

Proof That a Free Market System Enriches the Poor

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Most of society's welfare comes not from government, but from markets. In essence, capitalism has its own built-in welfare system. *Webster's Dictionary* defines welfare as "the state of faring or doing well." We call it by various names, such as "well-being" or "a standard of living." Ask most people what makes up their "a standard of living," and they will probably include the following things in this order: consumption and wealth; leisure time; working conditions; variety and new goods; health and safety (longer life expectancy, less disease, fewer accidents, less crime and external conflict), and the environment (less pollution, a more beautiful planet). A thorough examination of the data shows that by every one of these measures we are much better off today than we were just a few years ago.

Much of the data here compares today to 1970, because 1970 was the supposed apex of American prosperity according to most naysayers. By some of their favorite measures of well-being—real wages and income distribution—it would appear that things have gotten worse for the typical person in society since the early 1970s. It appears that median real (inflation-adjusted) wages have fallen, and that the rich have gotten richer at the expense of the poor. While it may appear that way on the surface, just the tiniest bit of scratching beneath the periphery reveals that those claims are not just wrong, they are spectacularly wrong—exactly backward, in fact.

Those oft-repeated myths, together with a few other favorites such as "both adults have to work these days in order to make a living for the family" and "the current generation of kids will be the

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first in history not to live as well as their parents@ have not been generated in

a political vacuum. They are part and parcel of a constant drumbeat of negativism, distrust, and doubt about our nation's economic system. The ultimate intent of this is a call for more government intervention, supposedly to help a growing social underclass, but in reality it weakens the role of our capitalist economic system and strengthens the role of socialist and democratic decision making in society.

Have we Americans been going downhill? Let's look at the data—not just a few cherry-picked numbers, but the reams of data that compare today to 1970. At 2,230 square feet, the average new home built today is 50 percent larger than those built in 1970 (at 1,500 square feet). Average family size has declined at the same time, so the amount of space per person has nearly doubled. More homes have garages (which are not counted into the square foot calculations), and increasingly they are for two and three cars. Fewer homes don't have phones. In 1970, only one-third of new homes had central heat and air-conditioning. Today, over four-fifths do. More people own cars. There are nearly as many cars as there are people old enough to drive them—94 vehicles for every 100 people aged 16 and over. In 1970, there was just one for every two people. More homes have color televisions, cable TV, clothes washers, dishwashers, dryers, frost-free refrigerators, and so on. And per capita consumption of bottled water is up from less than one gallon in 1970 to over thirteen today.

Net worth in constant dollars has shot upward. Median net worth has more than doubled, from just \$28,373 in 1970 to \$71,600 today; and mean net worth has more than tripled, from \$87,436 in 1970 to \$282,500 today.

In order to enjoy such gains in consumption and wealth, have we had to work harder? Not according to the Department of Labor data—or any other source you can find. The leisure and recreation industry in America today is booming. There are 289 American universities that offer a degree in Recreation and Leisure Studies, a

curriculum where you learn how to create a customized bike trip through the wine country of Napa Valley.

The recreation and leisure business is big business in America today, not because we are overworked but because we have more free time than ever before. The average work week is down by over 2.5 hours since 1970, and we have seven more days of paid vacation and holidays. We spend less time in the office and less time working at home. Twice as many people have retired from the workforce altogether retiring earlier (at age 62.6, on average) than their parents did and living longer lives in better health. We spend more time today watching movies, videos, and even TV programs. There are six times as many adult softball teams. Cruise vacationers have increased from only 0.5 million in 1970 to 6.5 million today. More of us run marathons, own boats, attend professional sporting events, and tee up (there were 11.2 million recreational golfers in 1970; there are 26.5 million today). There are 1,164 amusement and theme parks in America today, compared to just 362 in 1970. No matter where you look, the numbers refute the popular tale of an overworked American.

And what about variety? Have Americans had to narrow their selections to one type of food, one make of car, one type of running shoe, one soft drink in order to enjoy this increased consumption and leisure time? Are we all driving white Chevrolets? Hardly. There are twice as many models of cars forty different sport utility vehicles alone, compared to just eight in 1970. There are so many different magazines now (790 titles today; 339 in 1970) that if you happen to live in a trailer you can get a magazine called *Trailer Life*. When I was growing up, all you could watch on TV was ABC, CBS, NBC, PBS, and the test pattern. Now there are 185 stations. Radio stations have nearly doubled over the past three decades from 7,038 in 1970 to 12,458 today. At the grocery store, you can buy skim milk, half-percent milk, one-percent milk, two percent milk, whole milk, buttermilk, Bulgarian buttermilk, low-fat Bulgarian buttermilk, and Bovine-growth-hormone-

free milk. You can even buy milk with a shelf life of six months! Choosing dental floss can be a major undertaking because you have so many decisions to make: white, green, pink, or red; mint, cinnamon, flavor-less; striped blue-and-white with toothpaste in it; waxed or non-waxed. And consider running shoes. Runners appreciate that there are more than the five models available in 1970, when AConverse All-Stars@ were used for every sport. Today, there are 285.

What=s more, new goods enter our economy at an ever-faster pace. In 1970, less than one percent of households had a micro-wave oven. Today, over 90 percent do. In 1970, nobody had a VCR, answering machine, cordless phone, cell phone, camcorder, CD player, computer, or computer printer. There was no software for your PC; there were no PCs; and no websites. Today, there are over 93 million Internet hosts, and the majority of households have all the above goods, plus much, much more.

Have we had to pollute the environment in order to make all these goods? No. Air pollution is down by 43 percent since 1970. Water pollution is down. Our health, our safety, and the environment have all improved. We have longer life expectancies. The death rate is down by over 30 percent, and that is even including AIDS. There are fewer injuries on the road, at work, and at home.

Just about anywhere you look, things have gotten better, yet we still hear those myths about the decline in American=s well-being. Consider the myth that Aboth adults have to work these days in order to make a living for the family.@ The obvious flaw in that statement is that both adults in a family have always worked! The data show that in 1950 when the average work week at the office was 40 hours, the average work week at home was 54 hours. Work, properly viewed, is something that consumes our time and produces goods and servicesCwhether we are working at the office or in the home.

A century or two ago, both the husband and wife would work at home. The man typically would fell trees, build the house, grow food,

raise and slaughter the livestock, cure meat, build fences, and so on. The woman typically would cook and can the food, prepare meals, clean house, make and wash the clothes, darn socks, teach the kids, and so on. They worked from sunrise to sunset but were still Adirt poor, living in no more than a 20 by 20 hut with a dirt floor. At first, it was the man who left home for a Ajob in the market economy, where he would earn enough money both to replace what he did around the house and to purchase those things the family could not have afforded otherwise. Today, women are doing the same thing.

What evidence can we muster to disprove the myth that Athe current generation of kids will be the first in history to live as well as their parents? What, for example, is the Astandard of living for today=s average college student? To determine this, I compiled a list of what \$2,000 can buy. I chose \$2,000 because that equals about 2.5 months= pay at minimum wage, roughly a summer of work for a young person preparing for college. (That is not to say that in reality teenagers are working for \$5.15 an hour. A recently released report from the Department of Labor shows that 71 percent of America=s working youth aged 15 to 17 earn close to \$6.00 a hour.)

With a hard-earned \$2,000, a student can become the proud owner of the following items: a 466-megahertz Compaq PC, with monitor, color printer, and fax modem (\$499); a 19-inch color TV (\$119); a VCR (\$67); a DVD player (\$299); a cordless phone (\$49); fax machine (\$119); self stereo/CD player with speakers (\$70); microwave oven (\$49); 1.75 cubic foot refrigerator (\$89); toaster oven (\$35); cappuccino maker (\$100); blender (\$20); iron and ironing board (\$33); vacuum (\$20); table lamp (\$30); clock radio (\$17); electric toothbrush (\$30); digital camera (\$80); a Palm Pilot (\$230); and a seat massager (\$25)! No government welfare program made all these things available and affordable. It was the constantly falling prices.

In fact, let's look at what a poor household contains in America today. While you and I may not classify these households that way, the

government does because it makes its judgement using just one criterion for poverty—taxable income. The government doesn't look at consumption level. It ignores nonmarket income—such as government welfare payments, food stamps, rent subsidies, unreported income (such as tips), and the value of home production (the value of services an unemployed person may perform at home, such as cooking, cleaning, and child care). The government doesn't even look at your wealth! The fact is, the government's poverty calculation methodology is so flawed that you could win \$2,000,000 in the lottery today, put \$1.5 million in growth stocks (which reinvest earnings and, thus, pay no dividends), buy a \$350,000 house and a \$50,000 Lexus, then take \$100,000 in cash and vacation on a beach in Aruba for a year, and still be considered at poverty level according to government statistics. Why? Because the government only counts income in the calculation, and you would not have any income from those investments and assets.

According to the government, about 13 percent of Americans today live in poverty. What do people in poverty own? Ninety-seven percent of Americans in poverty have color televisions, three-fourths have VCRs, two-thirds have microwave ovens and live in air-conditioned buildings. About three-fourths own one or more cars. By consumption standards, the well-being of many Americans in poverty today is better than that to which the general population aspired in 1971.

Look back further, and the miracle of markets is even more evident. By today's living standards, virtually everyone alive in 1900 was poor. Would you trade places with a millionaire in 1900? Before you answer, consider what you would have had back then, with your extraordinary wealth. You would have lived in the biggest, fanciest house. You would have eaten the finest food, sipped the finest wine. You would have had maids to cook your food and servants to tighten your corset. You would have ridden in the finest carriage, pulled by

the strongest horses. But let's look at what you could not have had at any price. One a hot August day, you could not escape the heat in your air-conditioned home. If you took ill and needed an antibiotic, insulin, an antiallergen, or antiulcer drug, you would be out of luck. You couldn't even take an aspirin! You couldn't wear comfortable tennis shoes, or see a block-buster motion picture, or an NFL football game. You couldn't travel in a plane or even make a coast-to-coast telephone call. In 1900, the typical American rarely traveled more than twenty-five miles from home during an entire lifetime. Today, the average American flies twenty-five hundred miles a year.

What the history of the twentieth century shows is that we have progressed from a society in which only the wealthiest could have electricity, a telephone, a radio, or an electric or gas stove, to where nearly all households have not only these things, but hundreds more. Compare the typical household today to that in the year 1900 and you will be dumbfounded by the ignorance with which enemies of markets assert their claims.

How did this progress happen? It happened not through government involvement, but through markets, which constantly increase the value of our time, returning to us more and more each year for an hour of work. Competition in product markets causes firms to constantly strive to raise productivity, so they cut costs and increase profit. Cor, sometimes, simply in order to survive. Competition in labor markets causes workers to be more productive so they can earn higher wages. Cor, sometimes, simply in order to keep their jobs. The upshot is that productivity grows and real wages rise, or stated another way, the real price of products (the hours of work required for purchase) falls. That is the way of progress, and it is the way each generation in America is born wealthier than the last.

Here is a good way to view wealth. When you were born, you had nothing but time—the hours of life that God had given you. Your wealth at birth, essentially, was the sum total of what your time would

trade for over your life. With that perspective, consider the volume of goods a newborn's lifetime will trade for today, as compared to the lifetime of our great-great grandmothers and grandfathers. It is easy to see just how wealthy we really are.

To quote Henry David Thoreau, "The real cost of a thing is the amount of life which is required to be exchanged for it, immediately or in the long run (Thoreau)." Adam Smith said it as well, if not better, in 1776 in his book, *Wealth of Nations*, when he wrote, "The real price of every thing is the toil and trouble of acquiring it. What is bought with money ... is purchased by labor (Smith, 1937)." Looking at money prices may cause us to think that life is becoming more expensive. You may long for the days when a loaf of bread cost just a nickel because it sounds so inexpensive. But was it really? When bread sold for a nickel, average hourly wages were just 15 cents. The real price of that loaf of bread was 20 minutes of work. At today's \$14.50 average hourly wage, a \$1.00 loaf of bread costs just 4 minutes of work—one-fifth of what it did a century ago.

So we need to look at prices in real terms, in the currency of work time. A 19-inch color Sony Trinitron TV cost \$620 when it came out in 1971. The average hourly wage for a production and non-supervisory manufacturing worker in 1971 was \$3.57, so the typical worker had to work 174 hours—about a month—to buy one. Today, about two days work will buy you a 19-inch color TV—one of higher quality, with a better picture, remote control, stereophonic sound, and closed captioning that rarely needs repair. Money wages tend to rise faster than prices by an amount equal to the gains in labor's productivity over time.

Following this approach, look at the real cost of our basic needs—food, clothing, and shelter. A standard twelve-item basket of groceries—consisting of a half-gallon of milk, five pounds of sugar, three pounds of tomatoes, a pound of bread, coffee, bacon, ground

beef, lettuce, beans, and onions, plus a dozen eggs and oranges cost 9.5 hours of work in 1919. Today, it costs just 1.5 hours.

Yesterday's new homes may appear cheaper in money terms, but they were not cheaper in real terms—at least not on a per square foot basis. In 1920, it took 7.8 hours of work to pay for each square foot of the typical new home. By 1956, the work-hour price had fallen to 6.5 hours per square foot and the home had grown nicer with a few added features. By 1996, although the dollar price had risen to \$140,000, money wages had risen even faster, so that the real price had fallen to 5.5 hours per square foot. However, in 1956, only one-half of all new homes had garages. By 1996, 80 percent did. Most new homes today have central heat and air conditioning from 6 percent in 1956 to 81 percent in 1996. Moreover, included in the price of many of today's new homes is an oven, a stove, a dishwasher, microwave, a garage door opener, and a garbage disposal. Few new homes built in 1956 had storm windows (8 percent) or even insulation in the walls (33 percent). Today, the figures are 68 percent and 93 percent, respectively.

Consider the real price of clothing. Blue jeans, for example, are a lot cheaper than they used to be—about one-third of their 1920 price. Real prices are up a bit from 1970 because that was the last year we had to wear those stiff-as-board jeans, the ones you had to break in before they finally become comfortable. In the early 1970s, Levi Strauss had introduced a process to soften jeans, sometimes called Stone washing. The process, which uses a micro-biological agent, not stones, to soften the denim fibers, makes jeans a little more expensive but a lot more comfortable—and it is worth every penny.

If a product's real price does not fall over time, chances are that it either has improved a tremendous amount in quality (such as blue jeans or medical services), or it is being supplied to consumers by a noncompetitive market. In the second case, the discipline of competition can be insufficient in either product markets (such as in

the supply of cable TV service or in major league baseball) or in labor markets (such as in the supply of public education). The real price of products produced by unionized workers tend not to behave according to the rules followed elsewhere.

Evidence proves that most producers have to toe the line so that the real prices of their goods keep falling as time goes on. The share of our budget that we spend on food, clothing, and shelter has gone down from 76 percent in 1901 to 37 percent today. Buying the basic necessities used to consume over four-fifths of our budget, but now it is only about one-third, thereby enabling us to buy further down our list of needs and wants.

Home appliances are a great example. Appearing in 1910, the first electric range (Hughes Electric's three-burner stove) cost 345 hours of work—about nine weeks. Today, just three days of work will buy you one. The first refrigerator (the 1916 Guardian Electric), which was insulated with seaweed, boasted nine cubic feet of storage. It sold for \$800, the equivalent of about a year and a half of work for a middle-income worker. Today, with about 1.5 weeks of work, you can buy an electric refrigerator with 20 cubic square feet of storage that runs on the amount of energy consumed by a 75-watt light bulb. The Thor electric clothes washer (1911) used an extensive system of exposed belts and pulleys to do its job, an obvious hazard to the long skirts of the day. It required 553 hours of work to own. Today's much-improved washer costs just 26 hours. The Walker Brother's electric dishwasher cost about 463 hours of work at its \$100 price in 1913—not to mention the cost of replacing all the broken dishes. Today's dishwashers cost only about three days' work. Introduced in 1940, the first electric clothes dryer (General Electric's AD-3) required a 220 plug (meaning it consumed a lot of energy), but could handle only seven pounds of wet clothes. By today's standards it was very inefficient, yet it cost about 200 hours of work. GE's current model costs just 26 hours of work, uses a fraction of the energy the

old devices did, has a much larger capacity, and includes a moisture sensor and other useful features.

No home would be complete without a color TV. So what has happened to the TV's real price? In 1954, RCA introduced the first color television at a price of \$1,000 and that was for a 12-inch screen. It was state-of-the-art, but by today's standards its cost was exorbitant, and it frequently required the services of a repairman. Anyone who remembers the 1950s will recall hoping and praying that when the television went on the blink, the problem wasn't the picture tube. Television and radio repair used to be a booming business in this country, but there are far fewer TV repair shops in America today than there were back in the fifties, despite the fact that there are ten times the number of TVs. This is because today's TV is not only greatly improved, it is much cheaper. Today's 25-inch RCA color TV costs only 23 hours of work as compared to 562 in 1954, and 174 hours in 1971.

What about the electricity it takes to power all this stuff? Powering ten 100-watt light bulbs for four days in 1902 (consuming roughly one kilowatt hour) would require about two and a half weeks of work. Today, we light buildings as though electricity is free, which it is in comparison with a century ago. The work-hour cost per kilowatt is a mere 0.6 percent of what it was back in 1902. What used to cost two and a half weeks of work now costs 38 minutes and falling.

Consider our most beloved product—the automobile. The 1908 Ford Model T was called a "touring model" because it was an open vehicle with no hard roof. To get a car with a roof cost several hundred dollars more. Though an absolutely great vehicle for the day, the Model T did not have an automatic starter. You had to crank it by hand. For an extra \$75, you could buy an anti-kickback device which helped to prevent broken arms. The car had only two-wheel brakes. If you had a flat tire, you replaced the entire wheel. Obviously, there was no air conditioning or even a front windshield. At \$850, that car cost

4,696 hours of work—roughly 2.25 years. By the time we got to 1955, car prices had fallen to about 1,638 hours for the award-winning Ford Fairlane. Today's Ford Taurus costs about 1,365 hours of work, and it comes equipped with antilock brakes, air bags, a CD player, air-conditioning, cruise control, power windows, power doors and power locks—more and more every year. And it doesn't burn five quarts of oil on a 1,000 mile trip, as did many early cars.

The pre-Model T auto had a tiny two-cycle engine that powered something that looked like a four-wheel bicycle. There were no service stations; gasoline was sold at the paint store. When service stations began to appear around the 1920s, a gallon of gas cost about 35 minutes of work. Today it costs about 6.1 minutes. (Although in 1998, the work-hour price was about 4.8 minutes.)

The first coast-to-coast flight was made in 1930 on a Ford Trimotor by American Airways. Planes flew at about 2,000 feet, but because the aircraft was not pressurized, passengers' hands and feet often swelled at the high altitudes. Passengers were given gloves and foot mufflers and were warned not to throw anything out the windows. Flying at just 120 mph, with ten stops along the way, the trip took two days. Though not a very pleasant experience, people would pay \$200 for the opportunity (or 366 hours of work, about two months, for a mid-income manufacturing worker). The cost of air travel has fallen so much since then that today's college student considers it a rite of spring to hop down to Cancun for a week in the spring, wearing tennis shoes and a T-shirt. The Ajet set is no longer limited to wealthy business travelers or socialites.

The work-time price of a movie ticket is about the same as it was 80 years ago. Why? It appears that Americans have chosen to take their gains in this industry in the form of an improved product. Going to the movies today costs about 19 minutes of work, the same as in 1926—but it is not the same experience.

As a child, I needed braces for my crooked bottom teeth, but my family could not afford them. I had to wait until I was 34 to get them. Today's models cost less than half the cost of earlier appliances, and are much improved. Those uncomfortable metal bands have been replaced by clear braces, which are affixed to the teeth with a special high-tech glue. Now there are computer-designed fixtures, customized to an individual's unique set of teeth.

Typically, today's prices fall quickly after a product's introduction, but slow as the product ages. My first VCR, purchased in 1984, cost about \$480. Just 16 years later, a much better model costs \$67.

We no longer use those hand-cranked adding machines (which did not subtract, multiply, or divide), nor do we use slide rules, and we rarely find ourselves doing long-hand calculations because of the handheld calculator. At its initial 1972 price of \$120, Texas Instruments' pocket calculator cost about 31 hours of work. Today's better models cost less than an hour—possibly much less.

In 1984, when Motorola introduced the DynaTAC 8000X cellular phone, it cost \$4,200 or 456 hours of middle-income work (2.5 months). Today's middle-income worker (earning \$14.50 an hour) can buy a cellular phone for less than a day's work and a minimum wage worker can get one for just three days' wages.

At \$3,000, the first microwave oven was purchased only by restaurants and pizza places—wealthy people. Today, anyone who wants one can have one.

In 1944, IBM gave its Mark IV computer, valued at \$200,000, to Harvard. It made three calculations per second. The best way to compare the price of computing power over time is to do it in terms of a standard metric—say, one MIP (one million instructions per second). In 1944, a city of roughly 750,000 people all would have had to work their entire lifetimes to be able to afford the computing power of one MIP. By 1970, things had improved, but we were still using

mainframes, and the price was still as high as 1.25 lifetimes per MIP. With the introduction of the micro-processor in 1971, and the advent of the personal computer in 1975, computing costs fell quickly. In the early 1980s, the price per MIP was about 52 hours; in 1997, it was twenty-seven minutes; today, it is less than 5 minutes.

How did all these wonderful gains come about? Did our government, sitting there in Washington, DC, do all this for us? No. It was our market system, capitalism, which has its own built-in welfare transfer system. The economics of cheaper and better has to do with venture capitalists, able consumers, and the fixed versus marginal costs of bringing new goods to market.

Every good has fixed and marginal costs of production; the two can vary widely depending on the nature of the good. When you get a haircut, you are paying mostly marginal cost—the labor. The relatively small fixed cost—pair of scissors—gets spread over all the barber's customers. Compare that to a long-distance telephone call, which is mostly fixed cost. Before any could place that first call from New York to San Francisco, AT&T had to erect telephone poles over the 3,000 miles from coast to coast, hang lines, and install the equipment at each end to send and receive the calls. That first phone call was expensive. The second call cost closer to zero. Note that the fixed costs of this product were largely for material goods—can investment in physical capital—but fixed costs can just as easily reflect an investment in intellectual capital, such as the cost of acquiring the knowledge necessary to make a pill.

Who pays for a product's fixed costs? The first people who buy the product. Every new venture has its costs, its risks, and its potential returns. No venture capitalist ever invested \$10,000,000 with the intent of recovering that investment over a 40- to 50-year period. Given the risks inherent in any new venture, the anticipated recovery period has to be fairly short, with high initial prices which allow the rapid recovery of the investment. Economists call it price

discrimination charge a higher price to those more willing and able to pay. Well-functioning market economies do this routinely to recover the funds invested by venture capitalists, which encourages their further efforts, thereby making more goods available. Those most willing and able to pay high prices are those who have the most money.

People like to show off a little. It is human nature and it would be purely polemic to condemn people for it. The good news, though, is that markets harness that human trait to enrich all of us. The early purchaser pays a huge tax to be the first the tax of buying an inferior version of a product at a high price. High prices are the premium that capitalism recycles to pay the product's fixed cost.

Innovation would die on the vine if it weren't for the wealthy in society, who, in spending their money, bring new goods to market. When a wealthy person pays the fixed cost of bringing goods to market, it is as if that person reaches out to grab hold of the future and pulls us all forward. The first radios were found only in the mansions of society's elite. Today everyone has several. At one time, Henry Ford had to defend the automobile against claims that it was just a rich man's toy. That same claim was made about the telephone: Alexander Graham Bell's father-in-law called the device just a toy. Today, of course, these products are considered necessities by even the poorest households in society.

As economist Joseph Schumpeter said: A Queen Elizabeth owned silk stockings. The capitalist achievement does not typically consist in providing more silk stockings for queens but in bringing them within the reach of factory girls in return for steadily decreasing amounts of effort (Schumpeter).

Another aspect of free markets that is typically overlooked in understanding the growth process is the importance of free choice. In a free market, the only way to get ahead is to make a product that others voluntarily choose to buy. A free means free not to buy,

just as it means Afree to buy.@ Most of us enter the marketplace every day and make our preferences known.

In a free market system, you will never get rich by producing something that you alone want. The way to get rich in this system is by serving others. In fact, the rich are society=s best servants! They pay close attention to what we need and they deliver it. Their service makes them richCand it should because they make us rich as well.

Again Joseph Schumpeter said it best: AThe capitalist engine is the first and last engine of mass production which unavoidably means also production for the masses One problem after another of the supply of commodities to the masses has been successfully solved by being brought within the reach of the methods of capitalist production (Schumpeter, 1976).@

Our free market system has made the American masses the wealthiest people in history, proof that a free market system enriches the poor.

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