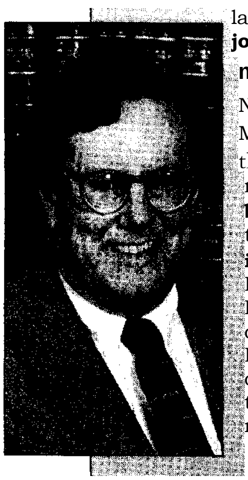
IMPRIMIS

"Three Cheers for Capitalism"

by Malcolm S. Forbes, Jr. Editor-in-Chief, Forbes



Malcolm S. Forbes, Jr. is the president and chief executive officer of Forbes Inc. and editor-in chief *of Forbes* **magazine, which, with a paid circulation of approximately** 750,000, is the world's largest business **journal. Also chairman** of Forbes Newspapers *Inc.,* Mr, Forbes serves on the **boards of numerous** civic, **business and** educational organizations, **including the** Ronald Reagan Presidential Foundation and the Foundation for Student Communication, From 1985 to mid-1993, he also chaired the Board for International Broadcasting, which oversees Radio Free Europe and Radio Liberty. 4

Preview: *This month's* Imprimis *issue by Malcolm S. Forbes, Jr. promotes understanding capitalism as a moral as well as an economic system. He observes that central planners and politicians always underestimate the power of the free market and of individual decisions. Mr. Forbes' remarks were delivered at Hillsdale's Shavano Institute for National Leadership seminar, "American Perestroika: Returning Public Services to the Private Sector, " in Atlanta before an audience of nearly 500 business and community leaders in May 1993.*

Living in the 1990s, we are uniquely able to judge what the American economy has achieved in the 20th century, For this reason, we ought to give three cheers for capitalism. By the term, I mean "democratic capitalism," which is as fundamentally different from the "managed capitalism" of modern-day central planners as it is from the "state capitalism" of old-style fascists, socialists, and communists.

Capitalism works better than any of us can conceive. It is also the only truly *moral system* of exchange. It encourages individuals to freely devote their energies and impulses to peaceful pursuits, to the satisfaction of others' wants and needs, and to constructive action for the welfare of all. The basis for capitalism is not greed. You don't see misers creating Walmarts and Microsofts.

Think about it for a moment. Capitalism is truly miraculous. What other system enables us to cooperate with millions of other ordinary people—whom we will never meet but whom we will gladly provide with goods and services—in an incredible, complex web of commercial transactions? And what other system perpetuates itself, working every day, year in, year out, with no single hand guiding it?

Capitalism is a moral system if only because it is based on *trust.* When we turn on a light, we assume that there will be electricity. When we drive into a service station, we assume that there will be fuel. When we walk into a restaurant, we assume that there will be food. If we were to make a list of all the basic things that capitalism provides—things that we take for granted—it would fill an encyclopedia.

How to Become Successful Capitalists

How do we become successful capitalists? The answer sounds simple, but it is often overlooked in places where you would think they would know better. (I am referring, of course, to government, the media, and our most elite business schools and economics departments.) We succeed as capitalists by offering goods and services that others are willing to buy. Many capitalists do not make correct assumptions about what to offer and fail, but that is as it should be. There is no guarantee of success in any area of life, including business—there is always risk. The particular advantage of capitalism is that failed businesses don't necessarily equal a failed economy; they make way for successful businesses.

But even the most successful businesses can't afford to forget about market principles. AT&T is a case in point. In the 1970s, fiber-

optic technology was available, but AT&T decided that it would delay fully converting for perhaps 30 to 40 years. It wanted to fully depreciate its old plants and equipment, and, because it enjoyed a virtual monopoly over its customers, it saw no reason to spend a lot of money on a new long distance call-ing system. But then an upstart company, MCI, raised a couple billion dollars through the much-maligned "junk bonds" market in order to set up its own fiber-optic network. AT&T had no choice but to keep up with its competition, and, as a result, the U.S. expe-rienced an enormous advance in communications that has put it ahead of its foreign competitors
and that has benefited hundreds of millions of consumers.

About twenty-five years ago, the federal government filed an antitrust suit against IBM because it had grown so successful that its name had become virtually synonymous with the computer industry. But the would-be trustbusters underestimated the vitality of an open marketplace. IBM's dominance of mainframe computers, microchips, and soft-ware did not prevent the rise of rival companies such as Digital Equipment, Apple Computer, Sun Micro-systems, and Microsoft. Today, IBM's very existence is in jeopardy.

Around the same time, John Kenneth Galbraith wrote *The New Industrial State,* in which he argued that though the Ford Motor Company was no longer the biggest
of the auto companies (GM had roughly 50 percent of all sales), Ford was so large that it did not have to pay particular attention to its shareholders or its customers. Apparently, Japanese automakers did not read John Ken-neth Galbraith, or the reports of countless other "experts" who claimed that it was impossible to compete against Ford, GM, and Chrysler. They even ignored their own early failures to storm the U.S. market in the 1950s and early 1960s. Finally, after years of trying, Japanese automakers succeeded—and succeeded to an extent that no one could have predicted—in challenging the hegemony of the "giants" in Detroit.

Then there is Sears & Roebuck. What more mundane business could there be than retailing? Yet, around the turn of the century, Sears
made retail-
the 1940s, it dwarfed all competitors. In the last several decades, however, the company lost its way and became a self-serving, insu-lated bureaucracy. Now it is closing its doors on numerous stores. Its market share has plunged—and its profits have almost disappeared.

Why, by contrast, has another retail firm, Walmart, achieved its phenomenal success? Not because its founder Sam Walton used to ride around in a pickup truck visiting his stores, though that was good publicity. It was because he recognized the importance of computer technology and had systems devised that help store operators respond to inventory information on a weekly and even daily basis. Sam Walton knew that success, even once it was achieved, was something
that couldn't be taken for granted.

What should be clear from each of these examples is that capitalism is not a top-down system—it cannot be mandated or centrally
planned. It operates from the bottom up, through individuals—individuals who take risks, who often "don't know any bet-ter," who venture into areas where, according to convention-al wisdom, they have no business going,
who see vast potential where others see nothing. Often, these individuals literally stumble across ideas that never would have occurred to them if they were forced to work in a top-down system. And they take supposedly "worthless" sub-stances and turn them into infinitely valuable ones. Look at penicillin. Whoever thought that stale bread could be good for anything? The same goes for oil before the invention of the gasoline engine and the automobile and for sand before the invention of glass, fiber-optics, and the microchip.

There is another important thing to remember about capitalism: Failure is not a stigma or a permanent obstacle. It is a spur to learn and try again. Edison invented the
light bulb on, roughly, his *ten-thousandth* attempt. If we had depended on central planners to direct his experiments, we would all be sitting around in the dark today.

Open vs. Managed Competition

This leads to the next question regarding capitalism: What is the market? Central planners don't like the word; they prefer to say, "market forces," as if describing aliens from outer space. But nothing could be further from the truth. The market is *people.* All of us. We decide what to do and what not to do, where to shop and where not to shop, what to buy and what not to buy. So when central planners trash "market forces," they are really trashing us.

Unfortunately, they are the ones who seem to be calling the shots today on a number of issues that should be left up to the market, i.e., up to us. One such issue is the spiraling costs of health care. Not surprisingly, central planners advocate a top-down approach to reform. With unconscious irony, they call it "managed competition."

But we have *already* tried managed competition; in fact, it is managed competition that has caused so many problems in the health care industry in the first place. Specifically, the tax code penalizes individuals who want to buy medical insurance by making them pay for it with after-tax dollars, even if they are self-employed. Only 25 percent of their premiums are deductible. But companies may buy health insurance with pre-tax dollars. So they, instead of their employees, have become the primary purchasers of insurance. This drives a wedge between the real customers and the real providers and obscures the real costs of such features of the system as low deductibles. Imagine if every time you went to the supermarket you gave the cash register receipt to your employer, who then submitted it to the insurance company for a claim. What would happen to food prices? They would skyrocket, because you wouldn't care whether a bottle of soda cost $10, $100, or $1,000.

The problem doesn't stop there. Growth in demand and improvements in technology—key ingredients to success in any other business—have instead led to crisis in the health care industry. More people are receiving better treatment than ever before and leading longer, healthier lives, but perversely this has sent costs up rather than down and has overloaded the delivery system.

If we want genuine health care reform, we must return to open competition. The tax code must be revised so that individuals can buy health insurance with pre-tax dollars and set up medical IRAs for their families that can be used to finance routine medical expenses. There is no doubt that a majority of Americans would choose this option. They want to have control over their own health care decisions. Many would choose policies with higher deductibles. Premiums would go down and so would paperwork. Physicians and hospitals would see their patient load come under control and would be induced to offer competitive rates and services. The potential benefits are enormous.

A couple of years ago, Forbes Inc. faced yet another round of steeply rising costs for health care. We wanted to do something that enabled our employees to police those costs in a way we, the employer, were unable to do. So we gave them a stake in the process. We offered them *a bonus:* They could keep the difference between their claims and $500—and we would double the amount. Thus, if they went through a calendar year without filing any health claims on the insurance company, we would pay them as much as $1000, tax free.

What happened? Suddenly, every employee became cost-conscious. On major medical and dental expenses, claims went down 30 percent. These savings financed the bonuses and our total health care costs went up *zero percent* last year. This was not because we compelled millions of people to participate in some "managed competition" scheme, but because we let a few hundred individuals make their own health care decisions.

Letting Individuals Make Their Own Decisions

Letting individuals make their own decisions is what capitalism is all about, but virtually all central planners (now in their heyday under the Clinton administration) and a good many members of the U.S. Congress (Republicans as well as Democrats) fail to realize it. They do not, for example, realize that it is the decisions of individuals that really decide how much tax revenue the government collects and how well the economy prospers. Between 1982 and 1986, the American private sector created well over 18 million new jobs, including a record number of high-paying positions. Of these, 14 million were created by new businesses. But, in 1987, Congress raised the capital gains tax to one of the highest levels in the industrial world.

What happened? New business and job creation declined sharply. The nation was hit with a recession. And tax revenues, which were supposed to rise, went down. All this occurred because individuals made the decision *not* to invest. Today, there is almost $7 *trillion* of unrealized capital gains that is going begging because of high taxes. If Congress lowered the capital gains rate, it would mean *more* not *lass* tax revenues. It also would overwhelm any stimulus package Washington could concoct for revitalizing the economy.

Central planners also tend to be big fans of "industrial planning," whereby government picks the "winners" in the marketplace through subsidization of select companies and technologies. They ignore the fact that this will obliterate incentives for companies to remain competitive, breed corruption and special interests, and penalize the small businesses that are the backbone of the economy.

And they want to micromanage the monetary system, knocking down the value of the dollar against the yen or raising it against some other currency in closed-door meetings with bureaucrats from other industrialized nations. They do not realize that one of the most important functions of money is to serve as a constant, reliable measure. A ruler is supposed to be 12 inches long, but they want to change it to 11 or 13 inches whenever it suits their political strategy. You and I might call this a swindle, but in Washington it is called sophisticated economic management.

Even such a simple word as "change" takes on a whole new definition in Washington, meaning change directed from above by well-intended central planners and politicians who think that they "know better" than most people when it comes to making decisions. But, in truth, the most revolutionary sweeping agent of change is capitalism. Look at what has happened in Eastern Europe, the Soviet Union, Latin America, and Asia. When people are free to make their own decisions, they have a stake in the economy, and when they have a stake in the economy, they have a stake in serving others, and when they have a stake in serving others, they have a stake in fighting for freedom.

Capitalism is the real enemy of tyranny. It stands not for accumulated wealth or greed but for human innovation, imagination, and risk-taking. It cannot be measured in mathematical models or quantified in statistical terms, which is why central planners and politicians always underestimate it. As I noted at the outset, it is up to us, then, to give three cheers for capitalism. Who knows? If we cheer loud enough, perhaps even they will listen. **A**

Hillsdale College President George Roche will be speaking on November 4 and 5 at the 20th anniversary celebration of Jim Blanchard's New Orleans Investment Conference. Fellow speakers will include Milton Friedman, J. Peter Grace, and Jack Kemp. For more information, or *to register for the November 3-7 conference, please call (800) 648-8411.*

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