POLICY REPORT

Volume V Number 1 | A Publication of the Cato Institute | January 1983

Is Business "Administration"?

By William H. Peterson

M.B.A. Ticket to the executive suite. Evidence of managerial insight. Testimony to business acumen. And so, with business schools turning out some 55,000 M.B.A.s this year, up from 4,600 in 1960, presumably America's persistent economic trauma is at long last about to clear up. Beams Donald Jacobs, dean of Northwestern's Graduate School of Management: "The 70s and the 80s are the decades of management."[1]

But just what is business? What does the holder of a Master of Business Administration degree see as the quintessence of business? Presumably administration, or management. For, apart from his degree, most business schools are so named, with "administration" outpacing "management" as the more popular term.

Such is the case with prestigious private schools such as Harvard's Graduate School of Business Administration and distinguished state schools like the University of California-Berkeley Graduate School of Business Administration.[2] In Los Angeles there is the UCLA Graduate School of Management, and MIT has its Alfred P. Sloan School of Management. Yale one-ups other business schools with its new Graduate School of Organization and Management.

Yet does our business system just amount to matters of organization, management, and administration? This is not to say these matters are not crucial to the success of the enterprise, for they most certainly are. Yet the fact is that these terms still seem to connote rather routine processes and professional competencies — skills and know-how like accounting, business law, computer programming, organizational planning, and statistical analysis.

Apparently these skills — again, as valuable as they are — are just as applicable to the public sector. Quite a few schools (e.g., Cornell, Howard, Florida Atlantic, Washington University in St. Louis, and City University of New York) declare themselves to be schools of "business and public administration." The juxtaposition is somewhat oxymoronic. The implication is that *all* business and managerial principles and problems are pretty much indistinguishable from one sector to the other. But are they?

"The persistent lack of entrepreneurship as a curriculum discipline helps explain why M.B.A.s are coming under a wave of criticism."

Certainly there is a world of difference between government and business. Government, while necessary, is basically static, monopolistic, and consumptive of wealth as opposed to productive; providing law and order and enforcing its orders by command. Indeed, consumptive: More than half of Uncle Sam's vast, deficit-ridden budget goes for entitlements — direct transfers or redistribution of wealth in contrast to business's creation of wealth.[3]

In addition, as Mises demonstrated in his *Bureaucracy,* government inherently is denied the rule of profit and loss and so has no built-in drive for constructive innovation or cost reduction/recouping.[4] In fact, government, with its bureaucratic underpinnings and innate Parkinsonian propensities, has a drive in reverse — to expand the size of the bureaucracy and hence, costs and inefficiencies.[5]

Business, in contrast to government, is dynamic, competitive, synergistic, literally wealth-creating; furnishing employment, goods, and services on a strictly voluntary basis. Too, business, with its profit-and-loss rule, is propelled toward efficiency, toward responding to supply-and-demand price signals. Accordingly, in the world of commerce, consumer sovereignty is the rule of the game — as witness Dun & Bradstreet's business mortality tables and the demise of Braniff Airlines, Revere Copper and Brass, Robert Hall, American Woolen, W. T. Grant, and American Locomotive.[6] But no such rule of consumer sovereignty holds with, say, the draft, the IRS, the post office, or social security.

The spirit of business seems to be captured in the idea of "free enterprise" — a phrase unknown to classical economists like Adam Smith and John Stuart Mill and said to be coined by some now-forgotten public relations writer for the National Association of Manufacturers early in the century. Later on, President Calvin Coolidge caught the same spirit in his observation that "the business of America is business."[7]

The Entrepreneur

But Jean-Baptiste Say, the 19th-century father of today's supply-side eco-

(Cont. on p. 3)

William H. Peterson is the director of the Center for Economic Education and the Scott L. Probasco Jr. Professor of Free Enterprise at the University of Tennessee at Chattanooga.

Real Reform for Social Security

At long last politicians of both parties are admitting that something is fundamentally wrong with the social security system. As recently as the 1980 election, after the system's trustees had warned that social security would run out of money during this presidential term, both President Carter and candidate Ronald Reagan insisted that the system was fundamentally sound.

Experts from across the political spectrum, after years of ignoring those who warned of the system's inherent flaws, now portray the approaching crisis in stark — and altogether accurate — terms. Former Secretary of Commerce Peter G. Peterson writes, "To put the matter bluntly, Social Security is heading for a crash." Congressional Budget Office Director Alice Rivlin has warned that a day of reckoning might come within the next six months. Peter Germanis of the Heritage Foundation sees the possibility of "the most devastating bankruptcy in history." James R. Capra, Peter D. Skaperdas, and Roger M. Kubarych of the Federal Reserve Bank of New York sum up the basic flaw simply: "A system that on average provides benefits with a value in excess of contributions cannot sustain itself indefinitely."

Social security has been a good deal for those already retired or near retirement, but it cannot be a bargain for today's young workers. Benefits have soared well beyond the taxes that pay them. A married worker retiring today will recover his lifetime contribution, including both the employee and employer portions *and* accumulated interest, in only about four years, while he or his spouse will likely live for 25 years after retirement.

With taxes continuing to increase, however, no young worker can expect to recover *his* full lifetime contribution. The tax rate for the full OASDHI program is now 6.7 percent for both employee and employer, and both halves in fact come out of the employee's paycheck because both represent the cost of labor to the employer. The maximum tax is now $4,783.80 a year, and it could well reach $10,000 by 1990 with scheduled tax increases and inflation.

That bone-crushing level of taxation may well prove more than young workers are willing to pay, especially since a *Washington Post*-ABC News poll found that 66 percent of Americans under 45 believe social security will have disappeared before they retire. For people between 18 and 30, the figure was 74 percent.

The proposed solutions to the problem are characteristically timid. Everyone's answer seems to involve even more tax increases, reduction of the planned increases in future benefits, and bringing more people (government and nonprofit employees) into the system. Federal employees — the largest group of workers currently outside the system — would pay taxes immediately but wouldn't collect benefits in significant numbers for some time. When they do begin to retire, however, we'll be back in the same bind. The economy is already staggering under the weight of heavy taxation; higher taxes are the last thing we need. In addition, higher taxes combined with future benefit slowdowns will only compound the system's bias in favor of current retirees over future retirees.

What we should be looking for is a permanent way out of this mess. Fortunately, such a plan exists and is gathering support. In 1980 the Cato Institute published Peter Ferrara's monumental study, *Social Security: The Inherent Contradiction*. In that book and in a 1982 monograph, *Social Security: Averting the Crisis*, Ferrara argued that the insurance and welfare aspects of social security should be separated and the insurance program privatized. He suggested that workers under 40 withdraw from the system. Instead, they could put up to the full amount of their social security taxes into private, tax-free retirement accounts (IRAs). A private, invested system would offer them a better return than social security. Current and near-retirees would be guaranteed their expected benefits out of general revenues, requiring cuts in other government spending. Not only would this program ultimately remove government from the retirement business, the new investments it would generate would pump hundreds of billions of dollars into our capital-starved economy.

As the social security crisis approaches, more and more people are studying Ferrara's proposal. The Heritage Foundation has published favorable analyses. The National Taxpayers Legal Fund has begun a grassroots campaign to win approval of the program under the name "Future Security Plan." Columnist James J. Kilpatrick calls it a "sound, wise, feasible" plan. The *Washington Times* editorially endorsed a variant. Even Senators-elect Pete Wilson (R.-Calif.) and Frank Lautenberg (D-N.J.) and Democratic presidential contender John Glenn have suggested considering such options for young people.

It is time for a fundamental reform of the social security system. The Ferrara plan offers the most feasible avenue away from the crisis. ■

"Administration"? (Cont. from p. 1)

nomics, made, I believe, a better contribution to understanding the nature of business. Say added a fourth, if frequently overlooked, factor of production to the classical triad of land, labor, and capital — namely, the entrepreneur: the searcher, discoverer, and coordinator of profit potentials; that highly creative fellow who continuously seeks out business opportunities and accordingly combines the other factors of production into a fresh, profit-optimizing arrangement in an ever-uncertain and dynamic world.[8]

I refer to that rather unappreciated human catalyst who mightily and indispensably helps create the goods, growth, and jobs we so urgently need. Let me put this proposition even more boldly: The entrepreneur is the personification of Adam Smith's "Invisible Hand," and however inadvertently, he greatly helped create and sustain Western civilization.

Hence, entrepreneurship, or rather its persistent lack as a curriculum discipline, helps explain why M.B.A.s are coming under a wave of criticism. Witness for example, *Business Week*'s detection of "disenchantment" with the product of the business schools. It reported employers' complaints over "the inability of newly minted M.B.A.s to communicate, their overreliance on mathematical techniques of management and. . . expectations of becoming chairman in four weeks."[9] Or witness *Time*'s recent M.B.A. cover-story assertion that "business school solutions may be part of the U.S. problem."[10] But neither *Business Week*, nor *Time*, nor other business school critics seem to point up what I consider the key problem: business schools' long-sustained relative nontreatment of the entrepreneur.

A notable exception is William E. May, until recently chairman of American Can and now dean of New York University's Graduate School of Business Administration. He calls for a lot more entrepreneurial training in M.B.A. programs. One of the relatively few other schools that appears to make a *big* thing out of entrepreneurship is the University of Virginia in Charlottesville, which has established a lively Center for Entrepreneurship. Another is Baylor University in Waco, Tex., which has set up a Center for Private Enterprise and Entrepreneurship. One more is Babson College in Wellesley, Mass., which has established an Academy of Distinguished Entrepreneurs and has already brought to its lecture platform such hands-on entrepreneurs as Ray Kroc, chairman of MacDonald's; Soichiro Honda, founder of Honda Motor; and Royal Little, former chairman of Textron.

Indeed, entrepreneurship just now may be catching on as course, study, or research material. At latest count, some 150 business schools, out of some 1,300 in the U.S. and Canada, are at least paying lip service to entrepreneurship.[11] But it is still not clear that this key essence of business is fully understood by all concerned, as evidenced in part by the very names of the business schools and their degrees.

Moreover, as will be explained later, it is not clear that administrations of these schools fully understand the political implications of modern entrepreneurship — that the heavy hand of inflation, taxation, regulation, and bureaucracy of the welfare state necessarily represses, frustrates, poisons, and may ultimately destroy entrepreneurship and its concomitant of capital formation, and that, indeed, it is this situation which really explains the core of our current economic plight.

Thus, I think business school administrations might well study — and implement — the work of two 20th-century scholars who have extended Say's pioneering work on entrepreneurship and pointed up its indispensability and political environment in a modern market society: Schumpeter and Kirzner.

Joseph Schumpeter (1883–1950), who held that the success of capitalism generally, if inadvertently, breeds socialism, noted how the entrepreneur neither

(Cont. on p. 4)

In This Issue

Is Business "Administration"? 1
Editorial:
Real Reform for Social Security 2
Is This What They Call a Debate? 5
Policy Forum:
The State Against Blacks 6
Policy Report Reviews:
Concentration, Mergers, and Public Policy 10
Registration and the Draft 10
Policies for Coping with Oil-Supply Disruptions 11
"To be governed . . ." 12

POLICY REPORT
ISSN: 0190-325X

Published by the Cato Institute, *Policy Report* is a monthly review that provides in-depth evaluations of public policies and discusses appropriate solutions to current economic problems.

David Boaz .... Editor
Tyler Cowen,
Daniel Klein .... Contributors

EDITORIAL BOARD

Yale Brozen ...... University of Chicago
Karl Brunner .... University of Rochester
Friedrich A. Hayek .... University of Freiburg
Israel M. Kirzner . . . New York University
Gerald P. O'Driscoll, Jr....... New York University
Edwin G. West...... Carleton University
Leland B. Yeager .... University of Virginia

Subscriptions and correspondence should be addressed to: *Policy Report*, 224 Second Street SE, Washington, D.C. 20003. The annual subscription rate is $15.00 (12 issues). Single issues are $2.00 per copy. *Policy Report* is published monthly by the Cato Institute, 224 Second Street, SE, Washington, D.C. 20003. Second-class postage paid at Washington, D.C.

Copyright ©1983 by the Cato Institute

"Administration"? (Cont. from p. 3)

invents nor creates the particular supply-and-demand conditions which the enterprise exploits.[12] In his book, *The Theory of Economic Development* (Harvard University Press, 1934), Schumpeter also noted the widespread confusion between the terms "entrepreneur" and "capitalist."[13] The entrepreneur is an initiator and something of a pioneer, he clarified; the capitalist, a lender or investor. He held that the entrepreneur's job is to recognize profit opportunities, to spot unmet or imperfectly met consumer needs, to "lead" the factors of production into new channels, new combinations, new technologies, or new organizational structures. Indeed, Schumpeter equated entrepreneurship with leadership and leadership with innovation.

Israel Kirzner, professor of economics at New York University, student of Ludwig von Mises, and profound believer in the concept of consumer sovereignty, has put out two important scholarly works on the entrepreneurial function — *Competition and Entrepreneurship* and *Perception, Opportunity and Profit* (University of Chicago Press, 1973 and 1979, respectively). While hailing Schumpeter's brilliant contributions, Kirzner takes him to task for arguing that entrepreneurship is nonetheless something of a destabilizing element in a market economy.[14] Rather, says Kirzner, the role of the entrepreneur is a stabilizing and equilibrating one, ever bringing human needs and scarce resources, including new technology, into closer proximity.

Kirzner, clearly the leader of the American wing of the Austrian school of economics, argues that entrepreneurship is a unique knowledge-discovering ability. The entrepreneur discovers or seeks to discover profit possibilities in price differentials, in missing links in the ever-shifting networks of existing production, marketing, and finance, in the changing tasks and wants among consumers. These profit possibilities exist in the perpetual state of disequilibrium that holds in the marketplace — notwithstanding all those neat but static open-scissors supply-and-demand diagrams in modern economics textbooks showing an equilibrium point where the supply curve crosses the demand curve. Kirzner wonders about all this play on equilibrium in the face of marketplace dynamics and writes:

> [D]isequilibrium occurs precisely because market participants do not know what the market-clearing price is. In disequilibrium 'the' quantity is not generally known nor is the highest (lowest) price at which this quantity can be sold (coaxed from suppliers) . . . . From the Austrian perspective, which emphasizes the role of knowledge and expectations, these explanations [of equilibrium] take too much for granted. What is needed is a theory of the market process that takes explicit notice of the way systematic changes in the information and expectations upon which market participants act lead them in the direction of the postulated equilibrium solution.[15]

"The role of the entrepreneur is a stabilizing and equilibrating one, bringing human needs and scarce resources into closer proximity."

The needed theory to such a solution sees market action as an ongoing process. It sees a vital, if much-neglected (in and out of business schools) equilibrating role in entrepreneurship. Kirzner writes:

> Entrepreneurial knowledge is a rarefied, abstract type of knowledge — the knowledge of where to obtain information (or other resources) and how to deploy it. This entrepreneurial alertness is crucial to the market process. Disequilibrium represents a situation of widespread market ignorance. This ignorance is responsible for the emergence of profitable opportunities. Entrepreneurial alertness exploits these opportunities when others pass them by.[16]

Who Are the Captains of Industry?

Are entrepreneurs, then, "the captains of industry" — to resort to the frequent jargon of business schools and the media? Not really. Kirzner takes a cue from his teacher, Ludwig von Mises, and notes how consumers literally direct entrepreneurs — if within the democracy of the market — to do their bidding. As Mises himself put it:

> The direction of all economic affairs is in the market society a task of the entrepreneurs. Theirs is the control of production. They are at the helm and steer the ship. A superficial observer would believe that they are supreme. But they are not. They are bound to obey unconditionally the captain's orders. The captain is the consumer. Neither the entrepreneurs nor the farmers nor the capitalists determine what has to be produced. The consumers do that. If a businessman does not strictly obey the orders of the public as they are conveyed to him by the structure of market prices, he suffers losses, he goes bankrupt, and is thus removed from his eminent position at the helm. Other men who did better in satisfying the demands of the consumers replace him.[17]

How does government fit into this entrepreneurial picture? Vitally. It furnishes law and order, defines and protects property rights, and seeks to preserve the sanctity of contracts — without any of which the market system would sink out of sight But as Mises noted, government can and, especially in the 20th century, does get out of hand. He called the operation "interventionism."[18] He argued that every government intervention into peaceful private activity tends to make things worse rather than better; in particular, every government interventionistic constraint

(Cont. on p. 9)

Is This What They Call a Debate?

by David Boaz

People around the country no doubt think it must be exciting to live in Washington. After all, every day the network news and the morning paper are full of the latest heated debates in Congress or between the President and congressional democrats.

Well, it ain't necessarily so. Increasingly, there is no real debate in Washington. There is heated rhetoric, true. There is the illusion of fundamental arguments. The Democrats charge the President with "balancing the budget on the backs of the poor and helpless," while President Reagan promises to reject the Democratic policy of "tax and spend, spend and elect."

But there is remarkably little real difference over issues. The drive toward rapid expansion of the role of the federal government that was so powerful in the 1960s slowed down in the 1970s, and few members of Congress today propose any major new government programs. Unfortunately, however, Democrats and Republicans have set in motion government programs that seem to grow on their own, so the size of government increases without any new legislative proposals.

Consider last year's major debate over the federal budget. The budget in recent years has become not only the most important element of economic policy under congressional control but also a vehicle for setting general government priorities and policies. Programs to deal with defense, housing, social security, unemployment, and other problems must be included as part of the budget resolution. The process of passing that budget resolution has become the arena where such programs are discussed, so it takes on an importance beyond even economic policy.

David Boaz is vice president for public policy affairs at the Cato Institute.

From the television and newspaper reports, one would have thought that a titanic struggle over the direction of the budget was occurring on Capitol Hill. That just wasn't the case. It's true that various interest groups were fighting to get their piece of the pie, though even that struggle was less than it might have appeared. But from the taxpayer's point of view, there was almost no difference in all the budget plans debated.

Early in the year President Reagan submitted a 1983 budget that he said would result in outlays of $758 billion and a deficit of $92 billion. The Congressional Budget Office (CBO), charging the administration with over-optimistic economic and budget assumptions, priced it at $786 billion with a $132 billion deficit. Almost no member of Congress wanted to support a deficit of that size (the size of the *spending* was apparently of little concern), and the President's budget was almost instantaneously forgotten as Congress moved to write its own budget.

By late May there were several proposals on the table. According to CBO, they stacked up like this: The Senate bill proposed to spend $784 billion; House moderates offered $779 billion; and those defenders of free enterprise and limited government, the House conservatives, proposed an austerity budget of $776 billion. *The titanic struggle that ensued was over a difference of one percent of the federal budget.*

The budget resolution as finally passed in late June called for fiscal 1983 outlays of $770 billion, actually ending up lower than all of the earlier proposals because of a different set of economic assumptions. The resolution itself projected a deficit of $104 billion, though the administration now says it will probably be $114 billion, and CBO projects about $150 billion. The point here is how close all sides were — 1 or 2 percent — despite the news reports of tremendous battles.

And it would be a mistake to argue that the differences over the makeup of the budget were significant even if the total level was less controversial. Military spending gives us one good example of the difference between liberal and conservative approaches in specific areas. President Reagan's budget calls for increasing the military budget 8 percent a year after inflation over the next five years. The liberal Brookings Institution, in its annual book on the budget, *Setting National Priorities,* warns of the dangers in such a buildup and calls instead for increases of 6.5 percent a year. Apparently the entire establishment debate is over the last 1.5 percent of increased military spending.

If that doesn't illustrate the fundamental agreement on Capitol Hill, last fall we saw the Republican Senate pass the largest peacetime tax increase in American history, including in their bill some of the tax "reforms" (read: increases) that the Democrats have supported for a decade. Such stalwart conservatives as Jesse Helms, Bill Roth, and Steve Symms voted for the bill on first passage. Meanwhile, the Democratic House decided to accept the bill without amendment so they could avoid the political fallout from raising taxes during a recession in an election year.

In short, there's not much room for fundamental arguments in Washington today. The great debates of the past — over the national bank, free trade, the New Deal, even Vietnam and civil rights — let the country hear two sides of a crucial issue. Today politicians duck crucial issues like the imminent bankruptcy of social security and have no real disagreements on the continuing growth of government and our expensive and dangerous foreign policy. ■

The State Against Blacks

Every month the Cato Institute sponsors a Policy Forum at its Washington headquarters, where distinguished analysts present their findings to an audience drawn from government, the public policy community, and the media. A recent Forum featured Walter Williams, professor of economics at George Mason University and author of The State Against Blacks *(McGraw-Hill and the Manhattan Institute, 1982). Commenting on Williams' talk was Margaret Simms, director of the Minorities and Social Policy Program at the Urban Institute.*

Walter Williams: Essentially, the working hypothesis of *The State Against Blacks* is that, contrary to conventional wisdom, racial discrimination, per se, is an inadequate explanation of the problems that blacks face in the United States. To attempt to explain the problems of blacks in terms of racial discrimination is very similar to attempting to explain the Grand Hotel fire in Las Vegas by saying that it was caused by oxygen. I might say that had there not been oxygen there, there wouldn't have been a fire. The problem is that oxygen just does not explain why the Hilton in Washington did not also burn down because it was surrounded by oxygen as well. Oxygen is so pervasive that you can't explain very much by it. Similarly, discrimination of all kinds is so pervasive that it alone just does not allow you to explain anything. For example, if discrimination could explain anything, you'd have to find out why Chinese, although they're 3% of the population of Southeast Asia and they have faced mass expulsion and massacres over the years, nevertheless produce 60% of the GNP in some Asian countries; or why the Armenians in the post-Ottoman empire similarly controlled wealth way out of proportion to their numbers. The Japanese in America are highly identifiable; they were discriminated against — they weren't allowed to own land and they weren't guaranteed constitutional rights back in the late 1800s and early 1900s and eventually they were interned — but according to the 1980 census, the Japanese have the highest per capita income in the United States. Or if discrimination can explain anything, surely Jews would not be where they are, because they have faced centuries of discrimination. Second-generation West Indian blacks earn more than the average white in our country, and first-generation West Indians earn just slightly less than median income.

Discrimination, in and of itself, does not explain anything. It's very important for policy reasons to identify correctly causal factors when we look at problems, because if we don't, then it's not likely that we're going to come up with compassionate policies to help those people whom we say we want to help.

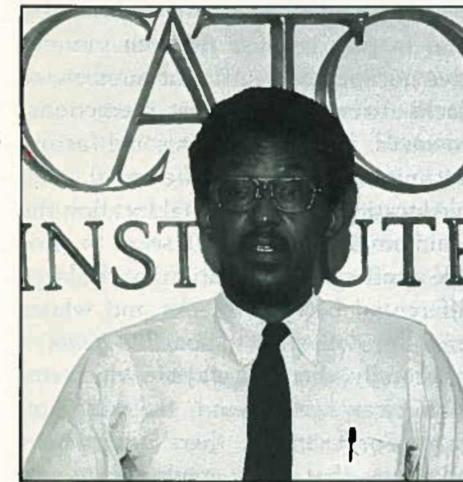
A Cato Institute Policy Forum

Consider the word "prejudice," for example. I look at prejudice the way an economist would. Prejudice, going back to its Latin derivative, means to prejudge. An economist can understand pre-judging as making decisions on the basis of incomplete information, or stereotyping. This occurs because information is very costly and people will act so as to economize on information costs. Now, some of you might say, well, you shouldn't stereotype or you shouldn't be prejudiced. But suppose after our meeting today, you were walking down the steps outside and you saw a full-grown tiger standing there, what would you do? Most people would endeavor to leave the area in great dispatch. But why do you leave? Is your action based on any detailed information that you have about that particular tiger or is your decision based on tiger folklore? Probably your decision would be based on the latter; that is, you would stereotype that tiger. Now, of course, you could seek additional information before you run; you could attempt to find out if that tiger was friendly and then, only then, run. But most people make the quick calculation that the expected cost of an additional unit of information about that tiger is greater than they expect to benefit through additional searching.

That way of giving an operational definition to prejudice or stereotyping can convey to us some other things about the operation of the real world. A company, for example, looking for a high school graduate for on-the-job training in physics, may be looking for a person who would score about 700 on the SAT. Now, if that company has to pay $1,000 or $2,000 per candidate, it's probably not going to search at an all-black high school in north Philadelphia, say, where I went. Why? Because his expected probability of finding successful candidates may be very low. So he just won't send his recruiters there to the extent that it costs them for their search. So if you describe his behavior as simply a dislike of blacks, when it's really a result of his playing the probability game, then you're likely to misidentify his behavior.

Maybe prejudice, the way I describe it, can explain why some lenders may decide not to lend money to blacks at the same terms that they lend it to whites. If the lender is playing the probabilities, he knows that blacks on the average would be higher credit risks. Why? Because credit default probability is associated with higher unemployment levels, greater residential mobility, and lower income. Blacks, if they indeed face higher unemployment rates and greater job instability, would then be worse credit risks *on average*. This kind of behavior by creditors does not differ that much from behavior by automobile insurance companies. That is, automobile insurance companies either will not extend an insurance policy to someone under 25 years old or, if they do, they'll charge him a higher rate. You cannot explain the behavior by saying that the executives of the insurance company do not like people under 25 years old. They have looked at probability charts and found that those under 25 have a higher probability of an accident, and so they make their insurance policies accordingly.

Basically I'm advancing the hypothesis in the book that racial discrimination in and of itself just does not explain as much as we say it explains. What explains more are the various "rules" of the game, numerous economic laws and regulations that we have in our country. One chapter focuses on the licensing of taxi cabs. I chose to look at taxi cabs because owning and operating a taxi cab is an activity where you don't need a college education — you don't even need an elementary school education — and you don't need a lot of money. So how come it's not a more open area for blacks and other poor people to move up the economic ladder? Well, it turns out that in New York City in order to own and operate one taxi, you need to buy a license that costs $50,000; in Chicago, it's $40,000; in Miami, $35,000. We're not asking what is the intention behind the law that generates that kind of license, but what is the effect? The effect is obvious. If you have a law that generates a $50,000 license price in order to own and operate one taxi, it's going to tend to discriminate against those getting in the cab business who don't have $50,000. In Philadelphia, no more than 2 or 3% of the taxis are owned by blacks in a city whose black population is almost 50%. In Washington, D.C., roughly 75% of the taxi licenses are owned by blacks. Now, if you go to the discrimination hypothesis, or the racism hypothesis, people would say blacks enjoy a greater opportunity in the cab business in Washington because Philadelphia is racist and Washington is not. But that hypothesis would not explain it. It turns out that in Washington you can own and operate a taxi for fees that total much less than $200. Washington has a relatively open market in the cab business.



Walter Williams

Another issue I discuss in the book is the minimum wage law. The minimum wage law is a significant contributor to the high rate of black teenage unemployment. Right now black teenage unemployment is around 50% and much higher than white teenage unemployment. But at one time, black teenage unemployment was *less* than that of white teenage unemployment. With each increase in the minimum wage and with the extension of coverage of the minimum wage, black teenage unemployment rose relative to white teenage unemployment. Many people support the minimum wage law because they have good intentions, but in South Africa the major supporters of the minimum wage law for blacks and equal-pay-for-equal-work laws are white, racist labor unions who would never have a black as a member of their union. Their stated purpose behind their support for the minimum wage law is to protect white workers from low-wage, low-skilled black workers. In the United States our stated intentions are a little bit more benevolent than that, but in both places the effects are the same: unemployment for the least skilled workers.

In another chapter, I ask what the meaning is of differences in income. As proof of the continuance of racial discrimination in the United States, many cite the fact that blacks, even when they graduate from college, make less than whites. Black male professionals or college graduates make 74% of the income of their white counterparts. Before I would subscribe to the conspiracy hypothesis, I asked, what about black and white females? I discovered the best-kept secret since the Manhattan project: Black female college graduates and professionals earn an income that's 125% of the median income of their white counterparts. Of the 26 occupational groups in the census that I looked at, black and white females are virtually identically distributed across the various occupations; that is, they're very similar in their distribution across the professional occupations, but black and white males are very dissimilar. The highest category for black male professionals is nonuniversity teachers. The highest category for white male professionals is engineers. In 1970 the median income of engineers was $14,000 compared to around $8,000 for male nonuniversity teachers. So the significant differences in occupations suggest that even if everybody were paid the same wage for the same position, you'd find significant differences based on the selection of the professional category. But you don't find those occupational differences with females, and I didn't come up with an

Margaret Simms

(Cont. on p. 8)

Policy Forum (Cont. from p. 7)

adequate explanation to explain why black females earn more than white females at the median. One possibility is that blacks as a group are more urbanized than whites. Roughly 44% of both black and white professional women are nonuniversity teachers and something like are 19% nurses. Nurses and school teachers earn more money in urban areas than in rural areas. And so the geographic distribution may explain some of it, just as Mexican-Americans who live in Chicago have a higher median income than Mexican-Americans who live in Arizona.

My policy recommendations seem to be simple, at least from an economist's point of view. In the 1930s the Supreme Court decided that it would not sit in judgment on the regulation of economic activity by the states. It switched from substantive due process interpretation of the 5th and 14th amendments to procedural due process. They will let the states regulate anything so long as the regulation does not appear to be capricious, discriminatory, and arbitrary. The states can very easily meet those conditions. The policy recommendations, then, must involve antitrust proceedings; that is, a courageous president could get the Justice Department Antitrust Division to start cracking down on these various state policies that give rise to market restrictions and monopolies. Then there are tools that the FTC can use. And finally, there is just the lawlessness on the part of people who are locked out of the system. In New York City, there are 11,787 legal cabs. However, it is estimated that there are 5,000 to 14,000 illegal cabs — gypsy cabs. I support that kind of lawlessness. These people are going out earning an honest, albeit illegal, living. They are protesting the state acting on behalf of powerful interest groups as do the ICC, the PUC, and other government agencies.

Margaret Simms: In his book [*The State Against Blacks*] Walter writes, "Racial bigotry and discrimination is neither a complete, nor satisfactory explanation for the current condition of many blacks in America." The problem with this statement is that it leaves the impression that discrimination plays little or no role. Moreover, what is not addressed is what, if anything, is the proper role of government in redressing whatever problems blacks do have, either as the result of discrimination or of other factors.

Walter discusses the issue that economists refer to as statistical discrimination. He discusses how employers or mortgage lenders might discriminate — differentiate — among candidates based on a probable correlation between some physical attribute and the attributes that are really of interest to the employer or the lender. Such discrimination might lead them to choose not to employ, or not to lend to, blacks. As he indicated, there is a correlation between race and education. There is a correlation, to some extent, between residential location and loan repayment. Now, there may be a statistical correlation, but in any given instance, an employer or a potential lender can be wrong. It seems to me, then, that the issue is whether or not one should raise the cost of not getting more information. As Walter says, the reason for engaging in this behavior is not discrimination, but the fact that information is costly. So the question is, how or should you change the balance between the cost of getting information and the cost of not getting information?

J.A. Parker of the Lincoln Institute makes a point at Cato Policy Forum.

The other area in which I would like to make some rather extensive comments concerns the minimum wage and its effect on minority groups' unemployment. The argument that Walter puts forth is that the minimum wage has increased both in level and in coverage and that black youth unemployment has gone up. Therefore, there is a connection between the two. The weight of research indicates that this may not be the cause of minority youth unemployment. Studies that have been done on the disemployment effects of the minimum wage generally show some reduction in probable employment of 1% to 3% for every 10% increase in the minimum wage. However, there's very little reliable information on how that differs by race, in part because research samples have not included sufficient numbers of blacks to make reliable predictions. However, if you consider some factors that might explain the differential, such as education and residential location the minimum wage does not seem to provide a sufficient explanation for the large differential between blacks and whites nor its growth over the past 25 years.

Secondly, there are ways in which employers can "get around" the minimum wage. For example, there are student reductions that allow employers to pay students less than the minimum wage for part-time employment, but they have not been used extensively.

In some cases Walter just didn't provide enough information to tell whether he could really prove what he was asserting from the information that was available. For example, he presents a table which shows the minimum wage increasing by year and the labor force participation ratio of black and white males. I find that very unconvincing in terms of establishing a causal relationship between increases in the minimum wage and black youth unemployment. It seems to me, at a minimum, the more appropriate table would either be a ratio of unemployment rates or a ratio of employment to population. That would tell more than labor force participation rates, although it still would not prove that changes in the minimum age are the cause of high unemployment among black youth.

In addition to the minimum wage argument, there is an assumption that is implicit but never explicitly addressed. Throughout there is the assumption that the demand for labor is solely a function of the price of labor and does not take account of any other considerations, such as the price of the product, whether or not the employer is operating in a perfectly competitive market or a monopolistic market, whether the employer might have other objectives besides just profit maximization, and so on. That means that to some extent this argument is incomplete because what one has to assume in order for some of these arguments to be valid is that if the price of labor goes down, employers will increase the total employment. Therefore those people who are at the end of the line will be picked up as employment increases, and that in the end, if we lower wages enough, we'll have full employment.

Walter Williams: If a person has a disadvantage, how can you handicap him the most? Well, if I were in charge of handicapping a disadvantaged person, the kinds of things that I would propose are laws that fix wages or make it difficult to fire somebody once you hire them. Consider a new supermarket that opens up in your neighborhood. It must win your loyalty from the store where you now shop. How does it get you to come in and try it out? Well, the most effective way they find is to have sales — lower their prices. If you did not allow them to lower their prices, then they would be further handicapped.

As for the minimum wage law and black youth unemployment, eminent economists such as Jacob Mincer, Finis Welch, George Stigler, Milton Friedman, and a number of others show that the overall burden of the minimum wage law is borne by black youths. And economic theory would predict that the most disadvantaged person would bear the greatest burden of the minimum wage law.

Just one final thing: Government, in my opinion, has no role in determining what is fair or unjust, except in the context of involuntary exchange. Very often the role that government does choose to play in the issues of settling what's fair and what's unfair just serves to reinforce the handicaps of the disadvantaged person. Let me just give you an example: If you see a fat, old, ugly, cigar-smoking man married to a beautiful young lady, what kind of a prediction would you make about the man's income? Well, you kind of guess that it is high. So what is he doing? He's saying to the beautiful young lady that I can't compete for your hand on the basis of looks, so I'm going to offset my non-pecuniary disadvantages by offering a higher price or by giving you a higher standard of living. Some people might say that it is unfair for beautiful young ladies to treat fat, old, cigar-smoking men any differently than they do handsome men, and that government ought to play a role here. They might want to make an equal-price law. They might say that beautiful young ladies can't "charge higher prices" to old fat men. After you make that law, then what happens to the probability of a fat, old, ugly, cigar-smoking man marrying a beautiful young lady? It goes down to virtually zero. The people will see that fat, ugly, cigar-smoking men cannot marry beautiful young women. But instead of eliminating the equal-price law, they enact a quota program. ■

"Administration"? (Cont. from p. 4)

(i.e., almost every "regulation") on entrepreneurship tends to repress actual and potential entrepreneurs and set back the market process and consumer sovereignty.[19] It follows that unhampered entrepreneurship, i.e., deregulation and indeed the withdrawal of the welfare state, spells in large measure not only the survival of free enterprise but the West itself.

Back to the M.B.A. phenomenon and the title question: Is business "administration"? Business, in essence, is dynamic enterprise — entrepreneurship in action. So maybe the M.B.A. degree should give way to M.B.E. — Master of Business Entrepreneurship or perhaps Master of Business Enterprise. Why not? ■

[1] *Time*, May 4, 1981, p. 58.

[2] Emphasis added.

[3] At an annual rate, entitlements (including grants-in-aid to states and localities and net subsidies to farmers and others) came to $410.4 billion out of total federal expenditures of $736.6 billion, or 56%, in the second quarter of 1982. See *Economic Indicators* (Washington, D.C.: Government Printing Office, September 1982), p. 34.

[4] Ludwig von Mises, *Bureaucracy* (New Haven, Conn.: Yale University Press, 1944), p. 1ff.

[5] Ibid., p. 40ff.

[6] To be sure, business mortality causation is also partly cyclical in nature, although here I emphasize the normal frictional attrition of firms in the competitive struggle.

[7] Address before the Society of American Newspaper Editors, January 17, 1925. I heard a prominent business school dean criticize Coolidge for this statement but I do not believe the dean understood what Coolidge really meant.

[8] *Cf.* Lewis H. Haney, *History of Economic Thought*, 4th ed. (New York: Macmillan Co., 1949), p. 356. Say may not have been the first to delineate the role of the entrepreneur but he certainly emphasized and popularized the concept, giving it a permanent place in economic literature.

[9] *Business Week*, November 10, 1980, p. 46.

[10] *Time*, p. 58.

[11] *Cf.* Calvin A. Kent, Donald L. Sexton and Karl H. Vesper, *Encyclopedia of Entrepreneurship* (Englewood Cliffs, N.J.: Prentice Hall, 1982), p. xxxii.

[12] The point about Schumpeter's theory that successful capitalism waxes under political democracy into socialism is the theme of the book, *Capitalism, Socialism, and Democracy* (New York: Harper & Row, 1950).

[13] His distinction between the entrepreneur and the capitalist can be found in his *The Theory of Economic Development* (Cambridge, Mass.: Harvard University Press, 1934), pp. 170–183.

[14] *Perception, Opportunity and Profit* (Chicago: University of Chicago Press, 1979), p. 115.

[15] Ibid., p. 5.

[16] Ibid., p. 8.

[17] Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, 1966), pp. 269–270.

[18] Ibid., p. 716ff. Mises held that interventionism frequently springs from an "anti-capitalistic mentality." *Cf.* his *The Anti-Capitalistic Mentality* (Princeton, N.J.: D. Von Nostrand, 1956).

[19] *Human Action*, esp. p. 764.

Policy Report Reviews

An Assault on the Idea of Monopoly

Concentration, Mergers, and Public Policy, *by Yale Brozen. MacMillan Publishing for Studies of the Modern Corporation Program of Columbia University, New York, 1982. 427 pp.*

Since the 1930s it has been accepted doctrine in Washington (and at Harvard) that the growth of big business in America has been synonymous with increasing monopoly power in the economy, and that government policy should attempt to halt or reverse industrial "concentration." The early work of Berle and Means (*The Modern Corporation and Private Property,* 1932) laid the foundation for the hypothesis that business concentration generates monopoly power, and many of the empirical investigations in the 1950s and 1960s seemed to support that hypothesis.

Since the early 1970s, however, revisionist critics of the concentration/collusion theory have severely challenged the logic and evidence concerning monopoly power in the economy. They have argued persuasively that large firms earn their market shares through an efficient competitive performance, and that the only important barriers to market entry that might give rise to resource misallocation are *legal* restrictions perpetuated by government. The critics have also challenged the findings of the early empirical studies that had discovered a positive relationship between business concentration and profitability. They have shown that the earlier discovered correlations tend to disappear with larger industry samples and a longer time period of analysis. Moreover, even if concentrated industries *were* more profitable, this would only attest to the fact that faster-growing, more efficient companies tend to earn higher rates of return than less efficient companies. Thus, what the "structuralists" accepted as proof of monopoly power, the critics regard as the just rewards of an intensely competitive process.

Yale Brozen's new book captures, summarizes, and extends the arguments of the revisionist critics. To assert that Professor Brozen devastates the structuralist orthodoxy is an understatement. In precise, non-technical prose he carefully picks the concentration/collusion hypothesis apart.

Most of the book is a masterful exposition of the empirical work of dozens of economists that have investigated industrial concentration. These studies indicate generally that advertising is not a barrier to entry and does not result in monopoly profits; that concentrated industries do not earn monopoly profits; that collusion is rarely successful; and that mergers are generally productive of economies and efficiencies. Brozen concludes that public policies hostile to mergers (antitrust policy) and concentration are misplaced, and that attention should be focused instead on removing legal restrictions to competition.

If there is any criticism of this important work it is that Brozen appears to accept the empirical/positivist methodology completely and rarely acknowledges the subjective nature of cost and efficiency. Can empirical research capture the relevant economies? What if tomorrow someone demonstrates that concentration *does* lead to higher than normal profits long-run? Is regulation now justified? Also, Brozen's analysis of collusive agreements falls short of identifying the legitimate reasons for business collusion. Brozen does not challenge the "output restriction" theory of monopoly power and, accordingly, does not dismiss antitrust policy completely. This is an important omission but it does not detract from the information value of this book. This is *required* reading for anyone interested in regulatory policy.

— *D.T. Armentano*
University of Hartford

Registration and the Draft, *edited by Martin Anderson. Hoover Institution Press, Stanford, California, 1982. 424 pp. $19.95.*

This volume provides the best opportunity to consider the arguments for and against registration and the draft. Edited by conscription expert and former senior Reagan adviser Martin Anderson, the volume is the result of a conference jointly sponsored by the Hoover Institution and the University of Rochester.

Registration and the Draft includes six papers, in both synopsized and complete versions, along with a debate between anti-draft economist Milton Friedman and pro-draft former Rep. Pete McCloskey (R-Calif.), and full comments and questions from the floor.

The opening paper of the conference, by William King, a professor at the University of Pittsburgh and chief author of a Senate committee's negative report on the AVF, is supposedly an assessment of the performance of the AVF, but it manages to ignore data, discoursing instead at length upon the interesting but only tangentially related subject of the sociology of science. In contrast, two anti-draft military economists from the Pentagon, Richard W. Hunter and Gary R. Nelson, present a wealth of illuminating data concerning recruitment patterns, changes in the future youth population, the impact of pay scales and bonuses upon first-term accessions and reenlistment, and other subjects. Their evidence demonstrates that, given adequate pay levels, the AVF can continue to successfully meet military manpower demands at less cost than a draft.

It is in the Friedman-McCloskey debate that the political and moral issue of the rights and obligations of the individual is raised, if not resolved. McCloskey, who sponsored a compulsory national service bill, argues that a volunteer system is unfair in its lack of representation of "groups," all of whom should equally share the burden of military defense. "Only if the rich as well as the poor are serving in the military will we see the whole country involved in the decision whether we go to war or not. Now, the libertarians say, 'Well, that's against our liberties.' But the courts have spoken time and again on that subject: if you're to preserve liberty, someone has to be ready to fight." Identifying himself with "the libertarians," Friedman argued that rights inhere in individuals, not groups: "[U]niversal national service has been supported primarily. . . by people who believe in a collective society. It has tended to be *opposed* by people like myself who believe in a *free* society, who believe that individuals should separately be free to choose their activities in accordance with their values, and that if some of us want to hire others of them to do certain jobs for us, we have to pay them what it takes to get them to do it for us and not impose it on them by force directly or indirectly."

Policies for Coping with Oil-Supply Disruptions, *edited by George Horwich and Edward J. Mitchell. American Enterprise Institute, Washington, D.C., 1982. 188 pp. $15.95/$7.95.*

Since the late 1950s the American Enterprise Institute has sponsored debate and published books on federal oil and gas regulation. This latest book contains papers given at a 1980 conference on future oil supply disruptions. The essays cover three issues: what the likelihood is of a Persian Gulf cutoff; what government measures should be in place in anticipation of a major cutoff; and what policies should be implemented upon such an occurrence.

In "U.S. Foreign Policy and the Energy Problem" the authors recommend that the United States "be careful to avoid even the appearance of interference in the internal affairs of [Middle Eastern] countries, especially decisions on oil production and supply, and capital investment" lest "U.S. intervention improv[e] the prospects for Soviet initiatives, and for greater dangers to the West." Acknowledged in this conclusion, as our recent experience with Iran painfully taught us, are the limits to any imposed international order in the face of nationalistic and xenophobic sentiment in many oil-rich areas of the world.

On the economic side, various authors consider a number of possible government actions intended to either constrain the price of oil or defuse wealth transfers that would accompany a major cutoff. Examined are: 1) price controls with coupon rationing at the pump; 2) an oil tax to be rebated to consumers; 3) an in-kind oil tariff to fill an oil stockpile; 4) discretionary monetary policy; and 5) lesser schemes such as tax incentives and World Bank energy loans. While each of these incentives receives well-deserved criticism, the writers manage to support one or the other as if they had been instructed to pick their favorite nonmarket alternative. The most popular recommendation is oil stockpiling, such as the Strategic Petroleum Reserve, albeit with a dose of privatization to improve efficiency. In one essay on contingency planning, George Horwich advocates a market approach only to recommend discretionary monetary policy to fine-tune aggregate demand that would be destabilized by a wealth redistribution from oil consumers to oil producers ("oil price drag"). Although his critique of oil-related intervention is useful, his methodological approach of analyzing oil disruptions in aggregates instead of the subjective evaluations of individuals weakens his case for the free market and leads him to erroneously transform the market-adjustment process to a Keynesian aggregate demand problem. Thus, monetary inflation, itself a major cause of instability by falsifying relative prices, is advocated.

Lastly, important omissions by the authors lead to an underestimation of the central role government policies played in the recent crisis and how market processes could work to prevent and cushion worst-case scenarios as postulated in the book. Not discussed are interfuel demand substitution, international supply substitution, and removal of current interventions — particularly state production ceilings, natural gas price controls, and energy taxes.

—*Robert Bradley, Jr.*

Statement of Ownership, Management, and Circulation (Required by 39 U.S.C. 3685):

Policy Report is published monthly at 224 Second St., S.E., Washington, D.C. 20003. Filed October 15, 1982. Number of issues published annually: 12. Annual subscription rate: $15.00. The general business offices of the publisher are located at 224 Second St., S.E., Washington, D.C. 20003.

The names and addresses of the publisher and editor are: Publisher, Cato Institute, 224 Second St., S.E., Washington, D.C. 20003; Editor, David Boaz, 224 Second St., S.E., Washington, D.C. 20003.

The owner is: Cato Institute, 224 Second St., S.E., Washington, D.C. 20003.

Known bondholders, mortgagees, and other security holders owning or holding 1 percent or more of total amount of bonds, mortgages, or other securities: none.

The purpose, function, and nonprofit status of this organization and the exempt status for federal income tax purposes have not changed during the preceding 12 months.

The average number of copies of each issue during the preceding 12 months:

A. Total number of copies printed (net press run): 3000

B. Paid Circulation: 1. Sales through dealers and carriers, street vendors, and counter sales: none 2. Mail subscriptions: 2305

C. Total paid circulation: 2305

D. Free distribution by mail, carrier, or other means — sample, complimentary, and other free copies: 400

E. Total distribution: 2705

F. Copies not distributed:

1. Office use, left over, unaccounted, spoiled after printing: 295

2. Returns from news agents: none

G. Total: 3000

The actual number of copies of single issue published nearest to filing date:

A. Total number of copies printed (net press run): 3400

B. Paid Circulation: 1. Sales through dealers and carriers, street vendors, and counter sales: none 2. Mail subscriptions: 2634

C. Total paid circulation: 2634

D. Free distribution by mail, carrier, or other means — sample, complimentary, and other free copies: 500

E. Total distribution: 3134

F. Copies not distributed:

1. Office use, left over, unaccounted, spoiled after printing: 266

2. Returns from news agents: none

G.Total: 3400

I certify that the above statements made by me are correct and complete.

David Boaz,
Editor

"To be governed . . ."

Neither rain nor snow. . .

The National Association of Mail Carriers' latest press release just hit the Media. It bowled in right on time, you'll be pleased to hear — borne by private couriers.

—*Washington Times,* Nov. 10, 1982

Defending Long Island

The Navy is complaining that Congress is forcing it to spend at least $85 million — and possibly as much as $300 million — on a radar system it doesn't want but which is built by a company on Long Island, home ground of Rep. Joseph P. Addabbo (D.-N.Y.), chairman of the House Appropriations defense subcommittee.

Navy leaders contend in interviews that Addabbo and his allies have kept the Navy from getting competitive bids.

—*Washington Post,* Sept. 14, 1982

And if you don't, we'll pass a regulation requiring it

Both the left and the right can agree on one thing — there is this entity called Washington, populated by strange, somewhat evil people who have nothing at all in common with other Americans, who, in fact, spend their days trying to make life miserable for everyone else. . . Don't Washingtonians have the same concerns as other people? . . . Enough is enough. Washington is just a place and Washingtonians are just people . . . So do us a favor, America. Get off our backs.

—Richard Cohen in the *Washington Post,* Nov. 9, 1982

Desperation measures

Many of the officials here [at the National League of Cities convention] have been on a starvation diet for two years and are resigned to a prolonged period of austerity. Dayton, Ohio, is buying its own phone system, Fort Worth has hired a company to pick up the trash, Minneapolis has gone to one-man police cars, and while firemen in Seattle still put out fires for free, they now charge to conduct building inspections.

—*Washington Post,* Nov. 30, 1982

Information under socialism

[Yuri Andropov] likes theater and the arts and has written extensively on ideological matters. The 15 years he spent as head of the KGB security police have made him probably the most informed man in the country.

—*Washington Post,* Nov. 21, 1982

Maybe deregulation means fewer sentences

While scanning the Federal Register the other day, Bill [Berman] came across a sentence that was 202 words long. . .

In publicizing an amendment to a regulation concerning tail-pipe emissions in high-altitude areas, the EPA described the proposal as:

"Requiring dealers in designated high-altitude locations to submit written statements to the manufacturer signed by the ultimate purchaser that a motor vehicle which is not configured to meet high-altitude requirements will not be used principally at a designated high-altitude location; requiring dealers in counties contiguous to designated high-altitude locations to submit written statements to the manufacturer, signed by the ultimate purchaser who represents to the dealer in the normal course of business that he or she resides in a designated high-altitude location, that a motor vehicle which is not configurated to meet high-altitude requirements will not be used principally at a designated high-altitude location; and for each sale or delivery of 10 or more such vehicles in a high-altitude location or counties contiguous to high-altitude locations, requiring either the selling dealer or the delivering dealer to submit written statements to the manufacturer, signed by the ultimate purchaser who represents to the dealer in the normal course of business that he or she resides in a high-altitude location, that a vehicle which is not configured to meet high-altitude requirements will not be used principally at a designated high-altitude location."

—*Washington Post,* Nov. 25, 1982

POLICY REPORT
224 Second Street SE
Washington, D.C. 20003

SECOND CLASS
POSTAGE PAID
AT WASHINGTON, D.C.

CATO
INSTITUTE