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Author(s): Lewis E. Hill

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On Laissez-faire Capitalism and 'Liberalism'

By LEWIS E. HILL

WHAT IS ECONOMIC LIBERALISM? Who are the economic liberals? The answers to these questions have been confused by the advocates of laissez-faire capitalism, who have been attempting to reclaim the word "liberalism" as the designation of their philosophy. In Europe, Walter Eucken, Franz Böhm and other West German neoliberals have led this movement.¹ In the United States, Henry C. Simons, Milton Friedman and other members of the "Chicago Group" have classified themselves as "liberals" and their philosophy as the "new liberalism."² Friedrich A. Hayek, in my opinion a liberal rather than a conservative.³

We may sympathize with these distinguished contemporary laissez-faire economists, because the "liberal" designation belonged to their predecessors, the laissez-faire economists of the eighteenth and nineteenth centuries. Nevertheless, their attempt to reclaim the "liberal" appellation is to be deplored, because it adds more confusion to a terminology which is already very confused. Words such as "liberal" always lack precision; these words become useless when they are given meanings diametrically opposed to the meanings they have assumed in common usage. When "liberal" may refer either to Alvin H. Hansen and John K. Galbraith or to Henry C. Simons and Milton Friedman—when "liberalism" may refer either to governmental intervention in economic affairs or to laissez faire, then these words have become meaningless and, therefore, useless.

Some Meanings of 'Liberalism'

THE PURPOSE of this communication is to clarify these semantic difficulties. The word "liberalism" meant one thing during the eighteenth and nineteenth centuries, but means something quite different in the twentieth century. These two meanings will be distinguished and contrasted, and the historical transition from the earlier to the later meaning will be explained. Finally, an attempt will be made to justify and to defend the

¹ Henry M. Oliver, Jr., "German Neoliberalism," *The Quarterly Journal of Economics*, LXXIV, pp. 117-49; and Carl J. Friedrich, "The Political Thought of Neoliberalism," *American Political Science Review*, XLIX, pp. 509-25.

² Henry C. Simons, *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948); and Milton Friedman, "Capitalism and Freedom," *Wall Street Journal*, May 17, 1961, and "The New Liberal's Creed," *Wall Street Journal*, May 18, 1961. The leading philosopher of economic liberty, still considers himself to be

³ Friedrich A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), pp. 397-414.

contemporary meaning of "liberalism" and the economic policy it implies.

The liberalism of the eighteenth and nineteenth centuries can be conveniently labeled "classical liberalism," because it is closely related to the principles of classical economics. The classical economists advocated "the obvious and simple system of natural liberty"⁴ and opposed unjustified or excessive governmental intervention into economic affairs.⁵ Their political economy was essentially negative, because their policy proposals were generally limited to the removal of external restraints and restrictions upon human action. Classical economics implicitly assumed the existence of a teleological natural order governed by natural laws. Therefore, it appeared to be necessary only to repeal the unjust man-made laws and other restrictions imposed upon man by man, in order that the infinitely just natural laws might impose upon man that perfect order which was ordained by nature and by nature's God.⁶ Liberty was thought to be the natural state of affairs which required no positive action. It was believed to be necessary only to remove the unnatural restraints from man in order to insure that liberty would naturally result. Classical liberalism was based upon a strong commitment to economic liberty and an overpowering fear that the government might impair or destroy this precious liberty.

Twentieth-century liberalism can be conveniently designated as "welfare liberalism"⁷ because it calls for positive efforts to augment the public welfare. Most welfare liberals follow John R. Commons' usage to distinguish between the negative removal of outside restraints, which Commons called "liberty," and the positive provision of accessible alternatives, which he called "freedom."⁸ Liberty, alone, is not enough; it must be supplemented with freedom. For example, the sharecropper in the South is at liberty to better himself. Feudalism and serfdom have never existed in this nation; slavery, indentured servitude and peonage have long since been outlawed. The classical liberal would contend that it was unnecessary to do more for the sharecropper. But the welfare liberal would contend

⁴ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: The Modern Library, 1937), p. 651.

⁵ *Ibid.*, pp. 397-652.

⁶ C. E. Ayres, *The Theory of Economic Progress* (Chapel Hill: University of North Carolina Press, 1944), pp. 63ff.; and Alfred F. Chalk, "Natural Law and the Rise of Economic Individualism in England," *The Journal of Political Economy*, LIX, pp. 332-47.

⁷ Welfare liberalism should not be confused with socialism. Marxian socialism is not consistent with the freedom which is the primary objective of welfare liberalism; therefore, these systems are not only different but also mutually contradictory. Welfare liberalism is much more inclusive than non-Marxian socialism. Most non-Marxian socialists are welfare liberals, but most welfare liberals, including this writer, are not socialists.

⁸ John R. Commons, *Legal Foundations of Capitalism* (Madison: University of Wisconsin Press, 1957), pp. 111, 118ff.

that the sharecropper was not really free until society had provided him accessible alternatives in the form of Federal Lands Banks to lend him money with which to purchase or set up a farm, Agricultural Extension Services to teach him improved methods of farming, etc. Freedom is not only different from liberty, but also more than liberty. Welfare liberalism is based upon a strong commitment to economic freedom and a firm belief that positive governmental action is necessary to provide this precious freedom.

The transition from classical liberalism to welfare liberalism can be explained both politically and economically. The political explanation lies in the emergence of political democracy, the rising level of morality in public affairs, and the increased efficiency of public administration. The government of which Adam Smith and David Ricardo were suspicious and hostile was based upon a voting franchise which was narrowly restricted and a parliamentary representation which was grossly unfair. The use of political influence for private gain was commonplace and accepted, and public administration was woefully inefficient. One hundred and fifty years and seven reform acts later, the United Kingdom has been transformed into a relatively honest and efficient democracy with universal suffrage, equitable parliamentary representation, a high standard of integrity in public affairs and an efficient professional civil service. Is it any wonder that contemporary welfare liberals have ceased to regard the government as a hostile oppressor and have come to regard it as a benevolent purveyor of cradle-to-the-grave security?

An Explanation: Social Change

THE ECONOMIC EXPLANATION of the transition from classical liberalism to welfare liberalism can be found in the technological revolution which created modern, mechanized, mass-production industry. This technological revolution has created great economies of scale, without which no modern industrialized nation could even feed its present population, much less maintain the present standard of living. But in most of these mass-production industries the cost structure is such that pure competition has been self-destructive, because the optimum scale of operation is so large, in relation to the size of the market, that the demand for the output of the individual firms is significantly less than infinitely elastic.⁹ The inevitable result is a system of administered prices in most basic industries.

Administered prices are not determined by the market. They are limited by the market, but they are determined by the business executives who

⁹ John Maurice Clark, *Studies in the Economics of Overhead Costs* (Chicago: University of Chicago Press 1923), pp. 104-48.

make price decisions. Once business executives begin to determine prices, within limits imposed by the market, there is a strong incentive to weaken and to broaden the limits on their discretionary price determination through vertical and horizontal integration, and formal and informal collusion—both of which have caused increased centralization of the decision-making process.¹⁰ Faced with this centralization of private authority to administer the prices upon which economic welfare depends, the public demands that the government assume the responsibility for protecting its economic welfare from the abuse of private power. Since the discretionary private power is highly centralized, it seems that the governmental regulatory authority should be equally centralized in order to deal with it effectively.

History indicates that it was not big government which destroyed the system of purely competitive prices in free markets—the system upon which the logic of classical liberalism depends. Rather, it was the growth of big business and the concentration of economic power in private (*i.e.*, non-governmental) groups which undermined the system. To rehabilitate the system, it would be necessary not only to liquidate the power of centralized government but also to disintegrate big business and big labor, abandon the technology which makes competition in many basic industries self-destructive, lower the level of living to eighteenth-century levels, and allow the surplus population to starve until the population is reduced to a level which could be maintained with a pre-industrial technology. If the “new” (classical) liberals want to travel the road to reaction, let them travel it to its logical conclusion. But please let them be honest! It is now, and always has been, impossible to have the best of two worlds without the evils of either.

If the remedy is limited to the liquidation of the economic power of governments (especially central governments), we will not achieve the heaven of the elimination or neutralization of coercive economic power. Quite the contrary! Such limited action would create the hell of rampant private power unrestrained by the regulatory authority of the democratic State.

Clemson College,
Clemson, S. C.

¹⁰ National Resources Committee, *The Structure of the American Economy* (Washington, D. C.: U. S. Government Printing Office, 1939–40), Part I, pp. 96–170.

Changes in U. S. Farm Size

U. S. FARMS are getting fewer and bigger. The number of farms in operation in 1962 was more than 3 per cent below 1961. But the average size increased from 307 to 325 acres.