"Good Wealth, Bad Wealth"

by Milton Friedman

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Mr. Smith uses savings of $60,000 accumulated over many years to build a factory producing widgets much desired by consumers. Mr. Jones uses savings of $60,000 accumulated over many years to buy a medallion entitling him to operate a taxicab in New York City, rendering services much desired by consumers.

Both Smith and Jones have created private wealth—embodied in a factory in the one case, in a taxicab medallion in the other. Both use their private wealth to serve the public. From a private point of view, their cases are indistinguishable and equally deserving of commendation.

From the public point of view, the two cases are radically different. Smith's wealth adds to the total supply of physical capital available to serve the public; it adds to the productive capacity of the community. Jones's does not. It simply transfers wealth from Jones to whoever owned the medallion before. Moreover, the existence of such a category of wealth—a share, as it were, in a governmentally created cartel—harms the community as a whole.

The medallion has a market value only because the sum that customers are willing to pay for the services rendered by the cab exceeds the cost of owning and running the cab, including, of course, the value that Jones attributes to his own labor. In the absence of the cartel, the excess of returns over costs would lead more persons to enter the taxicab business. The fares fixed by local authorities for taxicab service would go down, or cabs would be more easily obtainable, until costs and returns came into balance. Consumers would be better off and so would the additional owners of cabs and all hired drivers of cabs.

I make this comparison not to attack the limitation of taxicab licenses—though that limitation deserves to be attacked—but to illuminate a major source of confusion about the role of government in regulating industry, and a major source of the difficulty in ending undesirable regulation.

To continue with my example, suppose that the numerical limitation on taxicabs were eliminated, and licenses were freely issued. The effect on Jones would be identical to the effect on Smith of government expropriation of his factory without compensation—something specifically prohibited by the Fifth Amendment to the Constitution ("Nor shall private property be taken for public use without just compensation"). It is entirely understandable that Jones would oppose the one measure with the same righteous wrath with which Smith would oppose the other.

Though privately identical, the two actions would have wholly different effects on the public interest: the one eliminates "artificial" wealth that was created by government edict and that harms the public; the other confiscates physical wealth that benefits the public.

On an ethical level, Jones is as deserving of compensation for the taking of his wealth as Smith would be for the taking of his wealth—the only qualification being that Jones acquired the medallion in the knowledge that an exclusive privilege granted by government could be withdrawn by government. Yet acting in accordance with that ethical judgment would be disastrous. It would require government to compensate every vested interest in society, however created, for any harm to it as a result of legislation (including the taxpayers providing the funds to pay compensation!). Aside from the impossibility of determining even the rough monetary effects of legislation, such a principle would enshrine the status quo and prevent the correction of past errors. Moreover, its logical counterpart is that government should receive the monetary equivalent of any gains to persons from the legislation—again not only a practical impossibility, but a measure that in principle would drastically change the effect of legislation by eliminating any incentive for persons to take advantage of potential benefits—just as compensating for losses would eliminate any incentive to minimize losses.

My simple comparison has relevance to a wide range of problems—ICC restrictions on trucking and busing, CAB restrictions on airlines, FCC controls on television, radio and telephones, price ceilings on crude oil and natural gas, licensing of occupations, rent controls and on and on. All are cases of private wealth created by measures that harm the public. We have in the process created a Frankenstein monster that it will not be easy to subdue.

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