On Gilder and Wealth and Poverty

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Wealth and Poverty*, according to the preface is the culmination of a ten-year study of economics that began when the author read Milton Friedman's Capitalism and Freedom.1 Gilder's study led through the works of economists Schumpeter and Keynes and into the "supply-side" school of economics. The book itself (hereafter, sometimes denoted by WP) sprang from an earlier sociological study of poverty by Gilder,2 and, according to the author, began with the title "The Pursuit of Poverty" and ended as an analysis of the roots of economic growth; it has a definite sociological flavor. In advertisements and reviews, WP has been billed as the "Bible" of supply-side economics and as a moral defense of capitalism. The book is divided into three sections: "Mandate for Capitalism," "Crisis of Policy," and "Economy of Faith." What is the message of Wealth and Poverty? Is Gilder's moral defense of capitalism adequate? How do Gilder's supply-side and other economic insights differ from those of conventional economics? What is the potential contribution of these ideas toward the solution of current economic problems including inflation, stifled productivity, and sluggish economic growth?

Mandate for Capitalism

Gilder emphasizes the importance of developing a moral defense of capitalism stressing that freedom is good in itself and also makes us rich whereas collectivism compounds bondage with poverty.3 However, he doesn't do justice to recent works by Friedman and Hayek charging that their defense of capitalism tends to be "technical and pragmatic."4 In a recent study, after pointing out that the superiority of the market in terms of production of material goods and services is no longer in doubt, Friedman indicates that the battleground has shifted to ethical issues and explains why "social injustices are clearly greatest where you have central control."5 Similarly, Hayek recently devoted an entire book to the relationship between the type of economic system and "social justice."6 Hayek's book (which is not cited by Gilder) stresses that capitalism is the only voluntary method of organizing economic activity and that central direction, the only alternative to the price system, is inherently coercive. Morality has little meaning when it rests on compulsion. Thus, capitalism, the only economic system which allows the individual the right to choose the means and methods of his own livelihood, is a necessary condition for a moral society. Instead of making the moral case for capitalism in this way, Gilder attempts to do so by arguing that entrepreneurial activity is inherently altruistic. Capitalism, according to Gilder, "begins with giving" where the essence of giving is the lack of a predetermined return.7 While capitalist investments are surely made without a predetermined return, there is little evidence that entrepreneurship is inspired by altruism. Since the future is always uncertain, the entrepreneur necessarily acts without a predetermined return. However, he engages in speculative activity not because of a desire "to give" but rather because such action promises to improve his lot. While altruism is the essence of giving, market transactions are rooted in self-interest. Indeed, a principal contribution of Adam Smith was the demonstration that by pursuing self-interest the individual frequently promotes the interests of society more than when he submerges self-interest.

and really tries to promote the "public interest." Moreover, self-interest plays a key role in Gilder's analysis concerning the potential effects of incentive-restoring tax cuts. Thus, Gilder's attempt to give capitalism a moral or religious anchor based on "giving" is not likely to be persuasive to those not already convinced. Despite the fact that Gilder fails to provide an adequate moral basis for capitalism, he understands and appreciates the role of the entrepreneur as the primary motivating factor in the market economy. Galbraith and others have described the mature phase of capitalism as a system dominated by large corporations in which there is no scope for small entrepreneurs. Gilder provides ample evidence, however, that small firms can compete where they are not stifled by government regulations. Large firms by their very nature are less flexible and inventive, and growth in employment is coming mainly from the smaller firms. While Fortune's list of the one thousand largest companies experienced virtually no job growth during the past decade, smaller firms created 7.4 million new jobs from 1969-1976. Moreover, small companies are in the forefront in technological innovation—leading the way in the case of the microprocessor, lasers and microbiology. Thus, "communication satellites aside, there is no evidence that technological development has fundamentally changed to favor large firms." Gilder draws heavily on Schumpeter's view that "creative destruction" is the essential feature of capitalism. That is, new ideas and products replace old ideas and products. Since small firms are the chief initiators of change, there is an inherent conflict between established business concerns and new competing ventures. Governments act to benefit established firms in a variety of ways including tariffs, imports quotas, and accelerated depreciation. Moreover, central planning is inimical to dynamism and creativity since the government planner tends to live in the past, for only the past is sure and calculable. This bias favoring large firms is reinforced by media bias as well as by actions of labor unions and politicians.

Entrepreneurship for Gilder requires "faith" since economic and technical breakthroughs cannot be determined on the basis of rational calculations. At any given time in history, the future is likely to appear "hopelessly grim" as evidenced by the re-occurring "energy crisis." Decade after decade, experts have predicted exhaustion of wood, coal, and now oil and gas as fuels failing to recognize that:

All plans based on the calculable present, on the existing statistics, necessarily presume a declining field of choice, a contraction of possibilities, an exhaustion of resources, a diminishing of returns—entropy and decay. Thus, material progress is unpredictable and cannot be explained or foreseen in mechanistic or mathematical terms. Since innovation involves uncertainty and chance, men must act upon their judgments of opportunities left unexploited by others. Decision-making under such conditions is said to require faith—"in one's neighbor's, in one's society, and in the compensatory logic of the cosmos." There is a difference, however, between acting without perfect knowledge—a necessity in a world of uncertainty—and faith in a religious sense. Thus, Gilder's view of faith in the decision-making process appears to be closely related to recent work in subjective entrepreneurial theory where it is recognized that the entrepreneur must inevitably make choices on the basis of "playing one's hunches" rather than on the basis of an arithmetical computation of expected values.

Although the idea cannot be sustained that future-oriented decisions are necessarily based on faith in a religious sense, Gilder's stress on entrepreneurship is well put. Despite the fact that the entrepreneur has long been recognized as the central figure in the market process, entrepreneurial activity is not well handled in conventional economic theory. However, there has recently been a great deal of work (mainly by the neo-Austrians) dealing with
the entrepreneurial function which Gilder does not discuss. Kirzner, for example, in a number of recent articles and books has stressed why there is no need for entrepreneurship in conventional neoclassical competitive equilibrium theory. In competitive equilibrium, the decisions of all market participants dovetail completely so that there is no further scope for entrepreneurial choice. In the constantly changing real world, of course, markets are not in equilibrium and potential opportunities for gain offer scope for entrepreneurial activity. Indeed, entrepreneurial activity is inevitable when decision makers act to cope with an uncertain future.

Finally, entrepreneurship for Gilder is closely identified with innovation by firms—including such things as the introduction of new products and the improvement of management techniques. Entrepreneurship in a broader sense, however, applies to the decisions of any decision maker motivated by gain. In the words of von Mises: “Entrepreneur means acting man in regard to the changes occurring in the data of the market.” In this broader sense, entrepreneurship refers not to men but to a definite function. Consequently, entrepreneurial activity is not restricted to production decisions. Producers, consumers, and resource owners engage in entrepreneurial activity as they anticipate or respond to changes in market conditions. The important feature of entrepreneurship then is not “the ability to give” but rather the ability to perceive new opportunities which others have not yet noticed. This is as true for us as consumers as it is for producers.

The Crisis of Policy

The insurance principle emerged as a commanding theme of federal policy during the New Deal. Gilder stresses the importance of “moral hazard” in attempting to insure against all adversities of life including unemployment, disability, sickness, family breakdown, etc. Moral hazard is the danger that a policy will encourage the behavior—or promote the disasters—that it insures against. The moral hazards of private insurance may contribute to declining productivity by eroding the link between effort and reward, and if outcomes are excessively preordained, the economy will become too inflexible to prosper in a world of uncertainty. Gilder emphasizes that there is no good system of income maintenance and that any welfare system will perpetuate poverty if benefits exceed prevailing wages. Moreover, the moral hazards of current programs are clear:

The fundamental fact in the lives of the poor in most parts of America today is that the wages of common labor are far below the benefits of AFDC, Medicaid, food stamps, public housing, public defenders, leisure time, and all the other goods and services of the welfare state. As long as this situation persists, real family poverty will tend to get worse.

The solution to Gilder is evident. Welfare benefits must be decreased as inflation proceeds. “A disciplined combination of emergency aid, austere in-kind benefits, and child allowances—all at levels well below the returns of hard work—offers some promise of relieving poverty without creating a welfare culture that perpetuates it.”

A number of discrimination myths are effectively rebutted in WP. Alleged discrimination, it is shown, is often not discrimination at all. Most of the differences in pay between men and women, for example, derive from the fact that “women between the ages of twenty-five and fifty-nine are eleven times more likely than men to voluntarily leave work, and the average woman spends only eight months in a job compared to almost three years for a man.” Similarly, much of the difference between incomes of blacks and whites reflects differences in age, location, and education. Moreover, Gilder makes a persuasive case that anti-discrimination agencies and programs are enemies of black progress since the effect of federal
surveillance of employment policies is to encourage companies to protect themselves with paperwork. This system discriminates in favor of established classes and the credentials that the rich and middle class can buy over what the poor can offer—competitiveness, hard work, and drive. The affirmative action programs have been accompanied by an increase of "credentialism," but they also have other adverse effects. Large companies locate in suburbs, in part at least, to avoid discrimination suits and job quotas based on the racial composition of the work force in the locality—with an adverse effect on ghetto employment. Gilder does not emphasize that other federal programs, such as the minimum wage and the Davis-Bacon Act, also have harmful effects on work-training operations and self-advancement. 

Gilder points out that government programs to "save jobs" (e.g., Chrysler) or to make work (e.g., CETA) are no less damaging than welfare programs and affirmative action programs. The unemployment effects and costs of letting a large firm fail are obvious while the costs of saving it initially appear to be small. As Bastiat stressed, however, the unseen effects of such programs are just as important as the effects which are readily visible. The possibility of failure is an inherent feature of capitalism and a government policy of compensating for losses not only weakens the profit incentive but reduces the effectiveness of the price system in allocating resources toward more valuable uses.

Gilder contrasts socialism and capitalism in terms of knowledge and information. Socialism requires detailed knowledge about production and market conditions while capitalism acknowledges that decisions must be made before the outcome can be known. In reality, of course, detailed knowledge is no more possible in a socialist than in a capitalist economy. More emphasis in WP could usefully have been placed on the limitations and distortions in articulation of information under socialism when contrasted with the unarticulated knowledge transmitted through market prices. Knowledge problems in central planning are inherent due to the separation of knowledge and power. Gilder stresses that measurable inputs, such as those calculated in a planned economy, are not the most important factors in determining output. In Gilder's words: 

Matters of management, motivation, and spirit—and their effects on willingness to innovate and seek new knowledge—dwarf all measurable inputs in accounting for productive efficiency. The United States must overcome the materialist fallacy: the illusion that resources and capital are essentially things, which can run out, rather than products of human will and imagination which in freedom are inexhaustible.

There is a great deal of evidence to support Gilder's thesis that the major factors determining the level of income and rate of progress in various countries throughout the world are not physical resources but rather personal, social, economic, and political factors.

Gilder stresses work as the root of wealth and presents a number of telling examples where individuals have recently succeeded by the dint of hard work. Thus, the distribution of incomes is constantly changing. Changes in facts and fashion result in a "kaleidoscope of shifting valuations" which "redistributes the wealth of the world far more quickly and surely than any scheme of the state." When the fast movement up and down of the American rich in two generations is recognized, "Fears of a hereditary plutocracy are as groundless as hopes of a withering state." Furthermore, while the process by which wealth is shifted among people is held to be the secret of capitalist ferment and creativity, the chief threat to this process is progressive taxes graduated so steeply that the rich refuse to risk their money. In other words, to have capitalism it is necessary to have capitalists!

Gilder's views on the nature of poverty are refreshing. The poor are not poor because the rich are rich. Moreover, pover-
ty, it is argued in WP, cannot be cured by redistribution but only by work, family, and faith. Why is redistribution counterproductive? Welfare and subsidy programs decrease work and break the psychological link between effort and reward with a deadly effect on achievement. Gilder holds that the most damaging aspect of welfare is to family life. By making optional the male provider role, "welfare weakens and estranges the prime mover in upward mobility." In Gilder's view, the vast expansion of the welfare rolls associated with Great Society programs since 1964 halted an ongoing improvement in the lives of the poor and left behind "...a wreckage of broken lives and families worse than the aftermath of slavery." While his thesis concerning the effects of welfare appears plausible, it isn't clear to what extent the "wreckage of broken homes" was due to welfare and to what extent it was due to other factors since the incidence of broken homes for families not on welfare also increased during this period. There is little question about the validity of Gilder's emphasis on work as an antidote to poverty but his view concerning the effect of family structure on poverty has been attacked by feminists for its stress on the importance of the male role model.

Gilder blames the economics profession for the emphasis on income distribution and redistribution to rectify inequalities. As he rightfully charges, the distributionist mentality strikes at the heart of capitalism. Moreover, static statistical distributions invariably give a distorted picture of real world market activity. The distribution of income, for example, appears to be fixed since it remains similar year after year. Yet static distributions frequently conceal important factors such as the simple matter of age. Many people at the bottom of the income scale are either beyond their major earning years or young and yet to enter them. Social activists often miss the dynamism within the American system as evidenced by dramatic increases in earnings of Japanese, Jews, and Orientals and other ethnic groups over time. Gilder's comment is devastating:

It is a real miracle that learned social scientists can live in the midst of these continuing eruptions and convulsions, these cascades and cataracts of change and declare in a tone of grim indignation that "over the last fifty years there has been no shift in the distribution of wealth and income in this country." Supply-Side Economics

Only four chapters in Wealth and Poverty are explicitly devoted to supply-side economics. However, in stressing the importance of economic incentives, the book as a whole might be viewed as indirectly addressed to supply-side economics. Prior to Keynes, Say's Law—"Supply creates its own demand"—played a key role in economic thinking. With the collapse of investment during the Great Depression of the 1930's, Keynes held that Say's Law was no longer valid. Say's Law was replaced by Keynes Law—"Demand creates its own supply." The economic focus shifted from production to consumption and emphasis was placed on government spending as a way of maintaining aggregate demand and full employment during periods of economic slack. As emphasis shifted from supply to demand, there was a concomitant de-emphasis of the importance of economic incentives in working, saving, and investing. At the same time, the focus of economic analysis shifted from the production of wealth to the distribution and redistribution of wealth. In a chapter entitled, "The War Against Wealth," Gilder explores the mystery of society's long standing hostility to producers of wealth. The suspicion of wealth is not limited to the "have nots" since the notion "that all wealth is acquired through stealing is popular in prisons and at Harvard." This false image tends to incapacitate those who believe in it and is belied by the evidence presented by Gilder that "...the United States is probably the most mobile society in the history of the world." Supply-side economics represents an attempt to restore Say's Law to its classical position of importance. In Gilder's
words: “Say’s Law in all its variations is the essential enactment of supply-side theory.” There can be no doubt that a shift in emphasis of economic policy from demand to supply is long overdue. The controversy about supply-side economics concerns the extent to which tax cuts provide a panacea to cope with problems of low productivity and high inflation. Taxes, which (according to Gilder) have been rising 80 percent faster than prices due to “bracket creep,” affect individual choices between work and leisure, between market and non-market activity, and between consumption and saving. Thus, as Gilder suggests, increased tax rates deter economic activity, drive it underground, or cause it to switch into legal but untaxable outlets. Supply-side advocates are certainly on target in stressing the importance of these effects of high and increasing tax rates. Most households in the U.S. are in the 50 percent bracket and the top 25 percent of earners now pay 72 percent of federal income taxes. Although there are problems in comparing income tax rates between countries, Gilder concludes that the U.S. now has “...what is probably the most progressive, complex, and commercially destructive tax system in the free world.” In focusing on the importance of maintaining a high level of aggregate demand, the importance of saving is discounted in Keynesian analysis. The Keynesian “paradox of thrift” holds that attempts by individuals to save more may actually result in a decrease in output and less saving if savings are not invested. Gilder responds to Keynes’ example of the fallacy of composition with a “paradox of redistribution”: “Beyond a certain point already reached in most modern democracies, raising the taxes on high incomes leads to more, not less, luxurious living by the rich, and to less, not more, support and opportunity for the poor.” Gilder recommends reduction in tax rates to help the poor and middle classes. In the supply-side approach, taxes are considered to be a “brake on production.” Thus, it is argued, an across-the-board reduction in tax rates of the Kemp-Roth type would expand production enough so that there would be no reduction in tax revenues. The combined effect of inflation and taxes is described by Gilder as “taxflation” and it is held that “much of the damage of taxflation” can be mitigated or overcome by tax cuts.

One can agree with supply-side enthusiasts on the importance of supply-side incentives without agreeing that a tax cut will necessarily reduce inflation. A reduction in tax rates may result in a decrease in tax revenues increasing budget deficits leading to increases in the money supply as the debt is monetized. While it is true that there is no hard and fast relationship between budget deficits and inflation, the crucial variable in inflation is the money supply. As Milton Friedman states: “Inflation is always and everywhere a monetary phenomenon, resulting from and accompanied by a rise in the quantity of money relative to output.” This suggests that control of the money supply is the ultimate key to inflation. For Gilder, the answer is “...a widely uttered heresy, not modifying the Keynesian analysis, but turning it inside out: inflation is caused by taxes.” Although Gilder does not deny the importance of money, money supply does not play a major role in his proposed anti-inflationary program:

Although the Federal Reserve should expand credit only in a prudent way, in proportion to the growth of government and business, any attempt to fight inflation by monetary contraction alone at a time of repeated shocks to supply will cause new, yet more destructive, and more permanent inflation. At this juncture, there is no practicable anti-inflationary program except Lafferite economics and supply-side stimuli.

Moreover, there is an almost unlimited faith in tax cuts regardless of the propensities of governments to spend: “...even if Congress manages to pass the usual boon-doggles, we should not abandon the drive to retrench taxes.”

The remedy of tax cuts for inflation, however, is unlikely to stand the test of time. Neither the relative unconcern with
government spending nor the idea that inflation can be controlled by increased productivity induced by tax cuts is realistic under current conditions. Recent work in the theory of public choice suggests that tax cuts alone are unlikely to reduce inflation even if tax cuts increase production sufficiently to bring about an increase in tax revenues. In the "special interest state," there is a strong bias in favor of deficit spending because the benefits of various government programs are highly concentrated while the costs are widely diffused. When this bias in favor of government spending is taken into account, expenditures are likely to exceed revenues whatever the level of tax receipts, and it seems likely that effective constraints on government spending must take the form of constitutional restraints. Moreover, tax cuts and budget cuts under present conditions make sense irrespective of whether a decrease in tax rates leads to an increase in tax revenues.

Conclusions and Implications

Gilder explicitly recognizes the "incalculable subjectivity" of human beings and the consequent impossibility of "calculable rationality" in human affairs. However, he does not consistently follow a subjectivist approach and, in terms of prescription, the analysis is explicitly positivist. For example, it is held that the desirability of particular government regulations should be decided on a "cost-benefit basis." In evaluating the importance of the moral hazard of current welfare programs, the criterion given for program evaluation is to modify programs "to the degree that the moral hazards exceed the welfare effects...." Although increasing expenditures, it is said, may be warranted for environmental protection, for restoration of aging cities, for schools, roads, bridges, dams and other public works, government spending should be cut "...wherever its yield or benefit is less than private spending." Gilder acknowledges that the costs of the benefits of a more open and competitive economy are impossible to measure but fails to recognize that costs which motivate individual choice are subjective and not comparable between individuals. Consequently, the positivist proposals are of little use in deciding which programs are "unnecessary." It is important to recognize that all policy recommendations involve judgments of value. Moreover, since the welfare effects of alternative policies cannot be contrasted without making interpersonal comparisons, no objective measurement is possible. Thus, emphasis should be given to the framework of institutions and rules within which people can effectively cooperate in pursuing their own diverse ends. Consequently, decisions concerning the financing of schools, welfare and other services should be based on a principles approach rather than on case-by-case opportunism and expediency. Moreover, Gilder fails to recognize that there is a fundamental difference between markets and government in terms of the ability of monitor performance. In the case of the market, there is a built-in check on entrepreneurial performance. Mises graphically depicts the restraining influence on the entrepreneur: "His conduct is subject to the incorruptible judgment of an unbribable tribunal: the account of profit and loss." Government, however, is not a profit-seeking enterprise and its conduct cannot be monitored by conventional accounting methods. Thus, it does not follow, as Gilder suggests, that "...productivity in government is largely a management problem."

Wealth and Poverty is similar in some respects to the then widely acclaimed Progress and Poverty published by Henry George a hundred years ago (1879). Henry George, like Gilder, was a self-taught economist. Professional economists at that time were unkind to George's Single Tax (on land) proposal just as most professional economists today are unsympathetic to tax cuts as a cure-all for current economic problems. Will the supply-side approach have a more lasting impact than the Single Tax proposal? It depends upon how one defines the supply-side approach. If tax cuts are taken as a panacea for inflation
and other economic problems, supply-side economics is destined to be short-lived. However, the stress on the importance of economic incentives by supply-siders is rooted in classical principles of public finance. And if the supply-side approach is defined (as is done by some supply siders) to include spending cuts, reductions in regulations, and control of the money supply along with tax cuts, supply-side economics represents a return to economic orthodoxy which was eclipsed for a genera-
tion by the Keynesian stress on aggregate demand.44 A recognition of the importance of economic incentives on individual choices of workers, sav-
ers, and investors is long overdue and will undoubtedly have a lasting impact. In summary, Wealth and Poverty is well worth reading. Although it does not make the grade as an adequate moral defense of capitalism, the reader is am-
ply rewarded with a host of economic ins-
ights.

2George Gilder, Visible Man: A True Story of Post-
9*Ibid., p. 82.
12James M. Buchanan and A. DiPierro, "Cogni-
18Frederic Bastiat, "What is Seen and What is Not Seen," pp. 1-50 in Selected Essays on Political Economy, George B. de Huszar (ed.), (Irvington-on-Hudson, N.Y.: The Foundation for Economic Educa-
tion, 1964).