

FRIEDMAN'S BULLDOG? EDWARD YARDENI PRESENTS A BRIEF FOR CAPITALISM

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A PERSONAL REFLECTION

At some level you carry what you learned in school with you for the rest of your life. I went to the University of Chicago out of high school, hoping to study with Milton Friedman, who had published *Capitalism and Freedom* a decade earlier. I didn't wind up studying directly with Friedman but I got to know him through other channels and took courses from many of his friends and students including George Stigler, Yale Brozen, and Deirdre McCloskey. Friedman's values, Chicago School economics, and classical liberalism have shaped my intellectual life — as has the unrelenting dedication to free inquiry of University of Chicago presidents Hanna Holborn Gray and Robert Zimmer. It was a great way to start my adulthood.



Edward Yardeni
[Source](#)

ED YARDENI'S THREE CHEERS FOR CAPITALISM

I was therefore delighted to see that Edward Yardeni, a highly regarded investment analyst and consultant, has written [In Praise of Profits!](#),² a full-throated defense of capitalism, competitive corporations, and profits. In a time when free enterprise is under artillery fire and capitalism and capitalists (other than *some* tech company founders) are widely vilified, even “Two Cheers for Capitalism” are welcome. (That is the title of a 1978 book by Irving Kristol.) Yardeni offers three unapologetic cheers:

Market-driven profit is the *source* of prosperity, not its nemesis... [M]ost entrepreneurs who succeeded...struck it rich by offering consumers goods and services that improved their collective well-being, often spotting consumer needs that no one else saw... Entrepreneurs, driven by the profit motive, are

¹ The author thanks Stephen C. Sexauer for his extensive help, including significant passages (updated and modified) from a previous work by the two of us (<https://larrysiegel.org/the-age-of-experts-a-review-of-marc-levinsons-an-extraordinary-time-2/>).

² I leave out the typographically awkward exclamation point after this. *In Praise of Profits* is volume 6 of a longer series by Yardeni titled *Predicting the Markets*. It can be obtained at <https://www.amazon.com/Praise-Profits-Predicting-Markets-Topical/dp/1948025124>.

the ultimate source of prosperity that benefits everyone. Kill their profit motive, their entrepreneurial spirit and their work ethic, and you'll kill the golden goose.

No mincing words there.

A BALANCED VIEW OF PROGRESSIVISM

But wait — unlike many “conservatives” (Ed Yardeni says he is one, but a better word is liberals as in “classical liberals”), Yardeni has kind words for progressives:

Progressives no doubt mean well... [They] have made a great deal of progress in expanding the social safety net provided by the government to help people in need. Among their major achievements are Social Security, Medicare, Medicaid... [a long list follows].

In fact, one of his subchapter titles is “In Praise of Progressives.” Much of *In Praise of Profits*, then, is a less a direct presentation of the virtues of capitalism than an attempt to educate progressives on why the problems they seek to solve will be helped by more capitalism, not less.

The popularity of radical leftism among today's young people and some of their foolish elders strikes me as bizarre — like Elvis Costello, they want to bite the hand that feeds them. Because of shoddy education, young progressives don't see where their own future prosperity will come from; being young and not having yet accumulated capital like their parents, they think they never will. It was ever thus — I thought the same thing 50 years ago when I was a young dummy, as did my father at the same age, and probably his father who was born in the 1880s. From my grandfather to today, U.S. real GDP per person is up over 10 times. Capitalism and the pursuit of profits created this progress.

Yardeni, then, does the much-needed work of explaining to progressives where progress comes from. I would have been hard pressed to write such a sympathetic book addressed to progressives. I thank Yardeni for doing so.

ON THE ONE HAND, ON THE OTHER HAND

Moreover, Yardeni is, to his credit, a two-handed economist. He sees both sides to most questions. Not only does he praise his progressive opponents (who, the somewhat progressive author Steven Pinker says, “hate progress”), he joins them in hating crony capitalists. He documents the contribution to the economy of small corporations, partnerships, and sole proprietorships, often neglected by those who focus on the S&P 500 as the metric of business success. He is concerned about executive compensation that is hundreds of times that of the firm's median employee.

WHAT IS ECONOMICS FOR?

Yardeni calls for economics to play an activist role:

The latest (19th) edition of *Economics* (2010) by Paul Samuelson and William Nordhaus teaches students that economics “is the study of how societies use scarce resources to produce valuable goods and services and distribute them among different individuals.” ...[But] I’ve learned that economics isn’t a zero-sum game as that definition implies. Economics is about using technology to increase everyone’s standard of living... Free markets provide the profit incentive to motivate innovators to solve this problem... From my perspective, economics is about creating and spreading abundance, not about distributing scarcity.

This provocative paragraph accurately reflects a fundamental division in economics. First and foremost, the goal of economics has been, and probably should be, what Milton Friedman called “positive,” simply trying to understand how the economy works — how people behave in their roles as consumers and producers. (“Descriptive” is a better word with less baggage.) Let’s learn some physics before we design rockets.

But Yardeni’s view reflects the hope, shared by most economists, that their skills and observations can be used to improve everyone’s lives. That’s “normative” or prescriptive economics, used by policymakers. In view of the great mistakes that have been made by applying economic thinking to social engineering, Yardeni does us a favor by narrowing the discussion. He argues that his goals — creating and spreading abundance — can be fostered *by making profits*. Only profitable companies can generate well-paying jobs, fund large research and development projects, and provide the atmosphere and infrastructure needed to attract and retain high achievers.

BUT FIRST, A WORD FROM YOUR ACCOUNTANT

All this political economy is great fun and a worthy topic for a discussion at the University Club or a classroom, but there’s some practical learning to be had from *In Praise of Profits*. It’s about accounting — in particular, the way that profits fit into our system of National Income and Product Accounts (NIPA) designed by the Nobel Prize-winning economist Simon Kuznets and others almost a century ago.³

During the Great Depression, economists realized they did not have the tools to understand what was going on. They had primitive measures such as railroad car loadings, but much more was needed. Simon Kuznets, a Byelorussian⁴ Jewish immigrant who taught at the University of Pennsylvania, responded to this need by developing a method of “national income accounting.” Kuznets added up the dollar value of all the transactions in the economy over the span of a year, netting out intermediate transactions to avoid double counting, and

³ National product as a concept is much older and dates back to the Frenchman, Pierre le Pesant de Boisguillebert, in the 1690s, but Kuznets was the first to design a practical implementation of it and come up with accurate estimates.

⁴ Byelorussia is the name for Belarus that was in use at the time.

called it Gross National Product (GNP), from which GDP was later derived. Kuznets's method assesses the long-term growth rate of the economy quite nicely, although many economists quibble about its biases and shortcomings. Kuznets was well aware of these, stating that "the welfare of a nation can scarcely be inferred from a measure of national income." Still, having nothing else to work with, economists found GNP to be a vast improvement over the primitive measures they had been using to cope with the mystery of the economic collapse of the 1930s.

After World War II, which ended the Great Depression, Congress passed the Full Employment Act of 1946, which conveyed to the U.S government responsibility for full employment, stable prices, and growth in output.⁵ To assess how well they were doing, Congress mandated that unemployment, a consumer price index, and GDP measures be used. These measures are generally well constructed but are nevertheless imprecise indicators of economic well-being. Nevertheless, our leaders govern based on these NIPA data.

MILLIONS AND MILLIONS OF PROFITABLE BUSINESSES

Yardeni shows how the profits of public and private corporations, partnerships, and sole proprietorships fit into this picture. There are more than 6.8 million corporations in the U.S., *plus* partnerships, sole proprietorships, and individuals reporting income from a business or profession.⁶ Profits of non-S&P 500 companies are nearly as large (40% vs. 60%) as the profits of the S&P 500, and the *dividends* of non-S&P companies are much larger (64% vs. 36%) than those of the S&P because of S corporations passing their profits through to their owners in the form of dividends.

In 2018, Yardeni notes, there were 27.1 million proprietorships, and 4.0 million partnerships with 27.4 million partners. So, the number of pass-through business owners and partners totaled 54.5 million; adding in the 6 million corporations, there was one business for every 5-1/2 Americans (men, women and children)!

Profits, then, are vital to our economy and way of life and do not all go to "fat cats." They mostly go to us, the people, in the form of business income as well as dividends and capital gains on the stocks in our retirement plans and other investments.

⁵ For a fuller description of this period, see my article with Stephen C. Sexauer [here](#).

⁶ "Admittedly," writes Yardeni, "these numbers are inflated by partnerships that are limited liability companies (LLCs)," dominated by real estate partnerships that often are small holdings indeed. To manage liability, it has become customary for landlords to establish an LLC for each building they own.

A BOOK THAT SERVES TWO MASTERS

Yardeni's slim volume, accompanied by oodles of graphs and charts (actually printed in the book, not on a web site!), has two flaws:

1. *Yardeni should have written two separate books.* He tries to serve two masters. He starts with a serious discussion of profit in a national income accounting sense: what "profit" measures, how to calculate it, how it fits in with other macro concepts such as unemployment and economic growth. This would be book one and provides valuable education, but it pulls the reader's attention away from what Yardeni told me was his main purpose, which was to write a Capitalist Manifesto — book two. A lively video [interview of Yardeni](#) conducted by Josh Brown and Ben Carlson is a better manifesto.⁷ Two tight books would be a better one-two punch.⁸
2. *Yardeni's discussion of profits completely leaves out the cost of capital.* If you have deployed capital in an enterprise and only earned what you could have earned by putting the same amount of capital into the public markets, your entrepreneurial effort hasn't made you any money! An economist would say that your profit is zero. Any discussion of the role of profit in the economy should give the concept of the cost of capital (properly, the opportunity cost of capital) a central place.

Ignoring the opportunity cost of capital is a major omission. The concept is centuries old: in a survey taken *in the 1830s*, a group of businessmen said, "no profits should be considered earned until the fair rate of return on capital [that is, the opportunity cost of capital] is taken into account."⁹ This is as well-established an economic concept as has ever existed.

No one can efficiently deploy resources without considering what the best use, next best use (and so forth) of that resource might be. Capital is one of the most important of those resources and is the one being discussed. A brief treatment of capital costs as they affect the measurement of profits would have greatly improved the book.

WHICH WAY IS FORWARD? CLOSING THOUGHTS ON PROGRESSIVISM AND PROGRESS

One of the odd features of today's progressivism is that it looks for inspiration not to the future, but to an imagined past of shared prosperity and social harmony. The postwar period of American hegemony, say 1947-1973, in the wake of a catastrophic war in Europe and Asia, is regarded by some as a model for the future. During that period, many, but not all, Americans saw themselves as belonging to a very expansive middle class. Rich, poor, and those in between went to the same schools, spoke the same language, and shared the

⁷ For readers of the print version of this article, the interview is at <https://www.youtube.com/watch?v=tQqFCGcWvCU>.

⁸ Because *In Praise of Profits* is part of a series of books, this suggestion is not all that unrealistic.

⁹ As reported by Gary E. Hoover in a personal communication. Hoover is founder of the American Business History Center, <http://www.americanbusinesshistory.org>.

recent memory of a brutal war. Although more and more people were moving to cities and suburbs, small-town living — where people from all walks of life rub shoulders and are forced to get along — was the predominant memory, and for many the present reality.

But because both Yardeni and I are economists like many potential readers of this review, I want to look at the economic data — not just reflect casually on our past — to judge progress. In 1947, U.S. GDP per capita was \$14,018 (in the “2012 dollars” used by the St. Louis Fed to make comparisons across time); by 1973 it had grown to \$26,758. In 2020, it was \$58,759. And, we have much cleaner air and water, incomparably better medical care, cheap safe travel, and almost free instant communication. This is priceless progress.

Setting aside emotion and invoking rationality, would you rather live in a 1973 \$26,735 GDP per capita country or today’s United States with per capita income of \$58,759?

These observations call forth the question: Why are the good old days so often perceived as better than the present, even if they’re not? Steven Pinker writes,

[T]he negative coloring of...misfortunes fades over time. As the columnist Franklin P. Adams pointed out, “Nothing is more responsible for the good old days than a bad memory.”¹⁰

We also confuse our own situation with that of the commons. Beyond a certain age, life becomes a race against diminishing capability. As Pinker says, “we mistake a decline in our faculties for a decline in the times.” Each of us is getting closer to death each year. But society isn’t getting closer; because of increasing longevity, it is actually getting farther away from death.

LAST WORD

The University of Chicago professor Peter Leeson, who has carefully studied the relationship between economic systems and developmental success in different countries, would heartily approve of Yardeni’s book and his crusade to reform progressivism so that it supports progress once again:

Unless one is ashamed of unprecedented increases in income, rising life expectancy, greater education, and more political freedom, there’s no reason to be a milquetoast defender of capitalism. That is what sprawling free markets have meant for countries that became more capitalist over the last quarter century... I also find that the two cheers for capitalism variant that

¹⁰ In *Enlightenment Now!* This paragraph (of mine and Pinker’s), starting with “Then why are the good old days” and ending (ironically) with “death,” is from my review of Pinker’s book at <https://larrysiegeldotorg.files.wordpress.com/2018/05/ajo-siegel-pinker.pdf>.

desires markets, but “within reason,” is wrong... Development is monotonically increasing in capitalism. Maximal capitalism begets maximal development.¹¹

I'm pretty sure he's right.

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¹¹ Leeson, Peter T. 2010. “Two Cheers for Capitalism?” in *Symposium: Peter Berger’s Achievement in Social Science*, Soc (2010) 47: 227–233, published online at https://www.peterleeson.com/Two_Cheers_for_Capitalism.pdf