JOHN F. M. MCDERMOTT

EMPLOYERS' ECONOMICS *vs* EMPLOYEES' ECONOMY

How Adam Smith's Legacy Obscures Public Investment in the Private Sector

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John F.M. McDermott
State University of New York
Old Westbury, USA

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Special thanks to my wife, Frinde, my life partner in every realm.

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Introduction: The Argument

> *The ultimate problem of production is the production of human beings… It is by this standard that the present system stands condemned. "Security" is a means…, it is not the end… The means have to be implemented by a social-economic system that establishes and uses the means for the production of free human beings associating with one another on terms of equality. Then and only then will these means be an integral part of the end, not frustrated and self-defeating, bringing new evils and generating new problems.*
>
> *—John Dewey (Dewey 1939: 430)*

Dewey was more right than he understood: *The ultimate reality of production is the production of human beings.* In the USA, since 1970, for every dollar of private investment, government has invested roughly $1.17 into the economy to *create and maintain a modern labor force.* If we add in public investment in social and physical *infrastructure* and in *co-investment with the private sector*, the aggregate ratio of public to private investment in the US economy over the same 40-plus years is approximately 1.8 to 1.

There is, in short, no such thing as a stand-alone, self-contained private-sector economy.

That idea, however "obvious", is essentially an ideological construct since, to say the same thing more technically, there is no integral domain of institutions, data, and behaviors which will support such a concept. In short, the US economy is publicly funded, the private sector publicly underwritten.

But contemporary Economics assumes as its foundation abstraction just such a stand-alone, self-contained private economy. On such a false foundation, no science can be erected. Accordingly, the now dominant Economics is riddled through and through with readily falsifiable principles and conclusions, as will be shown.

The major findings of this study:

- As above, there is no such thing as a stand-alone, self-sufficient "private sector".
- Such a concept can be defended only on the Neo-Classical Economics assumption that the modern labor force is "a non-produced input into the economy", as would be, for example, uncaught fish in the sea or the natural fertility of some as yet untilled soil.
- Accordingly, this reigning "science" has entirely erased from its consideration the most important of all modern industrial revolutions, that is, the shift beginning in the last part of the nineteenth century from labor forces arising more or less spontaneously within the existing societies to those which are produced with extensive social foresight and direction via the massive public investment already cited.
- Misconception follows misconception in the resulting economic model. Standing alone, a "private economy" must generate its own inner dynamism, namely via "competition", Smith's fabled "price-competition". Yet the empirical evidence is overwhelming that *firm-to firm* prices are mutually and knowledgably consensual in nature and not competitive; only slightly less so are *firm-to-consumer* prices and *firm-to-employee* prices. It is only at the very bottom of the economy that we find "true" price-competition—among laborers forced to compete among themselves for the lowest-priced jobs.
- Further, this Neo-Classical model conceives of the whole of the private sector as exclusively comprising individual transactions: so-called methodological individualism. The mathematicization of Economics follows.
- But only if one ignores the elementary and fundamental differences from Set Theory (and Number Theory) between countable infinites and those which, like the mathematical *continuum*, are in principle non-countable. If all transactions are individual, then

they are in principle countable. Accordingly, their aggregates, no matter how large, fail to satisfy the requirements of the continuum, particularly with respect to the existence of special equilibria. But this is to say that their mathematicization via the Real Number system represents an illicit inflation, a *mis-mathematics*, as will be demonstrated.

- Accordingly, the regnant arguments establishing the existence and uniqueness of a General Equilibrium for a competitive economy lose their former support, as do the Welfare, Efficiency, and other theorems which depend upon the same illicitly inflated mathematics.
- Overall, the Neo-Classical Economics privileges a "merchant's model" of the economy, hence conceives of the most productive economic organism in world history, the modern diversified corporation, by skipping over its producing characteristics in favor of its selling behaviors.
- The history of this "productivist" model is sketched, and its dynamic characteristics are explored.
- Among the unhappy policy consequences that have flowed from this *faux* science have been the misdistribution of income now finally being observed of the USA and the world's economies and, consequent of that, the undermining everywhere of the social peace. Less remarked has been the intensifying oligarchy of employers over employees. And, beyond even that, the dramatic rise in *bondaged forms of labor*, especially in the non-developed countries. These give the lie to the familiar "Capitalism and Freedom" narrative—which mainstream economists nevertheless continue to espouse.
- The study also develops some elements—not systematic as yet—of a radically empirical Economics science. These point to the legitimacy and the necessity of extending full citizen rights into the workplace itself, reflecting the public's "majority" investment and, more especially, countering the present employer oligarchy and its corrosive social effects on today's US and international economies.

John McDermott
Cambridge, MA
2016

CHAPTER 1

We Invest More than They

In 2005, we, us, "the public"—via government—invested $1.82 in the economy for every dollar of private-sector investment. The actual figures: $2091.6 billion invested in the USA by local, state, and federal government in the economy; $1145 billion in private-sector investment in itself.

In 2010, the ratio was 2.33 to 1, while in 2000 it was only 1.34 to 1. But over the longer haul, 1.79/1 appears closer to "normal". "We", not "they", are the majority investors in the US economy.[1]

But, that's only the beginning of the investment story. "We" also more or less guarantee a profit-making environment for private investment through the actions of the Federal Reserve system—which acts as a "money pasture" providing whatever low-cost credit the private sector needs to stay profitable. Thus, "we" invest more than "they" and then underwrite private-sector investment too.

Where does all this leave "Economics" or, as professional economists may prefer, "Economic Science"? Economists of course focus on and deeply prefer "the private sector" whose mortal enemy, properly despised by all, is "government intervention". One can see how baseless that is. The facts cry out that *there is no longer such a thing as a stand-alone-self-contained, self-regulating Free-Enterprise private-sector economy!* Nor has there been for a very long time. The "economy" that professional econo-

[1] See the data tables I've placed at the end of the chapter.

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mists prioritize in their discipline is an ideological construct—just that—and does not constitute an integral domain of data, economic behavior, and institutions for study and analysis. It is but a special region of the integral economy, deeply dependent on public investment and "the money pasture". It will be difficult for the profession to accept this, but the issue rests between fiction and fact, between the ideologist and the scientist.

But these facts also argue that we have to look again at the privileged role accorded to the private investor in our society. It is that private investor, it is said, who saves while others consume, who, unlike the rest of us, sacrifices "his" present consumption with a view—in an argot now favored—to "growing the economy". Because we benefit from "his" sacrifices—unique and indispensable as they are—it is only right and just that we should defer to "him" and to "his" mastery of the Laws of Economics as to what should be infested in, with what priority and to what extent. Most important of all, that we should take care to guarantee the prosperity of "his" investments so that the fruitful cycle they initiate will continue, ideally uninterrupted and on an expanding scale. Which, of course, is what we do.

But what becomes of this special deference if the orthodox view is wrong and that it is our public investments which are one-sidedly important, both in their scale and in the sorts of things they produce? A generation ago, a then famous economist, John Kenneth Galbraith, worried that the US economy was too much marked by private opulence and public squalor. Galbraith didn't then see that all that much could be done about it, but if we ourselves are the dominant investors, wouldn't it be the case that we are inflicting that public squalor upon ourselves, unnecessarily so, wastefully so, and, as is so common now, at the expense of our common natural environment? Given the facts of public investment, these are not idle musings.

Some Background

Not very long ago I was led into this way of looking at the US economy by some TV-economists who were explaining the collapse and desolation of the City of Detroit. A familiar tale: "Looking for greater efficiency, the car makers had shifted elsewhere." It was sad, our economists admitted, but then soulfully added that it would be the worst kind of economic wickedness to waste "scarce economic resources".

But wait! Weren't the investments in Detroit's physical infrastructure just being thrown away, wasted? Roads and water mains? And those that

created its social infrastructure—schools, hospitals, concert halls, that sort of thing? And the investments embodied in its retail shops and services? Much less those of the many small auto firm suppliers now hung out to dry? And of course the investments in homes now deserted because their former owners lost work? And the accumulated skills of nurses and firefighters, teachers, and the rest?

I had conjectured on this in a 2004 book and mulled about it since. But now thoughts came to mind about those brand-new investments that would have to be made in South Carolina, or Mexico, or wherever they were now going to make their cars. Those for water systems and sewer lines! Schools and hospitals! Houses for workers—and shops, cops, and movie theaters! It looked as if for every dollar invested in Detroit, another dollar (or its equivalent in the new local currency) would have to be invested merely to replicate what was being thrown away back in Michigan.

Have we perhaps stumbled on a sort of perverse economic law, "The Rule of Two Times"? For every dollar wasted in the moving out, another has to be invested in the moving in. All in the name of "efficiency"!

A more systematic, searching look at these matters seemed in order.

Public Investment

"Private capital investment" is a vexed category, yet we do understand that private firms "invest". But government? It just "spends", and that is commonly thought the opposite of "invests" and, equally commonly, to be the wasteful opposite of "invests".

With that Detroit example in mind, I propose that we ignore such foolishness. In what follows, I am going to look at three categories of government expenditure = investment. These categories of governmental expenditure are precisely investments because they consist of spending today to create, expand, and/or preserve productive factors and agents for tomorrow. The three are expenditures for *Producing a Labor Force*, for *Creating Infrastructure*, and for *Public Co-investment* in partnership with private investors.

Producing a Labor Force

In 2005, local, state, and federal government spent $1403.7 billion on producing and maintaining a labor force. The federal part of the expendi-

ture took place under the budgetary categories: *Education and Training*, *Health*, *Veteran's Training*, *Unemployment Compensation*, *Housing*, and *Food and Nutrition*. Those for state and local government appear under the categories *Education*, *Public welfare*, *Health and Hospitals*, and *Parks and Recreation*. This $1403.7 billion is the sum for all government expenditures in those areas in that year.[2]

Of all expenditure categories, those seemed the most transparently apt for producing tomorrow's, and maintaining today's, labor force. I don't doubt that a more searching look at other government expenditures would add to our figure, so I think we can be confident that this $1403.7 billion figure is minimal.

The argument that these are investments is quite simple. You spend today to have a more productive, adaptable labor force tomorrow. To that very point, during the last part of the nineteenth and the early part of the twentieth centuries, the very largest private-sector firms extensively invested their own monies to produce a better labor force for themselves.

The business literature of that time evinced a considerable dissatisfaction with the qualities of the then US labor force. Aside from thinking that workers were too open to "un-American ideas" like trade unions and socialism, they also stressed that they were too lacking in knowledge and skills to work effectively with the rapidly developing and changing technologies then being introduced by the big firms. It was in that light that numerous schemes and proposals came forward from the private sector to invest in behalf of a more suitable labor force. Some, like Ford Motor's Sociological Department, involved monthly visits to worker homes by company agents to make sure that the workers and their families were suitable Ford employees. If you, your spouse, and the kids passed the inspection, you got a special bonus. If not, you likely got the sack.[3] Other schemes included Judge Gary's "welfare capitalism" at US Steel and the Rockefeller's Employee Representation, which fell apart during the famous Ludlow Massacre in Colorado.

Elsewhere, including the UK, France, and Germany, there were schemes to create company towns to rear company-certified workers, that is, whole towns in which everything from schools to libraries to churches to sewage works

[2] Again, for all figures cited here, consult the tables at the end of the chapter.

[3] That "special bonus" was the famous "$5-a-day" wage, received only by workers who subjected themselves to the Sociological Department and who met especially heavy output targets. See Lacey (1986: 125 ff).

and sanitation departments was planned, owned, and operated by the company. The most famous of these was Pullman, Illinois, now absorbed into the southern environs of the city of Chicago. There is a rich literature about the sort of private-sector social planning that was applied, as in Pullman,[4] but the ultimate lesson was that it wasn't feasible to create "islands" of extra-obedient, extra-industrious workers. A wider effort was needed, a mass effort which very heavily relied on government acting through the educational system.

Thus, private efforts were overtaken by what I have called "the Historic Advance", spanning roughly 1870–1970. As described in my 2010 *Restoring Democracy to America* (Penn State University Press), this century-long, world-historic improvement in the life conditions of urban dwellers in the USA and Western Europe came of an overlap of purpose between, on the one hand, popular movements like the Social Democracy and a big industry in the throes of very rapid technological change. Better conditions = better workers! However bitter their day-to-day clashes, both wanted, needed, and together encouraged—if unequally—a vast social investment to create a modern labor force.

"To Create a Modern Labor Force!"

With that expression, we've jumped over to the most important point in this entire discussion. We mark the world-historical change from societies which produced a labor force *spontaneously and without plan* to those in which the size of the labor force, the identity of those who will be part of it, and, especially, the infinite diversity of its specialized productive abilities are the subject of social forethought abetted by overwhelming public investment. This, and not steam or steel or electronics, marks the break from a pre-modern to a modern economy.

Historians and economists frequently refer to two "industrial revolutions". The first and best known, based on steam and iron (and cotton[5]), occurred in the very early part of the nineteenth century. Then, # 2 came about with the roughly simultaneous birth of the steel, chemical, and electrical industries in the last part of the same nineteenth century. Yet these are dwarfed by—and # 2 was made possible by—the most important industrial revolution of all, to wit when "we" ceased to be satisfied with whatever labor force the existing society just happened to offer "us" and instead set about to produce the needed workers, skills, aptitudes, and

[4] See Buder (1967) and its bibliography.
[5] See the groundbreaking Beckert (2015).

attitudes as a matter of deliberate social investment and social engineering. This is the third and most important Industrial Revolution of all. It marks the very point at which "the private sector" ceased to represent a stand-alone phenomenon and instead became, so to speak, the ward, the creature of public-sector investment.

In this way of looking at things, a modern, ever-changing labor force is itself the key product produced by a modern economy. This is the goose that lays those golden eggs; to concentrate on the eggs, as we have traditionally so concentrated, is to get things backward.[6]

Analyzing the Investment Numbers

Education and Training: This first category is the most easily understood. There is a whole sub-field—Human Capital Theory—that relates investments in education and other training to their (greater) productive outcomes later. Gary Becker's pioneering study of the question examined investments in schooling,[7] and it has become a newspaper, TV, and magazine staple to run tables showing increased earning following upon a student's more extensive investment in education.

Investments in an improved labor force are also at the very core of Economic Development Theory.

And they lie at the core of the rhetoric and impulse of today's educational reform. This calls for greater investment in schooling and training, the "reformers" explaining that high, persistent unemployment and persisting low wages in the USA are the fault of the unemployed themselves. We should pause a moment on this point.

That may have been true before The Historic Advance—but no longer. We now have a modern, adaptable labor force—which is now being radically under-used. But instead of admitting that we keep so many unemployed to keep downward pressure on wages, we are told, "No, No, those workers are not really qualified enough to hold jobs in a modern economy!"

[6] I should add here that I have not done the needed historical study, but a plausible hypothesis would be that government investment began to creep up on the private variety as elementary schooling became the universal norm in Europe, Japan, and North America, and began to exceed private with the expansion of secondary education into the norm, in the 1920s in the USA, and post-1945 in Europe and Japan.

[7] Becker (1975) calculates in "years of schooling", not "dollars advanced", but the field has not stood still since then.

Ideology Trumps Facts: An Informative Detour

This is not the first time that Economics "Science" and Economics ideology have swapped places. This is not only erroneous Economics, it is spectacularly so, as the following historical account makes clear:

In 1940, the US Civilian Labor force was counted at 55.6 million persons. This was the official measure of all those persons who wanted work and who were deemed qualified for work. With the onset of war, the armed forces drew 10.9 million men and women out of that 55.6 million, almost one in five. But then some 9.1 million other workers showed up out of statistical nowhere[8] who, "unqualified" as they were previously thought to be, helped to produce unheard-of numbers of state-of-the-art weapons and ships (and food) for the USA and its allies. And doubled the US GNP in the four years of the war!

On that experience, the bulk of today's unemployed are not "unqualified" and don't need to get "qualified" before they can get work. During those war years, patriotic reasons drove people to take what were called then "defense jobs". But they were paid good, in fact high wages, from day one, often getting their training right on the production line or in the warehouse and dockside. In that way, former housewives, ex-sharecroppers, the prematurely retired, people who had been "unemployable" for the six to eight years of the Depression, and others were motivated to get "qualified"—and they did so in their 9.1 millions.

The truer truth about today's massive un- and under-employment is that it is a policy outcome. Low wages and high unemployment are goals of our national economic policy and endorsed as such by virtually the whole of the mainstream profession over the past era[9] but with roots going back well into the nineteenth century.

Basically, we are speaking here of that "money pasture", the Federal Reserve system. The job of the Federal Reserve system is to make sure that there is neither too much nor too little credit available to the economy. Too little, of course, means bust, an economy that under-performs for investors—*not everybody*, emphasis *investors*! Too much credit tends to dry up unemployment, leads to price inflation, and threats to depress the values of the property—of those very same investors. This careful balancing

[8] Historical Statistics of the USA. Series D, Nos. 1, 3, 4. I first heard this analysis many, many years ago in a private talk given by the New Deal economist Leon Keyserling.

[9] Greider (1987), though dated, is still the best discussion of why and who "cooled" the US economy in the 1970s and of why this "cool war" against working people continues.

act is simply part of that systematic deference, cited earlier, that we pay the private-sector investor for—it is theorized—"his" sacrifices.

Reading the facts of the evidence is not a great merit in Economics. Thus, while some economists want to argue that the unemployed are too untrained and otherwise unqualified to find work, still others—even more orthodox—argue that the labor force isn't produced; it just is! Economics and economists need to do or think nothing about it.

In the regnant contemporary theory, there are two basic kinds of players, *Firms* and *Households*. Firms possess productive assets; Households possess leisure, some only of which they give up for its *disutility*, labor. In this view of things, what creates an economy is not what people do but what they want—utility, satisfaction, ophelimity. Accordingly, labor, work, sweating, and so on, are only by-products of economic activity. Not the main show. Best properly relegated to special studies such as those above.

Meanwhile, at the very, very highest, most prestigious levels of the Economics profession, the labor force and its menus of productive qualities are conceived like the fish in the sea before they are caught, the ore in the ground before it is discovered and mined, and the fertility of the soil before it is planted. Or, in the language of these theorists, labor and its productive qualities are a "*non-produced input*" into the productive economy. Hence the comparison to uncaught fish, unmined ore, and unplanted fields.[10]

These strained, deeply counter-factual explanations about the origins of the labor force and its menus of productive skills may be best explained by the very facts that we are exploring here, namely, that it is *public investment* that creates a modern labor force. It would be hard to maintain the idea of a self-contained, self-regulating *private* economy if its main productive agents come via the good graces of us and of government. Why not fur over this fact by means of theory and thus adopt the position that the labor force isn't produced—it just is. As they do.

Let us move on.

[10] In one of the most important theoretical works in contemporary Economics, Kenneth Arrow and Frank Hahn discuss some of the methodological difficulties in constructing a model of a productive economy. They go on to argue that there is "…at least one non-produced input that is needed directly or indirectly, for all production; labor provides an obvious example" (Arrow and Hahn 1971: 64). Curiously, the childhood of this now dominant view almost precisely overlaps the historic changeover from a spontaneously emerging to a socially fabricated labor force.

Health and Hospitals, Public welfare, Health and Hospitals, and Parks and Recreation: These categories of public expenditure come under the same compelling arguments as above. They are part of the cost of producing and maintaining a productive population.

Unemployment Compensation, Housing, and Food and Nutrition[11]: These categories of federal, state, and local expenditure have a different warrant. They are investments in that part of the labor force that earns less than a living wage, or is not now wanted by employers but that was once wanted or may be wanted again. The private sector wants workers, not a labor force. But the latter is needed if you are going to have the former. Why not pass that cost difference onto government, as it does? These are the categories which embody that process.

Whole industries depend on this subsidy = investment by government. Especially, all those industries which do not now pay a living wage.

There is no economic discussion more open to thoughtless, doctrinaire "analyses" than whether or not to raise the minimum wage. Economists truly wring their hands over the unfortunate prospect that raising it will cut down on the number of unfortunate jobs for these unfortunate workers.

Arrow and Hahn orthodoxy to one side, *it costs money to produce workers. If one doesn't pay a living wage, and doesn't want those workers to die in the streets of starvation and disease, someone else has to make up the difference between what they are paid and what it costs them to grow up and to live—and thus to work.*

At present, a living wage for a full-time worker in the USA should be about $15–20 per hour, depending on what part of the country we're talking about. But it is everywhere closer to $10 plus or minus change. That implies that that fried chicken, or processed chicken, or hamburger, or sweat-shop garment is sold under its actual cost of production—with government making up the difference via Medicaid, food stamps, housing allowances, and the reverse income tax. In one calculation I've made, government pays more than half the real wages of fast-food (and many other low-wage retail) workers.[12]

[11] I've included only federal assistance to states and localities under Unemployment Insurance expenditures: the rest of the unemployment benefit to individuals is paid for directly out of payroll taxes.

[12] A recent academic study argues that government, through these programs, subsidizes the wage-bill of the low-wage industries by about $150 billion per year (Cohen 2015a).

If those very same monies were invested in better jobs, we could eventually have enough of them to go around. This way, the present way, simply makes those bad, sub-living wage jobs a continuing scar on our society and an unnecessary burden on both those who have to work at them and those who have to pay the taxes for the subsidy. This is a perverse investment, a sterile "investment" that makes under-paid jobs economically viable. It is no tribute to the economics acumen of the Economics profession that it supports this sterile "investment", and can thus be counted upon to rouse up in its righteous indignation when someone proposes to raise the minimum wage.

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Looking back over the previous discussion, we, through government, in 2005, invested more in producing and maintaining the Labor Force than the private sector did in its whole investment program, $1403.7 to $1145 billion—roughly $1.22 to the dollar. If "the economy" is the sum of both activities, we—through government—are the majority investor.

But our public investment doesn't end there.

Creating Infrastructure

Under this category, government, mostly state and local, invested a further $518 billion in 2005. These are monies that went to building and maintaining highways, to creating and maintaining sanitation and sewage systems, providing water, electric power[13] and gas, and, of course, subway, local bus, trolley, and other transit systems, including airports.

And, lest we forget that we live in a society, not just an economy-in-the-narrowest-sense, this $518 billion also includes the annualized investment in police, fire protection, and the administration of justice. In short, under this category, we, through government, invested an additional 45 cents to every dollar of private investment ($518 billion/$1145 billion) to create the social and physical infrastructure the latter depends upon merely to function. Again, adding to our case that it is the society's investments

[13] In many parts of the USA, the electrical systems are owned and operated by local or state authorities. This is a legacy of the New Deal's Rural Electrical Administration . Private industry wouldn't take on the higher infrastructure costs for rural areas with, by definition, fewer paying customers. The rural cooperative movement, unsung as it is, also plays a part in many state and local economies.

which one-sidedly create the economy, not the smaller private-sector variety.

Public Co-investment

Under this category, government invested $169 billion in 2005, providing another 14 cents for every dollar of private investment. These are investments which the private sector would have/could have made for itself but which instead were provided by a kindly government.

Under Research and Development (R&D), I've listed only those monies spent by the military and space programs. Here it is useful to recall that virtually the entire science and technology that underlie today's computer and electronic "miracle" was funded by, mostly, federal investments in behalf of the military and space programs. Bill Gates is probably the only "welfare queen" who actually does drive around in, not just one Cadillac but a whole fleet of them.

The earliest computers consumed immense quantities of electricity, filled whole buildings with their wiring, and their vacuum tubes blew out all the time. R&D which was directed at producing better batteries, at miniaturizing components, and at system reliability were critical issues for space rockets, rocket weapons, and military communications. It was this R&D that created the commercial opportunities for Microsoft, Apple, and the rest.

Looking across government R&D and *Natural Resources* expenditures, these replace the investments that private-sector firms would have had to have made to achieve what government now does for them. Some of these government investments are direct and immediate. For example, in order to access timber and to open up mineral sites, government will survey and construct access roads—the very same roads that will be later used—gratis—by the private-sector lessee to take the timber and the ore out.

But there are other indirect, delayed investments as well. Back in 1950, the US Office of Naval Research funded the translation of a classic Logic text, published originally in German by David Hilbert and Wilhelm Ackerman.[14] The Navy was interested in artificial languages because of their significance for codes; Hilbert and Ackermann's study was an early attempt to treat Logic as a very fundamental artificial language, thus the Navy's interest. Here we witness one of the main and earliest sources of

[14] Hilbert and Ackermann 1950 (1938, 1928).