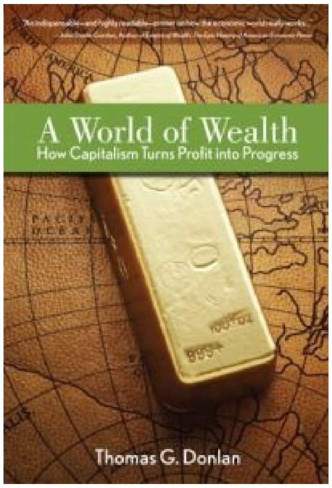

Book A World of Wealth

How Capitalism Turns Profits into Progress

Thomas G. Donlan
FT Press, 2008
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Recommendation

Journalist Thomas G. Donlan is one of the U.S.'s strongest advocates of capitalism. The editorial page editor of *Barron's*, he is a convinced, and often convincing, champion of free trade, free markets, deregulation and investment. These ideas went into something of an eclipse in the U.S. following the disastrous events in the real estate and asset-backed securities markets. However, *BooksInShort* finds that Donlan's book presents a spirited explanation of why these events were essential to putting the world back on course for economic growth and rising global prosperity. His style is concise, clear, pointed and frequently witty. True believers in the church of capitalism will value his defense of their doctrine; skeptics will likely respect his well-argued points, though they may conclude that he can be as much an apologist for capitalism as a proponent of it.

Take-Aways

- No energy shortage exists. The world has abundant oil reserves to tap once accessing them becomes more economical than buying oil.
- Environmental problems are economic problems, and markets can help solve them.
- Free trade is good for society as a whole, but those hurt by free markets often can mobilize politicians who will protect them.
- Immigration helps the U.S. – having immigrants onshore is better than having jobs offshore.
- Investment spurs invention and vice versa; a free market fosters growth.
- Taxation is always unjust. Taxes should be simple, stable and low.
- Individuals should provide their own retirement funding.
- Alan Greenspan, George W. Bush, Bill Clinton and Wall Street share responsibility for the U.S. stock market and real estate bubbles.
- Adam Smith was right: When people can pursue their self-interests, an "invisible hand" seems to work on everyone's behalf.
- Keynesian economic policies harm the economy.

Summary

The Basics of Capitalism

Markets work. Freedom is the reason why. Free market capitalism holds the best solutions for issues such as poverty, environmental ruin, immigration, energy costs, the health care crisis and whatever else politicians have addressed lately with ill-advised regulation and control.

> "There are two kinds of economists: those who think the free market always works, except when the results don't suit them; and those who think the free

market never works, except when the results do suit them."

These problems are rooted in economics. Poverty is an economic issue concerning the distribution of wealth. Capitalism creates wealth, so it can solve the problem of poverty. Environmental degradation is an economic problem that involves property rights – people protect what they own, but pollute and destroy what they do not own. Capitalism can encourage conservation by harnessing the power of property rights.

> "Democratic government has this fundamental problem: In broad terms, 20% of the people do most of the productive work and create most of the nation's wealth, but the other 80% command a heavy majority of votes."

Economics is not about what people should do, but about what they actually do. Economic theory depends on empirical observation. The most important objects of observation are supply and demand. Prices are the mechanism through which capitalism allocates limited resources. Value is not intrinsic; it is contingent upon supply and demand.

> "As the price of oil rises and falls, it drives businessmen to the edge of sanity and politicians well beyond the edge."

Pareto's Law, which has many applications, expresses the 80:20 principle. A business derives 80% of its revenue from 20% of its customers; 20% of patients account for 80% of health care costs; 20% of a nation's population earns 80% of its income. So-called trickle-down economics aims to increase national prosperity by making it possible for that 20% to earn and invest freely, since its expenditures and investments create prosperity for the poor. However, 80% of the voters in democratic countries are often inclined to take wealth away from the rich 20%. When they do, they interfere with the functioning of markets and decrease the society's wealth.

Markets Can Solve the Energy Crisis

No oil shortage exists; the world has plenty of oil. The U.S., Venezuela and Canada have many more fossil fuel reserves than Saudi Arabia. The problem is not a shortage of oil but rather a shortage of really cheap oil. The vast fossil fuel reserves in the U.S., Venezuela and Canada are in the form of tar sands, coal and oil shale. Converting these reserves into usable oil is so costly that it doesn't make economic sense when the price of oil is an inflation-adjusted $20 per barrel. However, when supply and demand push oil prices up, those reserves will become economical to exploit. The West faced the illusion of an energy shortage in the mid-1970s, when oil prices spiked and oil companies chased and found new reserves. As more oil came to market, prices fell.

> "The U.S. should return to the idea that its borders are open to all who share the principles of American citizenship."

The U.S. has worsened its energy problems with political interference in the energy markets. Talk of making the nation independent of cheap foreign oil is silly. Why not use the foreign oil, since it is cheap? When it is exhausted and prices rise, the U.S. can tap its harder-to-access domestic reserves.

Capitalism Can Address Environmental Issues

A great deal of worry about environmental pollution and global warming consumes the public. But global warming has both costs and benefits. Suppose that industry's use of fossil fuels is contributing to global warming. The more industry there is, the more fossil fuels it burns and the warmer the globe becomes. The solution is simple: Cut back on industry to reduce fossil fuel use and help cool the world. But, more industry means more economic growth and less poverty. Is it moral to throttle growth and consign billions to poverty to make the world somewhat cooler?

> "In matters of taxation, fairness is the enemy of simplicity."

Many of today's environmental problems are a consequence of the tragedy of the commons. In feudal England, villagers could graze their sheep or cows on public land. Because no one owned the land, the grass was free, giving every villager an incentive to put as many animals on the commons as possible. The result: too many animals eating too little grass. Overgrazing ruined the commons. Enclosing the commons made individuals responsible for their private property interests, so land management improved. Landlords became capitalists, villagers moved to the cities and worked in industry, and social welfare advanced. Similar solutions could apply to contemporary problems, such as overfishing the oceans.

How Free Trade and Immigration Benefit Almost Everyone

Free trade within the United States emerges from the Constitution. Indeed, the American Revolution was largely about freedom of trade. Free trade's benefits include:

- Efficient specialization as countries focus on doing what they do best.
- Scaleable economies as successful industries expand where climate, logistics and resources justify it.
- Technological development as competitors vie in open markets.
- Low prices for consumers as efficient foreign producers help push costs down.

> "Insurance companies, health maintenance organizations (HMOs), hospitals, doctor groups and any other organizations [should] compete to offer health care plans."

Economic analyses convincingly demonstrate that free trade is good for America. There is no economic question about that, though there is a political question. Free trade in any particular product or commodity may result in job losses in a domestic industry. Spread throughout the entire society, free trade confers large benefits. However, on the level of individual people, the benefits may seem less apparent than the harm done to "victims" of trade, who are vocal and committed. Thus, politicians have an incentive to do what is uneconomic and restrain trade to prevent individual harm.

> "The natural result of the Social Security-Medicare mess is a brewing political rebellion, still muffled for the time being but growing more potent with every year that passes without fundamental reform."

Immigrants come to the U.S. today for the same reason they have always come: jobs and prosperity. Immigration and attendant controversy have continually been part of the American experience. The "Know Nothing" political party of the mid-19th century rallied against Irish Catholic immigration. The Chinese Exclusion Act of 1882 was the first legislative salvo against immigration from Asia. In the post-World War I years, America throttled immigration altogether, only to reopen slightly in response to labor shortages.

> "Keynes' advice works out to this: Saving bad. Spending good."

The U.S.'s continuous efforts to restrict or control immigration generally have been at odds with economic reality. Immigrants come to the U.S. because companies need them to do jobs. In capitalistic terms, corporations demand labor and immigrants offer a willing supply of labor. Supply meets demand at a price, so no need exists for any regulations to block this market. Restricting immigration will not help U.S. domestic workers. If immigrants are willing to work for low wages in the U.S., they are willing to work for low wages at home. If the immigrants can't come here, outsourced U.S. jobs will go to their home nations to find them. Retaining domestic jobs is a better outcome for the U.S. Everyone benefits when immigrants move in, increase their personal productivity, educate their children, and become – as so many previous generations have become – valuable contributors to the American economy.

Capitalism Creates

Invention and innovation gave rise to the contemporary industrial economy, but not in a vacuum. Financial innovations such as investment trusts made it possible for people of moderate means to aggregate savings and invest them in diversified portfolios. That helped give entrepreneurs and inventors access to capital as it gave investors the economic benefit of innovation. Capitalism is a creative force, in that investment responds to the opportunity for profit. The rich spend and invest, creating markets and opportunities for the less prosperous. Adam Smith was right: When people are free to pursue their self-interests, an "invisible hand" seems to work for the good of all.

Low Taxes Are the Least Bad Taxes

You can't say much that's good about taxes. They consume an enormous share of American income. The average person works for months just to pay taxes. The richest Americans work almost six months. Of course, the rich pay most of the taxes since they earn most of the income. The tax system is unfair and complicated. Its complexity creates an opportunity for legions of accountants and tax lawyers to engage in economically unproductive activity, making plenty of money but not creating real societal value. If the people who earned the money could keep it, they would spend it, creating economic activity. The capitalist solution to the tax problem: Make taxes simple, stable and low.

Keep the Government Out of the Market

Price movements up and down are essential to the proper, efficient functioning of a free market. Regrettably, politicians spend time and effort interfering with price movements, distorting markets and leaving society in worse shape. Consider price gouging: After a natural disaster, entrepreneurs left to their own impulses scurry into an area in need of power saws, lumber, gasoline, carpentry and the like. They charge high prices, because demand is great and supply limited. Steep prices will bring more products and service providers who will increase supplies until they satisfy the demand and prices fall. Price gouging actually helps victims of natural disasters. The market works.

> "Pumped-up growth gives us enormous deficits and makes us dependent on somebody else's capital accumulations, instead of pushing us to create our own capital out of our own profits."

Whether in response to price gouging or other emergencies, price controls are damaging to economic well-being. Regulators do harm when they pursue companies on antitrust grounds. Monopolies, with the exception of government monopolies, cannot survive long. Antitrust laws prevent strong competitors from seizing market share, raising prices, and creating opportunities and incentives for even stronger competitors to displace them. Antitrust laws protect unfit competitors. Politicians and regulators should get out of the way and let the market do its work.

The Market Solution to Health Care Costs

When health care is universal, it is not affordable. European governments cannot afford their universal health care systems. When health care is affordable, it doesn't seem to be universal. Specific medical conditions or certain populations may remain uncovered in the interest of greater affordability for most people. As a rule, cheap health care is not high-quality health care.

> "The government's job is to stay out of the way of natural economic cycles and let markets work. When governments fight economic cycles, they usually make them worse."

For decades, the U.S. has been trying and failing to provide "universal, affordable, high-quality health care." Theodore Roosevelt, Franklin D. Roosevelt, Harry S. Truman, Lyndon B. Johnson, Richard M. Nixon, Jimmy Carter and Bill Clinton all tried it and failed. The problem is simple. To give more health care to some people, the government would have to take something away from others. U.S. health care problems are largely the result of government policies that interfere with the market. The answer is a market solution based on an effective precedent, the Federal Employee Health Benefits Program, which lets government employees choose from an extensive menu of health plans. The employees pay a quarter of the cost – the government picks up the rest. Thanks to aggressive competition among providers, costs are reasonably low and quality is relatively high.

Save for Your Own Retirement

The American Social Security system is in crisis. It is not, in fact, a pension or insurance plan. It is a straightforward charity or welfare program. It transfers income from workers to retirees. But demographic forces have changed the balance between those two groups. Soon, retirees will likely outnumber workers. The system is unsustainable. The time has come to get away from the idea of the government being responsible for retirees. People should save for their own retirements and, more so, they should welcome the freedom and opportunity this approach offers.

Who's to Blame for the Real Estate Bubble?

At the opening of the 21st century, America had a bubble economy – blame it on the Clinton and George W. Bush administrations, Federal Reserve Chairman Alan Greenspan, Wall Street bankers and rating agencies, and the others who created and encouraged dangerous debt and speculation in real estate. When the bubble popped and the country slid into recession, politicians offered Keynesian solutions. Keynesian economics discourages saving and encourages spending. It distrusts the wisdom of the market, and grants responsibility to supposedly wise, enlightened policy technocrats. However, Keynesian economic policies created the stock market and real estate bubbles in the first place. Loose money, extravagance, regulations to make mortgages more available to people who couldn't afford them, and similar wrongheaded measures were the disease. Capitalism, market discipline and freedom are the medicines that can cure it.

About the Author

Thomas G. Donlan, editorial page editor of *Barron's,* writes on the economy, politics and investing. He is a frequent media source and guest.