policy. The 'Invisible Hand' would be unleashed more and more.

The immediate effect of the initial policy restructures – as in the poorer countries which had adopted
Friedman's policies previously – was recession, but Friedman had said that this was a necessary period anyway, and while the most extreme elements of his monetary policies were abandoned, his overall vision largely remained as policy. Of course, when the relevant nations pulled themselves out of recession, Friedman and the free marketeers would claim victory. Successive governments – including Clinton's Democratic one – would employ free market policies.

Despite a building spectre of volatility, 'the economy' was consistently touted as successful in the U.S.; and the measures used which served the interests of corporations generally supported this. Profits and GDP soared, as did the incomes of Executives and many Speculators. Meanwhile, on the ground, neoliberalism was failing to deliver. Job security became a thing of the past as massive 'downsizing' of large corporations occurred while jobs were contracted out to people in poorer countries, and even these people, whose cost of living was potentially so much lower, were unable to make a living wage working 80-100 hours per week. Those jobs that remained were increasingly casualised, low paying, and without the other benefits that more permanent work had offered. The real wages of most Workers stagnated or declined and inequality greatly increased while the government provisions complementing those wages also declined. Workers – not only in the developing world sweatshops but in, for instance, the large meat manufacturing plants of the U.S., found themselves working under conditions reminiscent of and/or heading toward those of early industrial capitalism.

While pharmaceutical companies accepted subsidies, the U.S.' privatised health care system meant that many were left without insurance and therefore care, and even those with insurance found themselves subject to questions of profitability, so that the U.S. developed one of the highest rates of preventable deaths in the developed world. Privatisation of power in California resulted in rolling blackouts as insufficient power capacity existed and was exacerbated by power companies simply turning off power to artificially raise prices (Gibney, McLean & Elkind, 2005). While environmental consciousness among the general populace grew and talk of 'sustainability' abounded, Corporations, despite rhetoric, were a force against the tide – oil companies sponsored efforts to sow seeds of doubt about global warming while petitioning to drill for oil under the very arctic ice whose melting would cause some of the most dramatically deleterious effects of global warming; the food production industry became increasingly concentrated so that farmers became subservient contractors rather than capitalist entrepreneurs and the pollution it produced began causing health issues in surrounding communities; chemical companies took advantage of stagnant and declining regulation to introduce potentially dangerous new chemicals to the domestic market while exporting still regulated ones abroad, and the deregulated trade meant that these self same chemicals were used on imported food eaten by Americans. Meanwhile, expanding private intellectual property rights have meant that the human genome itself is now in the process of being

The people were for the most part either unaware of many of these developments, or when they became so and were concerned were told that this was necessary for their continued economic prosperity and that anyway, it was a state of the people's making as they could vote with their dollars (however few they may be) for whatever sort of economy they wanted. They were 'free to choose', and the new privatised and deregulated economy maximised the choices they had. When renewed demands for corporate social responsibility were made, Consumer choice rather than Corporate decision-making was frequently touted as the solution. When Consumers made such demands, Corporations mostly found it quite a simple matter of making a few charitable contributions (which translated into quite cost effective PR and promotion anyway) and advertising vague guidelines while otherwise going about their business as usual. Occasionally they broke what regulations that remained, but generally found the fines less than the promised return.

Further, the financial system, freed from both existing regulation and any of that which might otherwise have been enacted, took its natural course and became less a wealth producing and more a wealth extracting facet of the economy. It became less and less a system of Enterprise Investment and more a system of short-term Speculation, the system circulating currency at a rate 100 times that needed for real commerce (Davies, 2004). Corporations were increasingly owned by institutional investors and small absentee Shareholders, the latter of which were able to do little to oversee their interests. Where it was theorised that social responsiveness and sustainability would be in the long-term interest of business, this required long-term investment, and the system undermined this by demanding short-term returns and immediate profit maximisation and growth, often punishing those willing to forgo short-term profits in the interest of investing in long-term sustainability and a less destructive business model. Schumpeter's process of 'creative destruction' had been twisted to simply become 'destructive destruction'.

In the Financial Corporations themselves, the business model's emphasis on short-term profit maximisation facilitated increasing assumption of risk, frequent trading, and profiting from volatility. The companies and their traders had the power to cause and to profit from the rises and crashes of entire economies, far removed from the real effects of their actions on causing mass unemployment, for instance, in the Asian crisis by speculative fluctuations. Inevitably, however, their hubris got the better of them and they overplayed their hand – the poorer people whose wealth they sought to extract simply ran out of wealth to give, and the system faced collapse.

Almost immediately, much of the talk of free and efficient markets disappeared as companies sought massive bail outs and cheap money from government. This collapse achieved what all that had come before it, even the spectre of global warming, had failed to do – there was a realization
that if perhaps the regulations designed to protect the people and the system had not been so voraciously dismantled then this could have been avoided, and there was a reaction against the greed of Wall Street. Sadly, Friedman was not alive to comment, but his friend and fellow free market ideologue Alan Greenspan – the man whom Friedman had credited with facilitating unprecedented stability through fairly strict adherence to Friedman's monetarist ideas during his time as Federal Reserve chairman - was forced to admit that his ideology was fundamentally wrong – an unguided invisible hand does not produce society's greatest good. In this, as with the Depression, Friedman was proven right about one thing: only crisis produces real change. It remains to be seen, however, what shape that change will take.

23.2 The Invisible Hand is Blind

When unguided by government or ethics, the 'Invisible Hand' has shown itself unable to consistently deliver on any sensible measure of the wellbeing of society. The countervailing action theoretically attributed to it by Friedman simply does not bear out in reality, either theoretically or empirically. Information asymmetries hinder 'rational' action by market actors to a significant degree, as do power inequalities. Free markets often tend toward concentration and, as importantly, competitive cooperation, undermining the choices available. The marshalling of considerable concentrated resources toward persuasion crosses the line into manipulation, undermining the Consumer sovereignty at the heart of Friedman's theories, such that the producers often have more say than the consumer in the nature of what is produced. Calls to 'vote with one's dollars' obscure the fact that this is an undemocratic and mal-distributive form of voting because this implies that those with more dollars have more votes, and this is demonstrated in its tendency to forego adequately producing for services which are essential but potentially unprofitable while aptly providing services which may be profitable but are far from essential. The direct relationship between the cost and regulation of labour and the demand for that labour is a gross oversimplification, particularly given that demand for labour is derived from Consumer demand for the products that it produces. Incentives are to maximise the externalisation of costs, and these externalities exist outside of any realistic market transaction. While the market does at times 'correct' itself eventually, the consequences to which it is reacting are not only often irreversible by any market 'correction' but also unthinkable dire. Moreover, the freedom of the manager is continually constrained by an impetus to maximise short-term profits, both by a pervasive inter-institutional management culture and a speculative and extractive financial system. This aspect of the free market undermines much of the ability of the market to create incentives for longer term, more sustainable prosperity; to correct the perpetuation of harms; or to facilitate stability.

Simply, an unguided 'Invisible Hand' becomes an undeniably destructive force, creating more
disfreedom than freedom. The world is now at a cross roads, with the financial collapse only the most immediately obvious but equally the likely least long-lasting harm caused by the removal of the provisions which constrained the harms (and, perhaps, facilitated the benefits) of the market. Our economic system demands rapid and unending growth in a finite ecosystem. The wealthy, whose marginal utility is increased little by each dollar they gain, continue to extract wealth from the poor who gain substantially from each incremental increase in their wealth. Persistent pollutants continue to build in the biosphere, likely to cause health and other problems in people for many years to come. Despite technologies existing for increased efficiencies the current interests seem to be bound to ongoing waste of finite natural resources – there is said to be more copper in the garbage heaps of the world than in all of the potential mining sites altogether (Anderson & Fiedler, 2008). Moreover, in the face of a gradually occurring but soon irreversible and unprecedented horrendous catastrophe of human making, the free market economy seems, for the most part, to be reacting with complacency. In Interface CEO Ray Anderson's words, “the Invisible Hand is blind” (Anderson, 2004, in Achbar, Abbott & Bakan, 2004).

That the market does create incentives for innovation and production, that self-interested action can facilitate an increase in the wealth of nations and the wellbeing of society, is not here denied. But it is not always so; and more importantly it is most often so when there are institutional arrangements in place to guide that self interest away from harmful and toward beneficial innovation and production.

23.3 Flaws of Regulation

While the early regulatory and post-depression programs went some ways toward this, they suffered from some important problems, as alluded to earlier. Firstly, the regulation of specific behaviours could not keep up with the innovativeness of private enterprise and Corporations in particular – both a blessing and a curse of the 'Invisible Hand' – and nor could regulators (as with consumers and even at times employees) have full cognisance of the information which Corporations had of the potential harm or otherwise of the products they produced or the processes of that production. The automobile industry is a case in point – the Pinto, for instance, was argued to be in compliance with all existing regulations (of which there were, at the time, none in direct relation to the integrity of fuel tanks in rear collisions), and no doubt this was true of many of their most dangerous innovations. Braithwaite (1984) made a similar point about the pharmaceutical industry, and ultimately Vioxx had been approved by the FDA based on the information available to them. Financial Corporations were also highly innovative in creating more and more elaborate methods of volatility-creating wealth extraction. While in many cases regulation eventually caught up to behaviours, it suffered from some of the same problem of market correction of coming in after too
much damage had already been done. It also seems pertinent, given the destructive behaviours that have been discovered, to assume that there are many ongoing ones which have not yet been exposed, and may go on for many years (as with asbestos) with insiders having knowledge which they do not disclose.

Secondly, and related, at times the regulatory climate of the State has been able to be influenced by Corporations. As is in their interests, Corporations spend millions on lobbying and sponsorship of the political campaigns of the Political Class in order to facilitate a more favourable regulatory environment. As mentioned previously, one of the more disturbing discoveries made when researching Ford Motor Co. was that the figure of $200,000 for a human life used in the infamous cost/benefit analysis for Ford, and indeed the dollar-based cost/benefit analysis itself, were actually something which automotive companies, through lobbying, had managed to argue should be used in matters of negotiating regulation with the NHTSA.

Third, lack of regulation in one area made regulation in others ineffective and at times unfeasible. Prohibiting a particular behaviour by business in, for instance, the U.S.; is meaningless if U.S. consumers are then exposed to imported products produced by foreign companies who have engaged in those behaviours; and failure to regulate this not only fails to protect Consumers but disadvantages local business. The ‘cycle of poison’ in the case of pesticides and food production is but one example of this.

Fourthly, there has remained a great divide between the benefits of Corporate malfeasance and its negative consequences for those who perpetrate and profit from it. Fines for those breaches of regulation which have been exposed have frequently been less than the profit gained from them. Furthermore, while actions against Shareholders by Executives and Directors have been prosecuted in courts and Executives and Directors sentenced to hefty prison terms, the same has generally not been so for managers acting in the interests of Shareholder profits who have made decisions which have had dire consequences for non-shareholder stakeholders.

Finally is the simple fact that, when regulations were effective, this allowed the issue to be downplayed by those opposed to regulation. Generally regulation came into being in the first place because of consistently heinous actions by Corporations and Entrepreneurs – the earliest examples being the conditions in the mines and factories of early industrialisation. Unhealthy food practices precipitated the creation of the FDA in the U.S, consistent Worker injuries and deaths precipitated creation of occupational health and safety legislation, discriminatory practices led to antidiscrimination legislation, unsafe automobile designs lead to the creation of the NHTSA in the U.S., financial instability lead to financial regulation. Ironically, it was precisely because these things had become less of a problem due to regulation that Friedman and others had been so
successful in arguing that they were never a significant problem in the first place. and that these regulations were an imposition on individual freedom, which ultimately precipitated a deregulatory climate. While the regulators had previously taken on the role of 'reformers', the new 'reformers' stripped those regulations away. Should 're-regulation' occur, no doubt it will also be at least partly effective, which may allow another Milton Friedman to question its value.

23.4 A Political-Economic Instability Hypothesis

In his Financial Instability Hypothesis alluded to earlier, which now is gaining so much attention, Hyman Minsky (1977) envisioned that the very stability of a financial system would undermine the caution which formed the foundation of that stability. Addressing the final point above, it may be time to broaden this thesis – to the regulatory system, and to the public who help to determine which such systems are put in place. The instability which Minsky (1977) found in the financial system may be observed in the whole of the political economy which prevails at any time.

The 'Political-Economic Instability Hypothesis' starts with a society which is vigilant in its regulation due to the memory of past events. These may vary depending on what is being regulated. The Great Depression was a strong motivator for regulation in particular of the financial system and the establishment of the State's role as not only arbiter of the 'rules of the game' but as steward of the public welfare. The thought of the Dickensian nightmare of preregulatory employment also keeps Workers wary of their safety, and widely publicised product failures such as thalidomide or Ralph Nader's treatment of the automobile industry in *Unsafe at Any Speed* do the same for Consumers. The memory of a more visible pollution which Galbraith wrote about in *The Affluent Society* (1998, but originally written 1948) similarly keeps the public wary of the dangers of allowing it to run rampant as they are able to identify the potential for being Victims of Externalities. As new problems are discovered, the public sees protection against them by the powers of democratically elected representative government as a natural course of events, though no real systemic adjustment is made. However, from the 1950s, the expectations of the public grow, and a belief that Corporations have an obligation to society beyond profit-seeking prevails (Banerjee, 2007; Carroll, 1999).

As time goes on, regulation becomes routinised, and increasingly geared towards setting of standards to prevent negative consequences from occurring rather than to punish companies for breaches. Potentially harmful innovations are frequently vetted by regulatory bodies before they come to light in the public eye, while a sustained growth in living standards is facilitated in no small part by an activist government. Where breaches of the public trust occur, they begin to be deemed exceptional (Bakan, 2004), rather than a product of the inherently destructive nature of heedless profit-seeking, and the Corporation as a whole is regarded as a force for good. All of this allows a
complacency to set in about the need for government intervention. In Minsky's (1977) Financial Instability Hypothesis, it is purely the lack of an unsettling event which causes financial stability to become destabilising. If one is to give proper attention to the historical record, however, the 'Political-Economic Instability Hypothesis' must include the unsettling event which precipitated Friedman's rise to prominence, and its interaction with the destabilising stability of the regulated system.

That stagflation occurred under a regime of activist government made it easy to blame it on that self same activist government, though as was shown previously there are alternative explanations. However, the fact that the harms caused by stagflation were minor in comparison to those caused by the events which had precipitated the regulatory environment of the time was likely lost on a populace which had so benefited from vigilant protection for so long as to perhaps cause them to underestimate its importance.

This climate leaves the public vulnerable to persuasion that there was never any need to regulate in the first place. In Minsky (1977), financiers reduce their aversion to risky lending and borrowing, believing their initial risk assessments too conservative. They believe they can get richer faster, and could have done so in the first place, without the restraints of caution, not realising that their very success was dependent upon that caution. Here, the public is convinced (at least partly) that they needn't have used the State to protect them, that regulation and social protection was instituted prematurely, and that if only they had allowed the 'Invisible Hand' to do its work it would have protected them better than the government ever could (and even prevented stagflation). The conditions which precipitated the climate of regulation and protection are now a distant memory.

While as in Minsky (1977) Financial Corporations and other Speculators find that their excessive indebtedness is validated for a time, the negative consequences in terms of losses to the public begin almost immediately, worsening as deregulation progresses. But the pain caused is cumulative, subtle, and often hidden; rather than sudden and dramatic. Pollution is perhaps less visible than it once was – 'environmental issues' now dismissed as the concern of lovers of nature, but its effects on human health intensify and accumulate. Under-funded regulatory agencies, vulnerable to industry lobbying, allow more harmful products and processes to slip through the cracks without accompanying exposition. Real wages stagnate even as government safety nets are removed and the instability of employment tenure increases. The public is harmed but is often unaware or only partially so, and those most harmed – the poor – are least able to exercise the influence necessary. Moreover, they are made to believe that they are exercising their freedom, that they are 'free to choose' exorbitantly high interest rates, dangerous or useless products, low wages and poor working conditions; without interference from a heavy-handed government.
These issues are distorted by a focus on the measures which benefit, for the time being, from the risky actions of Financial Corporations and Speculators. Profits soar, GDP growth is solid; and so people can be told of 'prosperity' even as less people share in it. The removal of protections, and the negative repercussions thereof, are touted as necessary for this 'prosperity'. This includes, in particular, the removal of regulations on the processes of Finance – the capacity for risky and frequently destructive and extractive actions is credited with being the engine of wealth 'creation'. In this case, the instability was further masked by State intervention which sought to validate, rather than constrict, high-risk behaviour.

The opaque nature of these harms means that the discomfort felt fails to coalesce into a concerted outrage widespread enough to institute real change. Critics, instead, are relegated to the fringe as the new orthodoxy continues to assert itself. Even the threat of a future ecological and human disaster lacks the immediacy of effect necessary to break the spell of deregulatory complacency. Only a sudden and broad ranging event may be enough for the climate of political economy to make a return to caution and regulation. In this case, the fact that the limits of monetary policy in controlling financial instability appear to have been reached, and the disastrous economic consequences which have resulted from refusing to use other measures to curb excesses, may have been enough to do so.

If deeper systemic change is not implemented, however, it seems probable that the cycle will only repeat itself. As these new regulations are implemented, they may well be so effective as to allow their usefulness to be unfairly belittled. This may again result in a removal of protections in the future, with further harmful, even disastrous results. Clearly, a different approach may be needed.
24 Taming and Harnessing the Invisible Hand

24.1 The Need for Systemic Change

The above discussion summarises briefly both the flaws in reliance on the 'Invisible Hand' as a regulatory mechanism and the limitations on the effects of regulation of specific behaviours as currently conceived. Moreover, it is hypothesised that if systems put in place in the wake of the financial crisis are effective, there very effectiveness may make them prone to being dismantled.

The regulation of specific behaviours, then; while an important tool for directing the behaviour of Corporations; will not by itself provide a sufficient means of ensuring that Corporations act less destructively in their pursuit of profits. To do this, there needs to be a move beyond 'command and control' and toward 'governance', beyond specific regulation and toward institutionalising the checks and balances and even the ethics which Adam Smith envisioned in his version of a capitalist society. This must include methods of harnessing the 'Invisible Hand', of making it less blind and directing the self interests of business more closely toward those of the long-term benefit of society.

24.2 Institutionalising Views to the long-term

As previously alluded to, the drive to maximise short-term growth and profit-maximisation undermines the 'Invisible Hand's ability to preemptively correct behaviour for the short-term. Friedman's claims that companies will not take excessive risks or create dangerous products because they can be detrimental in the longer term are partly made moot by the fact that the longer term will be outside of the experience of the short-term speculators who profit from that behaviour. Therefore, while it may not in the long-term be profitable for the Corporation as an entity to make or do things that are very profitable in the short-term at the expense of the long-term (which is in itself questionable in many cases), it is often very profitable for the transient shareholders who own a stake in the company at any one time.

As in the above, the dominance of Speculation over genuine Enterprise Investment has become tremendously problematic. Korten (1995; 2009) and Davies (2004) have discussed the issue of investment being an exercise in attempting rapid short-term asset appreciation rather than real Enterprise Investment. While the defenders of this system assert that the liquidity of speculative investments is an important incentive for investment, both Korten (1995) and Davies (2004) have pointed out that this type of investment is often more extractive than productive: this in addition to the destabilising effects previously mentioned.

Korten's (1995) main proposed solution to this is to (somehow?) move toward smaller organisations. While moves toward smaller organisation may be feasible in some cases, it is not the position of this thesis to assume that the size of Corporations is their primary fault, and indeed the
concentration of resources that large Corporations facilitate can be effective in creating greater efficiencies in production and investment in production and technologies and innovations which might not otherwise be possible (though at present these things are undermined by the destructive nature of much of these 'efficiencies' and investments). The main disadvantage of having Corporations so large is that each one is able to exercise a disproportional amount of market power and power over the Political Class as outlined earlier, so 'smaller' organisations may be desirable in this sense, but there are limits on how small organisations can get without losing the productive benefits which larger organisations facilitate.

A number of propositions have been made to redirect the forces of the stock market toward more stable outcomes. Korten (1995; 2009) supports a tax, credited to James Tobin, on financial transactions. Because it taxes only the transaction, such a tax would disproportionately affect high-volume Speculative investment, as against those engaging in Enterprise Investment. A punitive tax on capital gains realised in very short periods is also proposed (Korten, 2009).

Keen (2008), furthermore, has advocated redefining shares themselves so that they expire after a certain period – say, 25 years – and the company issuing them re-buys them at the original sale price. Such a radical solution would likely limit Speculative behaviour with the knowledge that the share price will at some time reset while allowing those seeking business investment to garner a sound profit from dividends over the period - “to put some effective ceiling on how high a share price can be expected to go, and to therefore force valuations to be based more on soberly estimated future earnings (of the sort Warren Buffett now does) than on the prospects of selling a share to a Greater Fool–which is the real basis of modern-day valuations.” (Keen, 2008). Such measures may go some way toward curbing the destructive excesses of speculation, though they are in no way likely to be a panacea for Speculation.

**24.3 Responsible Share Ownership**

As alluded to previously, one of the problems with the current system is that no one within the Corporation is 'free to choose' goals for the organisation other than profit maximisation. Not only have the owners of the company(Shareholders) delegated the management of the organisation to agents (Executives and other managers) compelled to act in their interests, but these owners have little avenue for expressing and enforcing what these interests may be in any sort of complex way other than to vote for board members (who often exercise undue influence in the maintenance of their own positions, such that the number of candidates is frequently equal to the number of positions) (Monks, 2008) or send market signals by the sale of shares. The owners' 'interests' are simply assumed as profit maximisation, often of the short-term variety.

If the 'Invisible Hand' is to do what work it can properly; and particularly if, as has been suggested
above, the share market is to move away from Speculation exercise into a market for true, interested, long-term Enterprise Investment; then it seems to follow that the Shareholders who own the business should be given more scope to increase the complexity of what can be interpreted as their interests (and be assigned greater responsibility to do so). Furthermore, Shareholders should be given greater freedom to express goals, through the organisation, outside of those related only to their own self-interest.

Consumer advocate and independent presidential candidate Ralph Nader has expressed similar sentiments. On the website for his bid for the 2008 federal election, Nader proposed, as a way of curbing corporate crime, to

“Democratize Corporate Governance: Shareholders should be granted the right to democratically nominate and elect the corporate board of directors by opening up proxy access to minority shareholders and introducing cumulative voting and competitive elections. Shareholders should be given the power to approve all major business decisions, including top executive compensation. Shareholders should be treated as the owners of the corporation – since, in fact, that is what they are.” (Nader, 2008)

In the same vein, Shareholder activist and business leader Robert A.G. Monks has been one of the most vocal advocates of greater Shareholder involvement in Corporations in recent times. He attributes many of the problems faced in regard to Corporations as the result of what he describes as a 'Corpocracy', in which not only are Corporations the dominant institutions of our times, but where the owners of those Corporations are shut out of almost all decision making; while Executives indoctrinated in 'economic' ideology, and often serving their own self interests, effectively eschew any engagement with Shareholders to pursue their narrowly defined economic objectives with relative impunity (Monks, 2008). He also more generally laments an emphasis on 'economic' (re neoclassical) tests of value in society and government discourse (ibid).

According to Monks (2007), around 100-150 million Americans – a substantial proportion of the population - own shares through institutional investors such as mutual funds and employee pension funds, and that 67% of stock in public corporations in the U.S. are owned by institutional investors. Monks believes that enforcement of existing regulation in regard to the fiduciary responsibilities of such funds to their beneficiaries should be the main avenue of increasing corporate accountability, because the current environment is such that the leaders of such funds are, with few exceptions, uninterested in taking an active role in the ownership of the companies (Monk, 2007; 2008). He advocates that beneficiaries should take a more active interest in the behaviour of the institutional investors who act as their agents and that institutions in turn must be more active in their role as owners of Corporations (Monks 2007; 2008), however this process is seen to be hindered by the 'Corpocracy' above described.

Interestingly, Monks himself seems unable to himself break from the economic – the Statement of
Principles on Institution Shareholder Responsibilities he appends to his book *Corpocracy* still mainly limits its goals to the maintaining the financial interests (albeit more long-term oriented) of the beneficiaries of such institutions (Monks, 2008). Furthermore, Monks' vision of a Shareholder democracy, while providing some protection for minority Shareholders, largely ignores the inequality inherent within the 'one share one vote' policy.

Therefore, echoing some of the principles espoused by Monks (2007; 2008) and Nader (2008), but going beyond them, the following principles are proposed:

- Shareholders, institutional or otherwise, should be allowed (and perhaps even compelled) to take a greater role in the running of Corporations. In the case of board member elections, any Shareholder should be allowed to nominate a board member of their choice for election. While generally the day to day running of Corporations should be left to Executives and other Managers, Shareholders should be allowed to propose resolutions and policies in regard to the operation of the business to be voted on by Shareholders.

- This would not necessarily be restricted to issues of mere profit and loss, or even to the determination of pay for Executives. This might include, for instance, policies on payment and conditions for (or indeed use of) sweatshop or other labour; environmental policies; the production of particular types of products, etc. It could also include resolutions on how meetings are run and how often. Furthermore, major decisions in this regard should be done with consultation of Shareholders. Arguments could be made by both Shareholders and Executives for and against particular actions. Voting may be made compulsory for Shareholders (no rights without responsibilities) but could be done online if a Shareholder is unable to attend a meeting.

- Voting might be better democratised so as to better reflect the true interest a Shareholder has in a Corporation: their true risk of utility. As noted previously, currently the system is simple: the more shares a person has in a Corporation, the greater their voting power. The more wealthy a person is, the more shares they can purchase; and very wealthy people can potentially purchase a proportionally large number shares with *very little effect in terms of real sacrifice of utility*. For a manufacturing worker, for instance, an amount of several thousand dollars may represent life savings; while for a multimillionaire an amount several times that might represent little more than a passing hobby. Yet, despite the fact that the real risk to livelihood to the manufacturing worker is many times that to the multimillionaire, the latter's voting power is many times that of the former – the relative interest in the company is recognised only in dollar form.

- A solution (albeit imperfect) to help close some of this gap between voting power and
interest in the company not truly revealed in dollar (or share) amounts might resemble something like a progressive tax system. In most developed nations, income is taxed at higher rates depending on how much money one earns. In a similar way, individual shareholders could have adjustments in their voting power depending on what proportion of their personal income is invested in the company. Using a points system (the term 'votes' might have to be changed to some unit of voting power), lower income people would receive a higher voting power per dollar invested than those on a higher income, in a progressive way.

- Note that, just as a progressive taxation system seeks to moderate inequality rather than to eliminate it, so too should be the goal of such a share voting system, so that the wealthy are not unnecessarily punished for being wealthy. But such an emphasis on individuals' real interest would again tip the scales in favour of stable rather than excessively high-risk ventures and ways of earning money as precipitated the current crisis. A millionaire willing to lose a high amount for the chance of a high reward even at the risk of sending the company into insolvency should be able to be tempered by the person of humbler means who desires a stable dividend for many years to come. Special provisions may need to be made in regard to institutional Shareholders – while they may as institutions command large resources, they represent beneficiaries whose personal incomes may vary significantly. Generally such institutions should tend toward stable and ongoing dividends anyway, as the below should also facilitate. The above relationships described between Corporations and their Shareholders should be mimicked in the case of institutional Shareholders and their beneficiaries. Beneficiaries of the institutions should have the same rights as outlined above for Shareholders, and their vote within the institution should be moderated as per the above guideline.

- Where management, boards of directors, or governing bodies of institutional Shareholders have not carried out the express wishes of Shareholders and/or beneficiaries, they should be prosecuted for breech of their fiduciary duties.

**24.4 Regulation of Executive Pay**

For the most part, the free market has been allowed to set the pay of Executives, again using the argument that Shareholders (and their representatives on Boards of Directors) can best determine their own interests. The events of recent times in particular – from the Enron and HIH scandals of the early 2000s to the current subprime mortgage crisis – appear to demonstrate that this might not be the case. Of particular note is Directors paying bonuses to Executives of companies who required bailouts in the midst of the subprime crisis.

Intuitively, there seems a conflict of interest when boards of Directors – often populated largely by
Executives and where the board Chairman and the CEO are one and the same person – are charged with setting the pay for those self same Executives, yet this is the situation which the free market has produced. Furthermore, the proportional increase in executive pay has often been several times any benefit in terms of increased productivity; returns; or the income of line workers. This would therefore seem a frontier for regulation by government.

The above schemes of moderating Speculative behaviour and allowing for a more Shareholder-oriented management of firms would also need to be facilitated by the use of more direct incentives for agents, Executives in particular, to favour long-term stability and investment in the future over short-term profit maximisation. Long-term compensation has previously been regarded as that which can only be realised after a period longer than 1 year (Abowd & Kaplan, 1999). Interestingly, this is in contrast with definitions in the management literature on planning and strategy, in which 'long-term' is generally taken to mean a period of around 5 years. Redefining 'long-term' compensation to more closely reflect a view to the 'long-term' seems a pertinent starting point. The fact is that good strategic management may require investments in the company which will not be recorded as a profit for many years after their implementation. A manager whose 'long-term compensation' accrues over only one year may not have adequate incentive to make such investments. With the aforementioned emphasis on a dividend, the manager also needs a disincentive to maximise the yearly dividend at the expense of the long-term viability of the company.

One option could be fixed shares in the company which expire a fixed period of at least five years after the end of the executive's tenure (to be passed on to their successor). The manager cannot sell the shares but collects a proportional dividend in the company not only for the duration of their tenure but for a number of years afterwards, thus creating a further incentive for managers to invest in the long-term and to leave their successor in a favourable situation, because their own continued wealth accumulation would be dependent on the continued success of the company.

Obviously, this would replace the stock option systems as they currently exist, as these appear to continue to emphasise yearly wealth accumulation. In an unregulated situation, such an arrangement would face severe difficulties in implementation as a company unilaterally offering such a package would struggle to attract talented executives due to the substantially reduced liquidity of the offering. However, this problem would be averted in a regulated environment, as the reduced liquidity would be universal while the possible remuneration would remain quite high.

**24.5 Law and Liability: A Broader Approach to Dealing with Corporate Malfeasance**

Two of the most important problems with the current regulatory system in the U.S. and much of the
Western world are that, firstly, the disincentives created by the possibility of fines which vary greatly in proportion to the profitability of a given violation are insufficient to discourage profit maximising Corporations from violating regulations; and secondly that the regulations are frequently so narrowly defined that harmful behaviours fall outside of them. While neoliberals have attempted to use the extreme detail of some regulatory legislation as evidence of 'over-regulation'; citing, for instance, the number of articles or pages in a regulatory guideline; Parker (2003) makes the point that many of the pages are explanation of a few rules, and that in any case much of the detail is likely to be concessions or exceptions:

“Congress could eliminate thousands of pages of text by reducing all environmental obligations to a single sentence: 'No one may pollute.' Do the page counters think that this would make the environmental laws 99.9999 percent less burdensome?” (Parker, 2003)

A further issue is that the Executives and other managers who make decisions are so rarely disadvantaged directly, and that the transient nature of Shareholders means that those who have profited from a violation are often different from those who have lost from a fine. Following from this, this thesis takes the position that indeed the many pages of detailed regulation should be reduced; but in this case to broaden, rather than narrow, the scope of regulation. Though some guidelines and regulations may remain, it is argued that much of this could be replaced with a broader law prohibiting 'corporate malfeasance', a deliberately broad term which would cover any number of actions by corporations. The premise of this idea is that, as in civil cases; juries, judges and prosecutors should be given greater discretion in determining the liability or not of the corporation and its agents in regard to its activities.

The conditions of the law might be as follows:

1. To determine whether a Corporation and its Executives were guilty of 'Corporate Malfeasance', the jury would be charged with determining whether a 'reasonable person' would have deemed the Corporation's actions to pose an 'unreasonable risk of harm' to any stakeholder. 'Harm' would not be narrowly defined by legislation and could be determined and defined by prosecutors, judges and juries as the case arose. This would potentially stop Corporations from being able to find 'loopholes' in the current regulation. While the broadness of this law would potentially open up a veritable Pandora’s box of state prosecutions against Corporations, the 'reasonable person' test is certainly not without precedent in corporate law; for instance in laws prohibiting false or deceptive advertising. 'Let the buyer beware' would become 'let the producer beware'.

2. Fines levied against the Corporation would be partly based on independent estimates of past, current and future earnings or savings from the malfeasant action, so that the Corporation loses all of the profit from the action, plus an additional punitive amount. Amounts already
lost by corporations to civil suits would not be deducted from this amount. In some cases of, for instance, environmental violations, cleanup costs would be levied in addition to the profit-estimate based fines. The money from fines would be earmarked for projects related to the violation – compensatory damages for victims, for instance. The cost/benefit analysis which Bakan (2004) in particular laments would now necessarily show a loss from such actions.

3. Any manager culpable in the decision making which led to the commission of the malfeasant action would be liable to personal fines (partly based on any personal benefit they may have accrued from the action), asset seizures, and in some cases jail time; with charges again left to the discretion of prosecutors. This could include not only managers in office at the time of prosecution but those who had left the company but who were responsible for decisions at the time that they were made. To prove a manager to be guilty of corporate malfeasance, prosecutors would have to show that they were aware of the potential for harm when the decision was made. Where the malfeasant action has involved causing the injury or death of stakeholders, jail time may be comparable to that for assault, causing grievous bodily harm, manslaughter, or even murder. The principle is to make the punishment somewhat proportional to the harm caused by the crime.

4. Options to ensure that corporate malfeasance was not committed could be made available to Corporations. Corporations could pay to have regulatory bodies audit actions, and, provided that the information provided to such bodies could be shown to have been both complete and correct to the best of the corporation's ability, such audits could be used in defence of a corporate malfeasance prosecution – but would not necessarily preclude it. To prevent capture of the regulatory process, the funding of these regulatory bodies would need to be wholly independent of the number of, and payments received for, such audits. Similarly, Corporations could use the extent to which they informed stakeholders party to a transaction of potential risks – again completely and correctly to the best of the Corporation's ability – in defence of actions, thus increasing the incentive for Corporations to distribute information to consumers and employees. Friedman's condition of 'voluntary and informed' decisions – impossible in his world of unregulated markets and no direct accountability for the actions of companies – would be more often met given such an incentive.

5. In extreme cases where fines or prohibitions cast doubt on the solvency of the company, temporary or permanent nationalisation may be employed; such that the company would now be directed by the State. If temporary, later privatisation may be either complete or partial, in the latter case the state would retain some interest in the company. Unconditional 'bailouts' of such companies (as have been used in the recent subprime crisis) would not be
used.

6. The scale of crimes of corporate malfeasance, their potential ambiguity, and the separation of perpetrators from their victims, are mostly ill-suited to conventional avenues of investigation and prosecution. It is anticipated that a special body may be needed to conduct investigations, arrests and prosecutions. These may reduce the role of the current specialised regulatory bodies to perhaps research and the establishment of broad guidelines. Specialisation within the larger body (as in homicide, drugs or vice in the police force) may also be employed. Some of the costs of the body may be offset by fines to corporations.

7. I will leave the details of the law to those more specialised in law making; but have, I hope, made a case that a broad ranging law to hold corporations and their agents accountable is both feasible and necessary.

Estes (1996) has also proposed a ‘corporate accountability’ law. The focus here is on disclosure of important facets of production – not merely financial matters - to all stakeholders, through a corporate reporting system freely available to the public; and this would be required under such a law. While the position of this thesis is that this would be insufficient and be prone to arguments regarding competitive intelligence, in principle this does seem an appropriate complement to (but not replacement for) the above described ’corporate malfeasance’ law.

24.6 Restriction of Donations

Bernadette Budde (2003; cited in Moore, 2003b), senior vice president of the U.S.-based Business Industry Political Action Committee (BIPAC), gives a blunt answer when asked what her organisation does: “BIPAC elects business to congress”. Lobbying, through campaign funding; media propaganda; and production of industry-sponsored (and thus industry favourable) research, has created an influence for business in government akin to a partnership. Industry lobbying has fought regulation at every turn; and substantially delayed, prevented, and even rolled back regulation designed to protect the safety and wellbeing of consumers and workers; all in the name of preserving economic interests.

As discussed in the previous discussion of Class, the current system allowing large campaign donations undermines the very premise of a democratic system: that each person has an equal say in who will represent them in government. By allowing some to make campaign donations that most cannot afford, the system allows the influence of citizens in political discourse and debate, as well as their value to the political parties who will represent the people, to vary according to their wealth. As Schumpeter (1950/1976) has noted, what we call 'democracy' is essentially a system where parties are allowed free competition for government. But unlike in a market system, where an individual customer's value to the producer is dependent upon the money which they have to spend,
in theory our democratic system renders each customer's value to the government equal; such that the millionaire and the pauper should have an equal say in the government of their nation. However, the value of money to the persuasive needs of the Political Class undermines this process, reinforcing the inequality of say inherent in a market system in the democratic one – now the millionaire has something to offer the party more than their vote; and can make such an offer in proportions unavailable to most citizens. It is thus that Corporations, with their enormous concentration of resources, themselves not even citizens but merely legal constructions pooling the resources of citizens who have little direct say in their running, have made themselves inordinately valuable to the polity.

Furthermore, there seems no good reason to allow Corporations (or indeed any organisation) to make donations on behalf of that organisation. Interestingly, Friedman (1970; 2002) has objected to attempts to engage in Corporate Social Responsibility on the grounds that stockholders who wish to engage in Corporate Social Responsibility can do so with their own private share of the company's earnings; but makes no such assertion in regard to political donations, though it seems a substantially more pertinent point in the latter case (the former has been discussed earlier in this thesis). A Corporation, while at present in many ways a legal 'person', is not a citizen as such – only the people who constitute it are. How can it have political opinions, and as importantly, why, given that it is not a citizen, should it be allowed to express or push them? By allowing Corporations – with their enormous concentration of resources - to make such large donations, the system in effect allows legal construction that is not a citizen to become in some ways more valuable to the Political Class who govern the State than any number of the citizens who vote. This point is extended however, to other organisations – trade unions, environmental groups, lobby groups and the like; though Corporations are clearly the most powerful among these. Let the citizens which constitute them vote while the organisations garner no direct influence.

Following this, it seems reasonable to, in the first case, place severe limits on the amount that any individual can donate to a political campaign; and in the second, to place an outright prohibition on donations by organisations. The former limit should be set to a limit that the overwhelming majority of voting citizens would feasibly be able to give if they so chose (and only individual citizens eligible to vote would be allowed to make such donations). In Australia for instance, a one-time only donation of $100 might be set, or in countries such as the U.S. where the party nominee is also voted for more or less directly such an amount might be allowed for both the party primary and the presidential election. . The recent Obama campaign’s reliance on small donations has been described as being good for democracy – the position of this thesis to agree with such sentiments, but to also add that such an experience should be systematised – become the rule rather than an exceptional occurrence.
The latter limit should extend to organisations of all kinds, for the reasons alluded to earlier. Should organisations wish to exercise influence over government, the would be forced to do so either by force of argument, or through the direct votes and (limited) donations of their constituents; but not directly through funding. Of course, this does not negate completely the disproportional influence of large organisations. Their concentrated resources and economic power gives them a less direct influence over the Political Class an the State, through their importance to maintenance of employment and the like. But at least it would curb the more direct corrupting influences.

24.7 Managing Globalism.

Much as there have been some undeniable benefits from globalisation and free trade, the situation can undermine the ability of individual countries to regulate corporations, and create disadvantages for local companies under a regulated system who are forced to compete directly with companies and products produced in countries with a less regulated system. It would seem counterproductive, for instance, for a country to, on the one hand regulate its meat production in such a way as to make it both more humane and healthier & more sanitary; while at the same time allowing the importation of meat from countries with lower standards in this regard; or to regulate the use of pesticides in agriculture while importing fruits and vegetables from countries where use of these same pesticides is prevalent. This is not only at best an inconsistent protection of the Consumer, but it exposes local producers to an unfair form of competition. Further, some of the broader aims outlined above might create issues with capital flight if instituted unilaterally by any one country.

However, it is contended that a coordinated effort by, say, the largest four economies of the world could largely overcome these obstacles to regulation by instituting the following conditions:

- Any products sold in that country must have been produced in compliance with regulations set out by the importing country. Furthermore, a treaty must be signed in the producing country that the importing country may prosecute the producing company under its corporate malfeasance laws should any wrong doing be suspected of taking place.
- Citizens of the agreeing countries may only invest in companies incorporated under the above conditions of governance, or else face unlimited liability for any losses the company may incur.
- Any company operating in any of the agreeing countries must have been incorporated under the above conditions of governance, and similarly be liable for prosecution under the host country's corporate malfeasance laws.

It is contended that the importance and size of the markets of these large economies would be sufficient incentive for other countries – at least those incorporating multinational corporations - to follow suit. For them not to would simply cost them too great a market.
25 Further Considerations.

It is important to note that this thesis did not come initially from a desire to understand economics or economic theory, or to counter that *per se*. Economic theory – particularly Friedman's - was simply stumbled upon as a core reason for the ills in which I was most interested. Such theories legitimated the perpetration and governmental neglect of these ills. While they were always illegitimate in my own eyes, I perhaps somewhat naively believe that if these theories can as a whole be convincingly demonstrated – empirically and theoretically - to be fallacious, then the actions which they legitimize may become perceived as less legitimate by victims, perpetrators and intervening parties alike; and thus be reduced in number and severity. This thesis hopes to at least make some contribution to this.

Quite apart from the broad brush approach to history, there are many important related issues which have been given only passing attention in this thesis. For some of these, it has been because they do not directly serve to counter Friedman's theories. For instance, the alignment of corporate interests with physically coercive state intervention against poor indigenous populations and profiteering from the waging of (colonial?) war - which Banerjee (2008) labels 'necrocapitalism' – is at least *theoretically* something which Friedman and neoliberals should be opposed to (Friedman’s (2002) ideal society forbids coercion), though the perpetrators of *necrocapitalism* no doubt are likely to use an even more twisted version of the 'Invisible Hand' defence in conceiving of justification for their actions. In other cases, there have been issues about which the evidence was deemed too ambiguous as to be concluded upon. Free trade is one of these. In researching this thesis it was generally found that while there is a need for international regulation of such issues as the payment of a living wage and standards of safety for both workers and products, within this there does seem some case for free trade; and though I am not totally convinced on this point there is too much common ground with Friedman to have set about trying to counter him on this point.

With this in mind, however, the principal goals of this thesis seem well served by the above. By giving a relatively holistic picture of the problem, the 'Invisible Hand' is shown to be a powerful motivator but a poor regulator. In this way, the case is made for freeing managerial ethics from the constraints which Friedman's ideas put on them (though perhaps I am too uncritical of the individual greed of managers), and against stripping away the regulations which seemed so logical three decades ago.

Interestingly, a number of acquaintances have commented that many of the arguments made in the thesis are simply 'common sense', particularly in light of the financial crisis. Of course you can't avert crisis just by printing money, they might remark. Of course the government needs to step in
with regulation!

Unfortunately, many people, among them those with the most influence over the world’s resources, appeared to take leave of these intuitive sentiments, as they have in the past. Speaking of the Great Depression, Franklin Delano Roosevelt said in a 1937 speech:

“Old truths have been relearned, untruths have been unlearned. We have always known that heedless self-interest was bad morals; now we know it is bad economics. Out of the collapse of a prosperity whose builders boasted their practicality has come the conviction that in the long run economic morality pays” (quoted in Lux, 1990, p. 79)

Reflecting on the current times, it appears that there is a need to re-relearn those old truths, re-unlearn untruths, and to dismiss the boasts of practicality which Friedman and neoliberalism claim.
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