

MACKINAC CENTER

*Classics*

# THE FREE ENTERPRISE PHILOSOPHY IN A 12-CELL MATRIX

DALE M. HAYWOOD



# FOREWORD

LAWRENCE W. REED

WHAT A LEGACY Dale Haywood has left for us! It's a legacy best measured not by the numbers of his audience, which includes thousands of students over four decades, but by the nobility and constancy of his message. He never wavered, never lost an ounce of passion, never "leaked."

Early in his life, he settled on firm principles. He spent the rest of his life living them and teaching them. The power of what he said was magnified year after year by the very fact that he didn't conform to the whim du jour. Dale Haywood was the antithesis of the Groucho Marx character who proclaimed: "Those are my principles. If you don't like them, well, I have others!"

Two of Dale's former Northwood University students came to work for me at the Mackinac Center. One of them, Justin Marshall, told me this: "Dr. Haywood had a profound impact on my life and the direction it took after college. He is one of the greatest single reasons why I believe so strongly in freedom and the market system today." The other, James Hohman, who diligently transcribed the speech you're about to read from a video recording, said Haywood was "a master at showing what freedom meant."

I, too, was a Haywood student, though not in the traditional, classroom sense. I was a student in the way that just about anybody who ever met him became his pupil. His personality instantly drew you in and made you want to learn. The

very best students of Dale Haywood learned a lot more than just economics and philosophy. They learned that to persuade, you must be warm, cheerful, considerate, thoughtful, thorough, and quick to share a laugh. You must really care about people. Dale was enough of an accountant to know the importance of a bottom line, but he took pains to explain economics and philosophy in terms of real people and their everyday lives.

Dale was a collector of great quotes and on Oct. 3, 2005, I asked him what his favorite one was. More than one came to his mind. H. L. Mencken's famed description of an election as an "advance auction of stolen goods," and Milton Friedman's "There's no such thing as a free lunch," were high on his list. But when pressed, Dale gave the edge to this one from William Graham Sumner: "All history is only one long story to this effect: Men have struggled for power over their fellow men in order that they might win the joys of earth at the expense of others and might shift the burdens of life from their own shoulders upon those of others."

Throughout his teaching career (and he was always teaching, one way or another, in every waking moment and in every personal interaction), Dale must have had that Sumner quote in his thoughts. To him, personal responsibility didn't mean you get from the government what you can't persuade your fellow

citizens to give you freely. Being a responsible, able-bodied adult doesn't mean you seek to be a burden on others. He thought the Golden Rule said what it meant and meant what it said.

When I asked Dale what economics or philosophy book he would recommend if he could get people to read just one, he chose Henry Hazlitt's classic "Economics in One Lesson." It's one of the best primers on the free economy ever written. If any reader of this document would like to take Dale's advice and secure a free copy of that book or assist in its distribution, I invite you to contact the Mackinac Center.

The speech you will read here was Dale's last public address, but it was the first in what we have now christened as the annual Dale M. Haywood Intern University Lecture Series at the Mackinac Center for Public Policy. Students who comprise each summer's class of Mackinac Center interns will read this speech and listen to weekly presentations on similar themes by other lecturers. It is exquisitely fitting that a man who made a student of everyone who knew him should have a lecture program for students named for him.

Dale Haywood was one beacon for liberty whose light will never go out.

A handwritten signature in dark blue ink that reads "Lawrence W. Reed". The signature is written in a cursive, flowing style with a large initial 'L'.

*President, Foundation for Economic Education  
President Emeritus, Mackinac Center for Public Policy*

# THE FREE ENTERPRISE PHILOSOPHY IN A 12-CELL MATRIX

DALE M. HAYWOOD

Northwood University, where I taught classes and delivered this lecture to thousands of students over the years, exists in part to perpetuate certain principles and certain values. I think they're very much in line with the principles and values the Mackinac Center for Public Policy promotes. We just have different audiences. We have college- and university-age students. The Mackinac Center reaches journalists, legislators, high school students and the general public. Our philosophies about liberty, the free society and the role of government are, I believe, identical. That's one of the reasons I've been proud to serve on the Mackinac Center's Board of Scholars almost from the day that my former Northwood colleague, Lawrence Reed, opened the Center's doors in December 1987.

I'll never forget something I thought to myself when I first went into teaching four decades ago: "Wherever I go, I want to teach something that's practical. I want to teach accounting." But over the years, I've had a significant shift in my notion of what is "practical." I've now come to believe that philosophy is the most practical of all disciplines. Philosophy guides our day-to-day behavior, minute-by-minute. It profoundly influences us every waking moment. I think it even has a bearing on how well we sleep at night and how productive we are the following day.

Now to me, that sounds like something that's pretty practical and pretty darned important. I'm really glad that I've been able, for quite a period of time, to do my best in the classroom and elsewhere to perpetuate a particular philosophy — that of liberty and personal responsibility.

If you had a beautiful home overlooking Lake Michigan and you saw there was serious erosion, what you would do about it? You would try to stop the erosion. Well, I see liberty and personal responsibility being eroded in a country that

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was founded upon those notions. So I resolved personally throughout my teaching career to do what I can to stop the erosion. That means explaining the fundamentals, explaining the underlying philosophy in the classroom and to whomever will listen. Please note that I may use a variety of descriptive terms — “free enterprise,” “freedom,” “civil society,” etc. — but it all boils down to a way of life grounded in liberty and personal responsibility.

This 12-Cell Matrix I’m about to explain to you is my effort to get that philosophy into sharp focus. Millions of Americans talk about the American free enterprise system like motherhood and apple pie. Most would agree to it in the broadest context, but it’s in the details where the rubber hits the road. Now let’s get down to specifics by showing you what this matrix is all about.

A matrix is just a fancy name for a grid or a kind of chart. In the first column of my matrix, I list four components of what I think comprise free enterprise.

#1-4

Number one is private property. Number two is a free market. Number three is a profit and loss system. Number four is limited government.

These are the critical components of what I believe is the only system consistent with liberty and personal responsibility: private property,

free markets, a profit and loss system and limited government. In the second column, I have brief definitions. You say, “What do you mean, Haywood, when you talk about private property?” Let’s get it in still sharper focus.

#5

I think that if you earn a dollar, that’s your dollar. In other words, if you labor and you accumulate some fruit from your labor, I think you should be the person who controls the fruit. It’s that simple. If you’re Mother Theresa and you want to give it all away, I say be my guest. If you want to spend it all on yourself, that’s perfectly consistent with private property. If you think it’s wise, like I do, to save some, good for you.

Now, does this mean I’m an anarchist? No, I’m presenting the concept of private property in a broad and abstract fashion. I realize that out of that 100 cents, each of us must pay something for the services of government. But for reasons that will become apparent in the balance of my talk, I think that what government takes ought to be minimal, prescribed and spent with great care if a free society is to be preserved.

#6

Now what do I mean by a free market? Three things: flexible wages and prices, competition, and consumer-determined priorities.

By flexible wages and prices, I essentially mean a situation where prices and wages are not fixed

by force or decree, but are arrived at through voluntary contract and are allowed to adjust to changing conditions in the marketplace — supply and demand in particular. Why, when there are flexible wages and prices, do people tend to be more prosperous than in those places where governments impose prices and wages or otherwise forbid them from adjusting to changing market conditions?

Imagine this situation. There are four houses. A hurricane is coming with the potential to do a lot of damage to these houses. Suppose that homeowner number one is the first guy to get wind of the weather report before the storm arrives. He hightails it down to the lumber yard, because he needs plywood to tack onto the house to prepare for the storm. He asks the lumber yard owner, “What’s the cost of plywood?”



Now, suppose that the lumber yard owner says, “Well, it’s the usual price.” Oh, I should tell you: there’s only enough plywood to cover four sides of one house, or one side of four houses. But if you’re this first guy to get down there, and plywood’s just selling for its usual price, be honest with me: In your effort to protect your property, what would you want to do? Right — you’d want to buy it all.

That’s what I would do. Although the weather forecaster says this hurricane is going to hit from the east, weather forecasters are sometimes

wrong. So, to be on the safe side, what you do is buy it all. Certainly put it on the east side, but maybe it’s going to come in from the north, maybe it comes in from the south. But if you get all the plywood you can to protect your home, you can put plywood up on all four sides of the house.

Now, if the lumber yard owner jacks up his price (in response to the bump in demand), some people would say, “Oh, he’s gouging the public!” Businesspeople are under attack from others on those occasions when they “flex” the prices under these extreme and unfortunate circumstances. (And interestingly enough, those attacks usually come from people who themselves have taken no risks to go into business to provide the item in question and are supplying the market with none of it whatsoever. It seems odd to complain that somebody else isn’t supplying more of something at a price you think is right, when you yourself are supplying none at any price.)

In the previous situation, homeowners two, three and four, once they got to the lumber yard, discovered the place was out of plywood, and they were out of luck. No matter from which direction the hurricane comes, they’re going to be completely exposed.

But if the lumber yard owner jacks up his price, then the first guy to get to the lumberyard says, “Whoa, now just a moment. I’m sure going to buy enough to cover up the east side of my house, but I don’t know about the other sides.”

So you get the idea? The first guy doesn’t buy it all. And then subsequent homeowners are able to buy some, so everybody gets some degree of protection. Meanwhile, the higher price may entice plywood sellers from elsewhere to come in with additional supplies. Others will get creative and discover all sorts of alternatives, or perhaps find sheets of plywood they never knew they had in their attics or garages. If plywood is

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expensive enough, then I'll go out into my own shed and get the piece of plywood that's been there for 10 years that I haven't used and sell it.

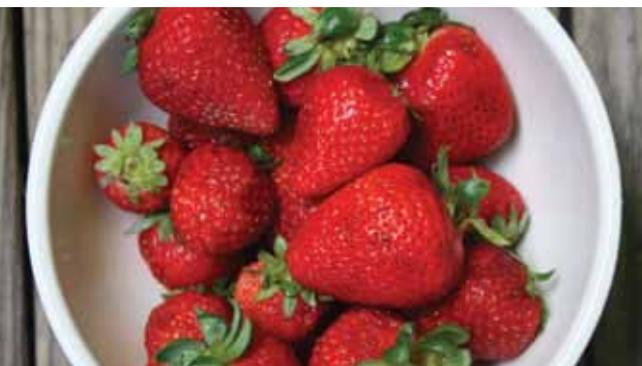
The idea is that if businesspeople can raise and lower prices, it ensures that resources are channeled into their most highly valued uses. Prices are signals. They embody large amounts of knowledge and expectations. They direct our consumption, and they also direct our production and distribution. Scarce resources are more efficiently allocated as a result. Believe me, it works far better than expecting some omniscient government agency to know what market conditions are and what prices should be at any given time. If you don't believe so, talk to some people who endured the fixed prices and "planned chaos" of the old Soviet empire.

If I'm selling strawberries, and I start to see some of those strawberries are looking too ripe, what do I do? I cut my price to move the merchandise. Or if it's a perishable item like dairy products, as the date gets closer, what do grocers do? They cut the price. And then what happens? If the price of those strawberries is cut enough, what will we do? We will change our menus for a day or two.

My wife goes shopping and she says, "I couldn't pass up the opportunity to buy these things at a bargain price." And if someone hadn't bought them at a bargain price, and hadn't consumed them right away, what would have happened? They could have spoiled and gone entirely to waste.

Well, if you have a mechanism in an economy which avoids waste, that mechanism contributes to the prosperity and well-being of the people in that society. That's what flexible prices do.

Flexible wages work the same way. Think of an unskilled worker, not very highly motivated, not much education, inexperienced. A potential employer says, "Well, I'd hire you at a certain wage, but I can't afford to hire you at one that is higher than what you or the service you would provide is worth to me." What interferes? Minimum wage laws, which are an attempt by government to introduce rigidity, not flexibility, in wages.



As economist Henry Hazlitt wrote in “Economics in One Lesson”: “You cannot make a man worth a given amount by making it illegal for anyone to offer him anything less.” With a minimum wage, you are telling the young or the unskilled, “If you can’t find a job that pays a certain amount, you’re not allowed to work.” But what if his or her services at this stage of life are not worth that much to an employer? Which is better — a job at \$5 per hour or *no job* at a higher wage?

The irony of the minimum wage, as economists have demonstrated time and again, is that it prices out of the labor market the very people it is supposed to help. If it really made sense, why should we settle at a mere \$6 or even \$10 per hour? Why not declare that everybody must be paid at least \$20 per hour? Do minimum wage advocates really believe in magic-wand economics? Do they honestly think that everybody — and every single job — suddenly and magically become worth whatever Congress might decree? What kind of childish fantasyland do they live in? Are they oblivious to the consequences of their fantasies?

Competition is another essential element of a free market. It means that we shouldn’t artificially bias the marketplace with laws that bestow special privileges on certain producers and not others. It means that you and I are free to start a business and challenge even the largest and most longstanding of firms. And by the way, if you’ve ever studied the Fortune 500 list over time, you know that business mortality is quite high. Many giants of one year have been eclipsed later by firms begun sometimes in somebody’s garage.

Competition means that no business is “entitled” to your patronage and every business knows that if it misbehaves, consumers can go elsewhere. My friend and former Northwood University colleague Lawrence Reed used to describe free market competition to his students as “a dynamic, never-ending, leap-frog process by which the

leader of today can easily become the follower of tomorrow.”

Consumer-determined priorities, the last item that appears in cell number six of my matrix, means that consumers are in the driver seat. Producers make what consumers want, not what some central planner wants or thinks that others want. Consumers are merciless, by the way. They don’t go into stores and say, “Hmmm, I think this item is only worth 10 bucks, but I’ll offer 20 because I understand the seller needs a new TV set at home.” They don’t pay more than what they think they can afford or what the item is subjectively worth to them just because the company might go bankrupt if they didn’t. No business can long survive if it fails to attract and keep customers — unless, of course, government intervenes to give it a special favor or subsidy, thereby thwarting the verdict from the court of consumers.

Now to my definition of the profit and loss system, the third component of my matrix. All businesses require inputs. Exactly what inputs depends on the nature of the business. If the output is pizza, you’ll need input like tomato sauce, onions, maybe ground beef, and so on. You’ll need ovens, pans, employees, etc.

#7



The whole purpose is to try to combine them into a product or service that adds value. You add value to the inputs as you apply your talents

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and direction to the process and generate a final output — a finished pizza or a new Honda Civic or whatever. You hope to have a lot of happy customers who voluntarily buy these goods and services. If they buy them in sufficient quantity and at a price that pays for your inputs and then some, you’ve earned a profit. If you combine inputs worth  $x$  but the most that customers will pay you later for the output is something less than  $x$ , then you’ve subtracted from value in society and you’ve earned a loss. Fortunately, the market will make sure you don’t do that with much frequency.

Earning a profit may be easy to describe, but it’s not always easy to accomplish. Talk to the people who were at Northwest Airlines when they were working through bankruptcy. Why did they go bankrupt? Because for an extended period of time, their expenses were greater than revenues. They were suffering losses. They were consuming more inputs than they were generating output — another way of saying they were wasting scarce resources.

When we let the profit and loss system operate, what happens to a losing enterprise? It goes down the tubes. And whose verdict is that? Hillary Clinton’s, George Bush’s, Dale Haywood’s? No, that’s not our verdict. It’s the customers’ verdict, of course. They opted to vote with their dollars in a kind of marketplace election that is generally far more decisive and responsive than any of the political



elections we have. The market is in the process of exerting a kind of discipline over Northwest’s prior mistakes that will either produce the needed corrections or they’ll disappear for good. As Frank Borman once put it while he was chairman of Eastern Airlines, “Capitalism without bankruptcy is like Christianity without hell.”

If the money coming in is less than the money going out, that means that the men and women of the organization have not added value; they have not created wealth. They are not efficiently utilizing resources. Since we don’t live in a Garden of Eden where there’s a superabundance of anything anybody could want, those who waste scarce resources by losing money must find something more efficient to do. The market lets them know that, and nobody has to wait for some commissar to figure it out.

Now let's assume that it's the other way around, as in the case, say, of Southwest Airlines. The men and women there figured out how to have revenues greater than expenses. They survived. They made a profit. Even during the big slump in the airline industry after the Sept. 11, 2001 attacks, Southwest Airlines made money. They figured out how to make money even in periods of adversity. They combined scarce resources in a way that added value to society.

My wife and I go to restaurants and the waiter or waitress comes by and asks, "What would you like to drink?" I say, "Water with lemon." What do you suppose at that moment the waiter or waitress really thinks? If you said, "Cheapskate," you're probably right. Over the years, I've developed a reputation for being a cheapskate or a tight wad. Do you know why I have developed that reputation? Because I am a tight wad. I even wear a reversible belt because the fact that it's black on one side and brown on the other means that I can make one belt suffice for all occasions. That's the kind of person I would want in my organization, because in the contest to add value to society, you have to be especially careful that you don't rack up needless costs.

So the big challenge of the profit and loss system is to have revenues (which you get in voluntary dealing with your customers) greater than expenses that come from voluntary dealing with

your suppliers and your employees. Anybody can earn a loss. That's easy. Earning a profit is the challenge.

Now what do I mean by limited government? # 8

Limited to what? Let me start by noting that there are two kinds of force — defensive and offensive.

I believe that we human beings have a right to defend ourselves. And if we have rights, I think we can delegate them to other people. We can say to some people (government), "We'll give you the guns, police, army, and so on, and you use those guns to defend us from aggressors." If someone threatens us, then the people to whom we've delegated our individual right to self-defense can legitimately employ defensive force on our behalf.

Throughout history there's been widespread agreement that initiating an offensive use of force (that is, the use of force that is not in response to actual aggression or the threat of it) is wrong, but defensive use is okay. I happen to agree with that.

When my brother and I were growing up, we'd sometimes get into fights. He's two years older than I am. The first thing my mother would ask after she broke up a fight was, "Who started it?" Once she established which of us that was, that one would get a good paddling.

She never used a whip or belt. She always used her bare hand. I don't think she would ever have been accused of being abusive. I think she wanted to have an accurate feel for how much penalty she was meting out. What are mothers trying to teach us on these occasions? Don't start fights; don't use force aggressively. If you do, you should expect to pay a penalty. I think mothers are vastly underrated as teachers, I really do.

So when it comes to government, I think it should be limited to performing a defensive function — defending us from aggressors at



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home and abroad. In 1941, when the Japanese government attacked Pearl Harbor, I was glad that we had a navy, marines, air force and so on. If government is limited, limited to performing a defensive function like defending our lives and personal property, it forms a very important and indispensable role — allowing us to go about our lives and affairs in peace, so long as we do not initiate offensive force against others.

So there you have private property, a free market, the profit and loss system, and limited government in cells one through four of the matrix. In cells five through eight, you have brief definitions. In cells nine through 12, you have a few words about why each of the components contributes to our economic well-being.

One of our goals in life (but not, of course, the only one) should be that people be prosperous. I would like everybody on the planet to have adequate dental care, food, shelter and so on. That requires that we have an economy that is productive. Not even magicians in government can distribute what hasn't first been produced by somebody else.



inclined to work if someone takes some of the fruits of your labor? How is your incentive to work, save, invest and take risks affected? Isn't it obvious? All of the earthlings that I know have more incentive to produce when they get to keep the fruits of their labor.

Why, where there are flexible wages and prices, do people tend to be more prosperous? Well, the plywood and the strawberry examples explained that. There's less waste. Goods are allocated to their more highly valued uses and less highly valued uses are sacrificed. #10

#9 Why, when there is private property, are people more likely to become more prosperous? It's simple. If you earn a dollar, and 65 cents are taken from you so you net 35 cents, how does that affect your incentive? Are you more or less

Competition makes us more prosperous because it pressures us to shape up, to be alert, to keep costs down, and to listen to consumers. Can you think of any good or service that would improve in price or quality if we prohibited competition?

Moreover, when a free market is in place and consumer wishes must be reckoned with, the result is that you and I get more goods and services of higher quality at reasonable prices. We get more choices. Indeed, when people from government-planned economies come to countries with free markets for the first time, they are usually stunned by the plethora of choices before them. They are able to get farther down their personal shopping lists than they could have gotten where the government, not a free market, was in charge.

#11 Take a look at cell number 11, which explains why the profit and loss system contributes to our economic well-being. It rewards producers for being considerate of consumers, and it causes producers to be extra-conscious of their expenses. It makes them conservation-minded. What seem like exceptions to that rule — examples of wasteful spending — are indeed precisely that. They are exceptions. And they are minimal in a free economy because of the built-in penalties incurred by their perpetrators. Those who waste resources eventually are not “re-elected” by consumers; they can’t rely on taxpayer subsidies.

#12 Finally, why does limited government contribute to our economic well-being? When government is limited, you and I must assume responsibility. We must be adults. When government is unlimited, when it does everything for everybody, it not only ends up doing very little very well, but more importantly, you and I descend into infancy. We sit on our fannies expecting to be provided for. Society degenerates into a free-for-all in which everybody has his hands in everybody else’s pockets. The Mackinac Center has published a little pamphlet titled “Are We Going the Way of Rome?” that explains what happened when the ancient Romans traveled that path. They lost their liberties first, then their responsibilities went out the window, and when all was said and done, they lost everything. The pie-in-the-sky, we’ll-take-care-of-you promises

of politicians spending other people’s money in ancient Rome look pretty lame now, don’t they?

America’s Founders knew that when government is confined to defending life and property, the people prosper. Government doesn’t need any more of a full-time job than that. If it just did that well and efficiently, a free and compassionate and productive people will take care of the rest. Liberate our creative energies from the stifling hand of compulsion, subsidy and meddling nannyism and we’ll feed and clothe and house more people at higher levels than anybody ever did on the face of the planet. In fact, that’s just what this country did as long as it held fast to the philosophy I’ve described with this 12-Cell Matrix.

Thanks for this opportunity to share a simple but profoundly important philosophy and set of principles with you. And thanks to the Mackinac Center for advancing those very same ideas, in so many ways, for so long here in Michigan. I hope that people reading the printed version of these remarks will decide to do their part to help you do even more of that. If we don’t step up to the plate and support groups like the Mackinac Center that are doing this critical work, we can’t complain later if our liberties are eroded. ♦







Dr. Dale M. Haywood was a professor of economics and philosophy at Northwood University in Midland, Mich. for almost four decades. He also served as a founding member of the Mackinac Center's Board of Scholars for nearly 20 years.

## About the Mackinac Center for Public Policy

The Mackinac Center for Public Policy is dedicated to improving the understanding of economic and political principles among citizens, public officials, policymakers and opinion leaders. The Center has emerged as one of the largest and most prolific of the more than 50 state-based free-market “think tanks” in America. More information about the Mackinac Center and its publications can be found at [mackinac.org](http://mackinac.org).

Additional copies of this monograph are available for order from the Mackinac Center. For more information call 989-631-0900 or visit [mackinac.org](http://mackinac.org).



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