

THE POOR AS FIRST VICTIMS OF THE WELFARE STATE

By Walter E. Williams

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The first thing to set at rest in the development of our discussion is the concept of exchange. In doing so, I will try to paraphrase faithfully Ludwig von Mises in his development of the concept. Ludwig von Mises was not the first scientist to characterize the essentials of exchange, for it has much earlier roots which pre-date Adam Smith. But Ludwig von Mises' contribution, in his treatise *Human Action*, was that of filling a void caused by the rush of the energies of intellectuals to build and justify the welfare state as a method of coping with the problems of the Great Depression and afterwards.

The essential characteristic of exchange is that it consists of acts by individuals (or collections of individuals) whereby the property rights or use rights to goods and services are transferred from one individual to another. Voluntary exchange is charac-

terized by a proposition such as: "I will do something good for you if you will do something good for me." People will not enter into voluntary exchanges unless they, in their own estimation, are or expect to be better off as a result of the exchange. Therefore, in voluntary exchange there can be no exploitation.¹

By contrast there is another kind of exchange whereby the following proposition is offered: "If you do not do something good for me, I will do something bad to you." Examples of this kind of exchange are holdups and rapes. These exchanges are ones that people will not enter into unless they are coerced into by violence or the threat of violence. In general, coercion involves making a person say or not say something, or into making or not making an exchange under the threat of violence. The person being coerced always loses utility as a result of coercion. The per-

im•pri•mis (im-pri-mis) adv. In the first place. Middle English, from Latin in primis, among the first (things).

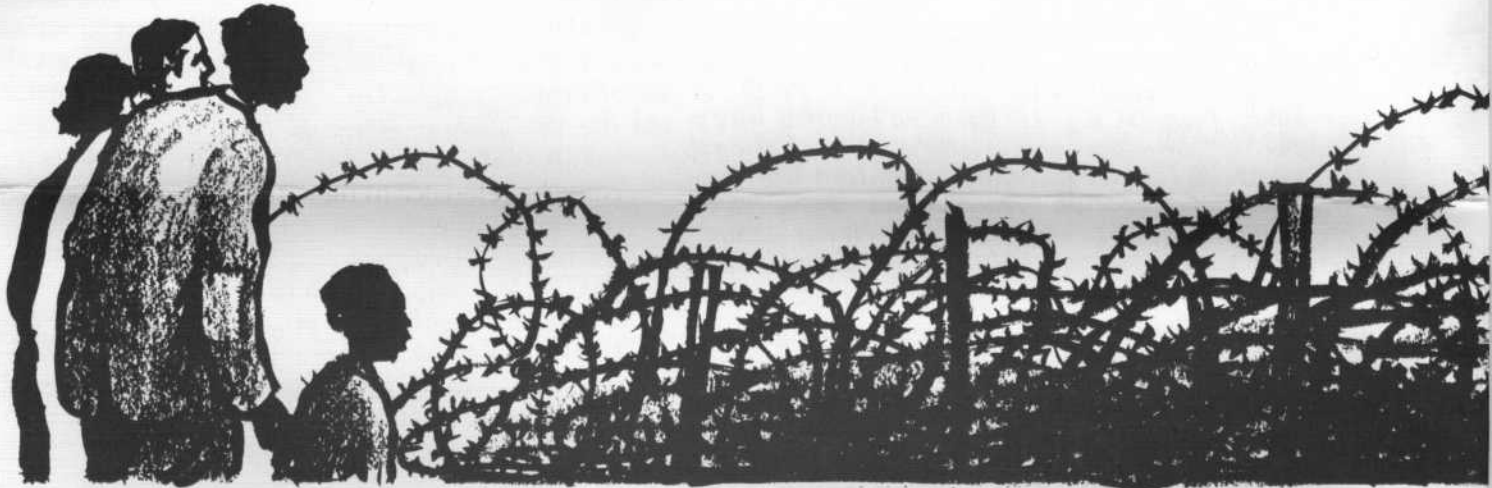
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son who gains from the coercion is the coercer or the people that he represents. When there is coercion, one party gains at the expense of the other party. This is contrasted with the free market where *both* parties to the exchange benefit.

Most of the problems that poor people face in the United States are a direct result of coercion and the absence of free markets. As such this cause has gone virtually unnoticed by policymakers, researchers and many other groups who express a concern for the socioeconomic welfare of the poor. I will make my

and more Annie Green Springs wine sold than Lafite-Rothschild. The point of this observation is that an individual's choice is not only determined by his preferences (or what he likes most) but *also* by his income and the prices that he faces as well.

Now let us turn to an example of this principle as applied to race. Governor Wallace may, because of his preferences, go to considerable lengths to avoid physical proximity to a black in a theatre or restaurant. But suppose Governor Wallace were on the battlefield under bombardment and in seeking



argument concrete by using the plight that many black people face. At the same time I want it to be clear that black people are not the only people who suffer from coercion. Black people are merely the most visible component of some of the effects of coercion by the state.

All too often the problems that minorities face are viewed in terms of collective conspiracies, societal preferences, or good and evil. Such an approach to their problems not only ignores basic human behavior, but because it does, this approach will at best suggest policies that are relatively ineffectual and at worst harmful to the intended beneficiaries. Such an assertion makes an important break with conventional wisdom, so a few words are in order to explain and illustrate.

To say that certain outcomes are a result of individual preferences ignores the important distinction between what people *want* to do and what they *can* do. For example, suppose we polled people around the country asking them which they *prefer*: filet mignon or hamburger, Lafite-Rothschild or Annie Green Springs wine, fine jewelry or costume jewelry? I bet that most would say that they prefer: filet mignon, Lafite-Rothschild wine and fine jewelry. But if you watched to see what they actually purchased you would see more hamburger sold than filet mignon, more costume jewelry sold than fine jewelry,

cover he ran up to a foxhole that was occupied by a black. Do you think that he would say, "Oops, let me look for another one"? I predict that he would not. Such a prediction is not predicated on Wallace's preferences changing. No. A better answer would be that the cost of indulging a preference to avoid blacks is prohibitively expensive. Such a prediction is consistent with a wide body of economic theory which predicts that as the cost of an action (or good) rises, people will do less of it.

What about collective conspiracies by whites as the explanation of the socioeconomic problems that blacks face? Collective conspiracy hypothesis ignores a basic fact of conflicting goals among men. The attainment of one man's goal may be inconsistent with the attainment of another man's goal. This means that there are considerable pressures for one or more parties to the conspiratorial agreement to break that agreement in the pursuit of his own personal goal.

This principle may explain how blacks managed to take over the use of housing resources in many urban areas even during racially hostile times. Imagine that a group of white neighbor homeowners agreed not to sell their houses to black people. Suppose one of the neighbors were moving to another city and he found that he could get \$30,000 if he sold his house to a black and only \$20,000 if he sold it to another white person. Immediately, he is faced with an internal

pressure between honoring his agreement with his neighbors and his own goal of having more money for himself. One only needs to look at ethnic neighborhood progression to see how the goal conflict was resolved.

Since collective preferences, good and evil, and collective conspiracies arguments do not contribute substantively to our understanding of the problems that minorities face, what does? I assert that a better understanding is gained, which yields more effective public policy, when we pay greater attention to the

for blacks in every age group is less than that of whites. For some age groups the labor force participation rate is less than 50 percent of that of whites.

How can we explain this dramatic reversal and deterioration of employment opportunities for black youth relative to white youth? Can we explain it by saying that today's businesses are more racially discriminatory in their hiring policy than those in 1948? Can we say that blacks, in 1948, had more education than whites did in 1948? There is no evidence that I know of that would even remotely



rules of the game, the legal structure of our society. We will see that it is the rules of the game which determine the outcome of the game, namely who wins. There are numerous laws, regulations and ordinances in our country that are benign in racial intent but malevolent in racial effect. They rig the economic game against today's disadvantaged.

EMPLOYMENT

Black unemployment, particularly among its youth, is no less than a national scandal. Black youth unemployment today is nearly 40 percent. White youth unemployment is about 16 percent. This is common knowledge. Furthermore, if we were to include youths not working, not in school and not looking for work, both figures, black and white unemployment, would be considerably higher.

What is not widely known or appreciated is that black youth unemployment and their low labor force participation rate is unprecedented in United States history. For example, in 1948 black and white youth unemployment in every age group was just about the same. In fact unemployment for blacks 16 to 18 years of age was *less* than that for whites in the same age group (9.2 percent compared to 10.4 percent). Furthermore, until 1954 blacks in *every* age group were more active in the labor market than their white counterparts. Today the labor force participation rate

support either contention. We cannot even blame the loss of black youth employment opportunities on the economic cycles. Labor statistics show that black youth unemployment rose both relatively and absolutely during periods of rapid economic expansion.

What does explain the bulk of the trend of deteriorating employment opportunities for black youths and to a lesser degree white youths? The minimum wage law and other labor laws can do a good job of explaining. The minimum wage law effectively discriminates against the employment of low skilled workers. We can see how it discriminates by putting ourselves in the place of an employer and asking the following question: If I must pay a minimum wage of \$3.10 per hour, does it pay me to employ a person who can produce only \$2.00 worth of goods and services per hour?² It turns out that to do so would be a losing economic proposition.

Who are the low skilled? It turns out that youths in general are low skilled workers. They are low skilled (less valuable to the employer as workers) because they lack maturity and experience. Minority youths not only share this characteristic of youths in general, but they bear some of the burden of past discrimination and they for the most part attend grossly inferior schools. Therefore, if there is a law which discriminates against low skilled people, one would expect that minorities would be more adversely af-

ected. The empirical evidence supports the economic prediction.

If the total effect of the minimum wage law were merely that of depriving youths of spending change, we could pass it off as just another form of foolish government intervention. But early work experiences do more than provide spending change. Early work experiences teach youngsters: effective job search techniques, effective work habits, respect for supervisors, and they create a sense of pride and self-respect that comes from being financially independent or semi-independent. All of these gains from early work experiences, *in any job*, make a person a more valuable employee in the future and they give him the opportunity to make mistakes at a time when the mistakes are not as costly as they would be when he has a set of dependents counting on him for a continuous source of income. In addition, the potential lessons to be gained from early work experiences are especially critical for many black youths who attend grossly inferior schools where such habits and attitudes are not likely to be stressed.

COLLUSION AGAINST LOW SKILLED OR LESS PREFERRED WORKERS

If the minimum wage law has the effects that I have suggested, a reasonable question might be: Why do we have such a law? Part of the answer is that decent people, albeit misguided, want others to have a higher income. But a larger part of the answer is that the minimum wage law serves the economic interests of one class of workers at the expense of another class of workers. We gain this sort of insight if we can find out who are the major supporters of the minimum wage law. Who spends hundreds of thousands of dollars lobbying for increases in both the level and extent of coverage of the minimum wage law? Without question the answer is, labor unions do. With such a finding one is faced with the next question: Why should labor unions, whose members earn far in excess of the minimum wage law, be the strongest supporters? Is it because those people are the most altruistic with a deep and unabiding concern for the less fortunate among us?

We readily have answers to these questions when we recognize, as economists do, that for many productive activities low skilled workers can be used as substitutes for high skilled workers. For example, suppose a fence can be built by using either of two techniques: three low skilled workers or one high skilled worker. The wage of a single low skilled worker is \$13.00 per day while that of a single high skilled worker is \$38.00 per day. Clearly, the employer would hire the high skilled worker because it is cheaper (\$38.00 labor cost versus the \$39.00 if he used three low skilled workers).

Suppose the high skilled worker demanded \$55.00

per day. He would be fired because the employer would simply switch to the three low skilled workers, which would cost just \$39.00 and yet produce the identical fence. But suppose instead the high skilled worker lobbied for a minimum wage of \$20.00. He could advance his cause by arguing that workers needed protection from greedy bosses, that they needed to earn a living wage, that they were being exploited, etc. After the government passes a minimum wage of \$20.00 per day, *then* the high skilled worker could demand \$55.00 per day and have a higher probability of keeping his job. The reason is that he has used the coercive powers of government to price his competition out of the market. He has used government to enforce a collusion against other sellers of labor.

One thing must be made clear about union support for the minimum wage. I am not asserting that I have accurately described the intentions or motives underlying union support for the minimum wage. However, when we are analyzing the *effects* of a particular policy, we do not have to deny or affirm or even acknowledge intentions. Intentions are irrelevant to effects. In fact there are numerous human activities where the effects of an action bears little or no relation to the motives underlying the action.

However, there is very strong evidence that would support the argument that unions advocate the minimum wage law because of its discriminatory effects. The minimum wage law encourages racial discrimination. It does so because if an employer must pay the same minimum to no matter whom he hires, he has greater incentive to indulge his preferences for worker physical characteristics such as race or sex. Minimum wage laws and their analogous counterpart equal-pay-for-equal-work laws are such powerful inducements for racial discrimination that in South Africa white racist labor unions are the most powerful supporters of the selective application of these laws. The *New York Times* reported:

Right wing white unions in the building trades have complained to the South African Government that laws reserving skilled jobs for whites have broken down and should be abandoned in favor of equal-pay-for-equal-work laws The conservative building trades made it clear they were not motivated by concern for black workers but had come to feel that legal job reservation had been so eroded by Government exemptions that it no longer protected the white worker.³

To understand how the job reservation laws, reserving certain jobs for whites only, became eroded requires only two bits of information: (1) during the post World War II period there had been a significant and sustained building boom in South Africa and (2)

black skilled workers were willing to accept wages less than 25 percent of those wages paid to whites. Such a differential made racial discrimination in employment, when it could be avoided, a costly proposition. That is, firms that chose to hire whites when they could have hired blacks paid dearly—\$1.91 per hour versus \$.39 per hour. White racist unionists well recognized that equal-pay-for-equal-work laws would lower the cost of racial discrimination by building contractors and thus improve the competitive advantage of white workers. In other words, if contractors had to pay blacks the same wages as they paid whites, the cost of discriminating against black workers would be zero.

Even in our own country racist railroad unions, at the turn of this century, went out on long and bitter strikes attempting to force railroad companies to pay black firemen the same wage that white firemen were paid.

As our discussion has shown, preferences and collusion alone cannot adequately explain the employment problems that blacks face. In the examples of South Africa and the railroad companies in the United States, the contractors in South Africa and railroad owners in the U.S. were *white*. And more likely than not the racial preferences that they held were similar to the people that they hired as workers but “white man’s” solidarity was not enough to keep them from hiring blacks. In each case to make effective a collusion against blacks the coercive powers of government was needed.

OCCUPATIONAL AND BUSINESS LICENSING

The minimum wage law is only one form of collusion against the disadvantaged. Federal, state and local occupational licensing and business regulation is another. The economic impact of licensing and regulation is that of raising the cost of entry to a particular business or occupation. For the most part the major supporters of occupational and business licensing/regulation are the incumbent practitioners. These people advance their cause of restricted entry by arguing for rules and regulations that are ostensibly in the “public interest.”

One of the most flagrant forms of business regulation is the licensing of taxicabs in most major U.S. cities. Particularly interesting about the taxicab industry, so far as the disadvantaged are concerned, is that it is a business where the entry costs are low. To be successful one does not have to have years of formal education; neither does he need large financial resources—just the price of a down payment for a car. As such the taxi industry should be an effective way out of poverty.⁴ Government regulation, however, robs the poor of this opportunity.

Most cities place a numerical limitation on the number of taxis licensed. This means that if one

wants to enter the taxi business he must purchase a license from an existing licensee. The prices for these licenses can be prohibitively expensive. Such a license sells for \$65,000 in New York City, \$45,000 in Boston, \$35,000 in Philadelphia and \$40,000 in Chicago, just to list a few cities. What is the effect of such licensing requirements? They tend to discriminate against people who do not have the license price or who have credit records such that they cannot get bank financing for the license price. Obviously, the disadvantaged are disproportionately represented among such persons, particularly minority disadvantaged. In Philadelphia, for example, there are two black-owned taxi companies having a total of approximately ten cars.

In Washington, D.C., the picture is quite different. Blacks own approximately 75 percent of all the taxis that operate in the District. Can we explain this outcome by reference to the standard arguments of racial discrimination? No, we cannot. It turns out that the entire cost of licenses and other fees in Washington, D.C. is less than \$100.00. Furthermore, there are no numerical restrictions on entry.⁵ Earning opportunities for the disadvantaged are not the only benefits from the free market for taxis. Taxi consumers are better off also. Washington’s taxi prices are among the lowest in the country. Services, measured by the number of taxis, are also higher. Washington, D.C. has 12 taxis per 1,000 of the population. New York City, the next highest, has 2.3 taxis per 1,000 of the population.

The occupational licensure of cosmetologists is another example of legislative disadvantage. Stuart Dorsey did an unpublished study of the licensing of cosmetologists in Illinois and Missouri. He found that in both states the failure rate for blacks was about four times that of whites. However, when he broke the examination into its parts he discovered some interesting observations. In both states there is a written and a practical examination. On the practical portion of the examination, the candidate fixes somebody’s hair in the presence of a board of examiners. Dorsey found that on the practical part of the examination the black failure did not differ from the white failure rate. In fact the pass rate for everyone was about 96 percent.

It was the written portion of the examination where blacks had a high failure rate. Such a finding implies two things: (1) the written examination was a poor predictor of one’s ability to fix hair and (2) people were being denied work opportunity when *in fact* they could perform adequately as indicated by their performance on the practical part of the examination. This means that blacks are doubly penalized: first by the grossly inferior schools that they attend as children, and second, because of this they face difficulty hurdling the artificial state barriers to entry.

CONCLUSION

There are many other specific areas of economic life which could have been selected as examples of the adverse effects of state coercion on the lives of disadvantaged people. If a list were to be formed, we would have to include the effects of government conferred union monopoly, state education monopoly and the destruction of housing choices through local rent control laws, zoning ordinances and the U.S. Housing and Urban Development agency's policy.

The characteristic features of virtually all forms of state intervention are: (1) they are legislated in the name of good; (2) they tend to redistribute income in favor of the more preferred; and (3) they involve coercion by the state. But in addition they make the political arena a more important decider of the economic issues of who gets what is produced, how things are produced and what things get produced. In the political arena these questions tend to be settled in favor of the more numerous, more preferred and more politically powerful people.⁶ Such a set of characteristics hardly describes the disadvantaged of America, both black and white. As empirical evidence of such an assertion, albeit anecdotal, is the readily made observation of any city slum. The observer would see *some* nice cars, *some* nice homes, *some* nice clothes and *some* nice food, but *no* nice schools. Such an observation would be puzzling were it not for an appreciation of how cars, houses, clothes and food are distributed versus how schools are distributed. The former are distributed, for the most part, by the market mechanism, while schools are distributed by the political mechanism. It turns out, incidentally, that there are a *few* nice schools in some slums. And interestingly enough these schools, for the most part, are produced outside the state education monopoly; they are the parochial schools, private community schools and Black Muslim schools.

The free market implies that poor people will get at least some of what they want, while political distribution may very well imply that poor people get none of what they want. All too often the plight of poor people is observed and their plight is used as justification for massive government programs. It turns out that if we tallied all federal, state, and local annual expenditures that are justified on the basis of fighting some aspect of poverty, we would find that over \$250 billion dollars is spent on these programs. It turns out that if we were simply to give that money to the poor, each poor family of four would receive about \$40,000 per year. They do not get that money. Most of it goes to non-poor people, bureaucrats, and professionals charged with caring for the poor. It is like feeding the sparrows through the horses. This turns out to be an

inevitable way to feed sparrows, particularly from the horse's point of view.

The most unique feature of the United States is that we are a nation of minorities. Virtually all of these minorities arrived penniless and uneducated. To add to our uniqueness, all of these immigrants faced varying degrees of hostility; none were welcomed to our shores with open arms, often not even by their own kind.⁷ But these people were able to melt, *en masse*, into the mainstream of American society. They did it in many ways. They worked in sweatshops; they were hucksters and peddlers; whole families, including children, worked. Indeed the conditions were rough—but they made it. Today, through numerous so-called progressive laws, these harsh conditions have been removed. And ironically it turns out that the very people that we saved from the harsh conditions are having the greatest difficulty in entering the mainstream. The reason is that jobs for the lowest skilled person have all but been destroyed. In this sense we have cut off the bottom rungs to the economic ladder.

What today's poor lack that yesterday's poor had is a free economic system. Today's poor have subsidies that flow from the welfare state; yesterday's poor had economic opportunity. Poor people today need just what the poor of yesterday had: a life with government off their backs.

¹Most of the time when people use the term, it reflects that they disagree with the terms of exchange, the price.

²Actually, the minimum wage understates the minimum compensation because employers must pay Social Security, unemployment compensation and other fringes.

³*New York Times*, November 28, 1972.

⁴Several other businesses share the characteristics of the taxi industry: airport limousine service, city express delivery service and other kinds of messenger service. But the Interstate Commerce Commission and state Public Utility Commissions restrict entry.

⁵The Washington taxi industry remains open despite repeated efforts to close it by blacks who are taxi owners. Black people benefit from a monopoly just as white people do. It is not so much an issue of race as it is insider vs. outsider.

⁶An interesting example of how the elite use the coercive powers of government to get what they want is public television. Commercial television, financed through the market, tends to deliver according to the tastes of the masses. The elite, to get what they want, must turn to the coercive power of government (taxing the common man) to get the operas, concerts, and children's shows that they want.

⁷German Jews did not look upon the peasant Polish or Russian Jew with favor. Northern Italians were embarrassed by their Southern Italy brothers. Free persons of color often looked with disdain at their newly freed ex-slave brother.