
Ludwig von Mises, ***Human Action: A Treatise on Economics, vol. 3 (LF ed.)*** [1996]

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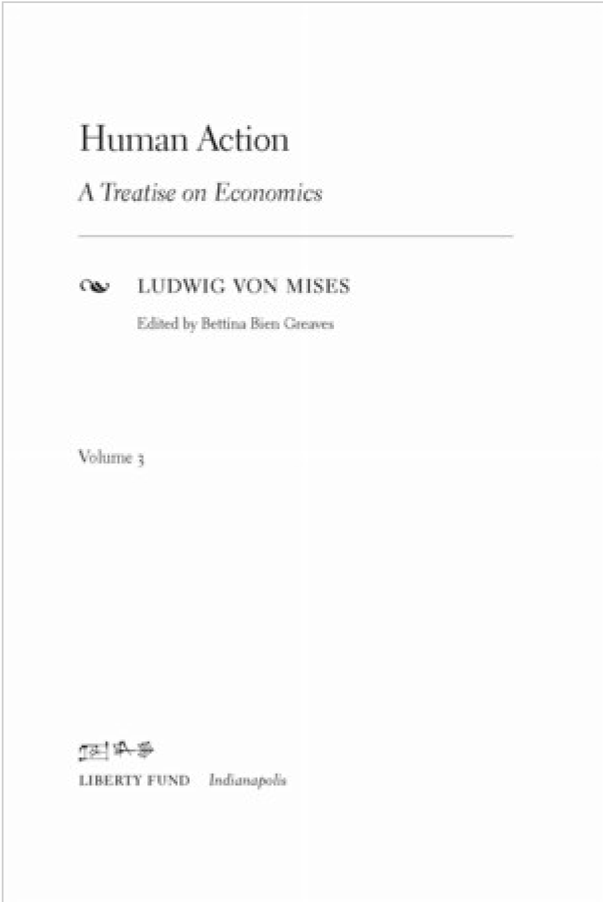
Human Action

A Treatise on Economics

LUDWIG VON MISES

Edited by Bettina Bien Greaves

Volume 3

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About This Title:

In the foreword to *Human Action: A Treatise on Economics,* Mises explains complex market phenomena as “the outcomes of countless conscious, purposive actions, choices, and preferences of individuals, each of whom was trying as best as he or she could under the circumstances to attain various wants and ends and to avoid undesired consequences.” It is individual choices in response to personal subjective value judgments that ultimately determine market phenomena—supply and demand, prices, the pattern of production, and even profits and losses. Although governments may presume to set “prices,” it is individuals who, by their actions and choices through competitive bidding for money, products, and services, actually determine “prices”. Thus, Mises presents economics—not as a study of material goods, services, and products—but as a study of human actions. He sees the science of human action, praxeology, as a science of reason and logic, which recognizes a regularity in the sequence and interrelationships among market phenomena. Mises defends the methodology of praxeology against the criticisms of Marxists, socialists, positivists, and mathematical statisticians. Mises attributes the tremendous technological progress and the consequent increase in wealth and general welfare in the last two centuries to the introduction of liberal government policies based on free-market economic teachings, creating an economic and political environment which permits individuals to pursue their respective goals in freedom and peace. Mises also explains the futility and counter-productiveness of government attempts to regulate, control, and equalize all people's circumstances: "Men are born unequal and … it is precisely their inequality that generates social cooperation and civilization."

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HUMAN ACTION

A Treatise On Economics
Volume 3

PART 5

Social Cooperation Without A Market

CHAPTER 25

The Imaginary Construction Of A Socialist Society

1

The Historical Origin Of The Socialist Idea

When the social philosophers of the eighteenth century laid the foundations of praxeology and economics, they were confronted with an almost universally accepted and uncontested distinction between the petty selfish individuals and the state, the representative of the interests of the whole society. However, at that time the deification process which finally elevated the men managing the social apparatus of coercion and compulsion into the ranks of the gods was not yet completed. What people had in mind when speaking of government was not yet the quasi-theological notion of an omnipotent and omniscient deity, the perfect embodiment of all virtues; it was the concrete governments as they acted on the political scene. It was the various sovereign entities whose territorial size was the outcome of bloody wars, diplomatic intrigues, and dynastic intermarriage and succession. It was the princes whose private domain and revenue were in many countries not yet separated from the public treasury, and oligarchic republics, like Venice and some of the Swiss cantons, in which the ultimate objective of the conduct of public affairs was to enrich the ruling aristocracy. The interests of these rulers were in opposition to those of their "selfish" subjects exclusively committed to the pursuit of their own happiness on the one hand, and to those of foreign governments longing for booty and territorial aggrandizement on the other hand. In dealing with these antagonisms, the authors of books on public affairs were ready to espouse the cause of their own country's government. They assumed quite candidly that the rulers are the champions of the interests of the whole society, irreconcilably conflicting with those of the individuals. In checking the selfishness of their subjects, governments were promoting the welfare of the whole of society as against the mean concerns of individuals.

The liberal philosophy discarded these notions. From its point of view there are within the unhampered market society no conflicts of the rightly understood interests. The interests of the citizens are not opposed to those of the nation, the interests of each nation are not opposed to those of other nations.

Yet in demonstrating this thesis the liberal philosophers themselves contributed an essential element to the notion of the godlike state. They substituted in their inquiries the image of an ideal state for the real states of their age. They constructed the vague image of a government whose only objective is to make its citizens happy. This ideal had certainly no counterpart in the Europe of the *ancien régime.* In this Europe there were German princelings who sold their subjects like cattle to fight the wars of foreign nations; there were kings who seized every opportunity to rush upon the weaker neighbors; there was the shocking experience of the partitions of Poland; there was France successively governed by the century's most profligate men, the Regent Orléans and Louis XV; and there was Spain, ruled by the ill-bred paramour of an adulterous queen. However, the liberal philosophers deal only with a state which has nothing in common with these governments of corrupt courts and aristocracies. The state, as it appears in their writings, is governed by a perfect superhuman being, a king whose only aim is to promote the welfare of his subjects. Starting from this assumption, they raise the question of whether the actions of the individual citizens when left free from any authoritarian control would not develop along lines of which this good and wise king would disapprove. The liberal philosopher answers this question in the negative. It is true, he admits, that the entrepreneurs are selfish and seek their own profit. However, in the market economy they can earn profits only by satisfying in the best possible way the most urgent needs of the consumers. The objectives of entrepreneurship do not differ from those of the perfect king. For this benevolent king too aims at nothing else than such an employment of the means of production that the maximum of consumer satisfaction can be reached.

It is obvious that this reasoning introduces value judgments and political bias into the treatment of the problems. This paternal ruler is merely an alias for the economist who by means of this trick elevates his personal value judgments to the dignity of a universally valid standard of absolute eternal values. The author identifies himself with the perfect king and calls the ends he himself would choose if he were equipped with this king's power, welfare, commonweal, and *volkswirtschaftliche* productivity as distinct from the ends toward which the selfish individuals are striving. He is so naïve as not to see that this hypothetical chief of state is merely a hypostatization of his own arbitrary value judgments, and blithely assumes that he has discovered an incontestable standard of good and evil. Masked as the benevolent paternal autocrat, the author's own Ego is enshrined as the voice of the absolute moral law.

The essential characteristic of the imaginary construction of this king's ideal regime is that all its citizens are unconditionally subject to authoritarian control. The king issues orders and all obey. This is not a market economy; there is no longer private ownership of the means of production. The terminology of the market economy is retained, but in fact there is no longer any private ownership of the means of production, no real buying and selling, and no market prices. Production is not directed by the conduct of the consumers displayed on the market, but by authoritarian decrees. The authority assigns to everybody his station in the system of the social division of labor, determines what should be produced, and how and what each individual is allowed to consume. This is what nowadays can properly be called the German variety of socialist management.1

Now the economists compare this hypothetical system, which in their eyes embodies the moral law itself, with the market economy. The best they can say of the market economy is that it does not bring about a state of affairs different from that produced by the supremacy of the perfect autocrat. They approve of the market economy only because its operation, as they see it, ultimately attains the same results the perfect king would aim at. Thus the simple identification of what is morally good and economically expedient with the plans of the totalitarian dictator that characterizes all champions of planning and socialism was not contested by many of the old liberals. One must even assert that they originated this confusion when they substituted the ideal image of the perfect state for the wicked and unscrupulous despots and politicians of the real world. Of course, for the liberal thinker this perfect state was merely an auxiliary tool of reasoning, a model with which he compared the operation of the market economy. But it was not amazing that people finally raised the question as to why one should not transfer this ideal state from the realm of thought into the realm of reality.

All older social reformers wanted to realize the good society by a confiscation of all private property and its subsequent redistribution; each man’s share should be equal to that of every other, and continuous vigilance by the authorities should safeguard the preservation of this equalitarian system. These plans became unrealizable when the large-scale enterprises in manufacturing, mining, and transportation appeared. There cannot be any question of splitting up large-scale business units and distributing the fragments in equal shares.2 The age-old program of redistribution was superseded by the idea of socialization. The means of production were to be expropriated, but no redistribution was to be resorted to. The state itself was to run all the plants and farms.

This inference became logically inescapable as soon as people began to ascribe to the *state* not only moral but also intellectual perfection. The liberal philosophers had described their imaginary state as an unselfish entity, exclusively committed to the best possible improvement of its subjects’ welfare. They had discovered that in the frame of a market society the citizens’ selfishness must bring about the same results that this unselfish state would seek to realize; it was precisely this fact that justified the preservation of the market economy in their eyes. But things became different as soon as people began to ascribe to the *state* not only the best intentions but also omniscience. Then one could not help concluding that the infallible state was in a position to succeed in the conduct of production activities better than erring individuals. It would avoid all those errors that often frustrate the actions of entrepreneurs and capitalists. There would no longer be malinvestment or squandering of scarce factors of production; wealth would multiply. The “anarchy” of production appears wasteful when contrasted with the planning of the *omniscient* state. The socialist mode of production then appears to be the only reasonable system, and the market economy seems the incarnation of unreason. In the eyes of the rationalist advocates of socialism, the market economy is simply an incomprehensible aberration of mankind. In the eyes of those influenced by historicism, the market economy is the social order of an inferior stage of human evolution which the inescapable process of progressive perfection will eliminate in order to establish the more adequate system of socialism. Both lines of thought agree that reason itself postulates the transition to socialism.

What the naïve mind calls reason is nothing but the absolutization of its own value judgments. The individual simply identifies the products of his own reasoning with the shaky notion of an absolute reason. No socialist author ever gave a thought to the possibility that the abstract entity which he wants to vest with unlimited power—whether it is called humanity, society, nation, state, or government—could act in a way of which he himself disapproves. A socialist advocates socialism because he is fully convinced that the supreme dictator of the socialist commonwealth will be reasonable from his—the individual socialist's—point of view, that he will aim at those ends of which he—the individual socialist—fully approves, and that he will try to attain these ends by choosing means which he—the individual socialist—would also choose. Every socialist calls only that system a genuinely socialist system in which these conditions are completely fulfilled; all other brands claiming the name of socialism are counterfeit systems entirely different from true socialism. Every socialist is a disguised dictator. Woe to all dissenters! They have forfeited their right to live and must be "liquidated."

The market economy makes peaceful cooperation among people possible in spite of the fact that they disagree with regard to their value judgments. In the plans of the socialists there is no room left for dissenting views. Their principle is *Gleichschaltung,* perfect uniformity enforced by the police.

People frequently call socialism a religion. It is indeed the religion of self-deification. The State and Government of which the planners speak, the People of the nationalists, the Society of the Marxians and the Humanity of Comte's positivism are names for the God of the new religions. But all these idols are merely aliases for the individual reformer's own will. In ascribing to his idol all those attributes which the theologians ascribe to God, the inflated Ego glorifies itself. It is infinitely good, omnipotent, omnipresent, omniscient, eternal. It is the only perfect being in this imperfect world.

Economics is not called to examine blind faith and bigotry. The faithful are proof against every criticism. In their eyes criticism is scandalous, a blasphemous revolt of wicked men against the imperishable splendor of their idol. Economics deals merely with the socialist plans, not with the psychological factors that impel people to espouse the religion of statolatry.

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2

The Socialist Doctrine

Karl Marx was not the originator of socialism. The ideal of socialism was fully elaborated when Marx adopted the socialist creed. Nothing could be added to the praxeological conception of the socialist system as developed by his predecessors, and Marx did not add anything. Neither did Marx refute the objections against the feasibility, desirability, and advantageousness of socialism raised by earlier authors and by his contemporaries. He never even embarked upon such a venture, fully aware as he was of his inability to succeed in it. All that he did to fight the criticisms of socialism was to hatch out the doctrine of polylogism.

However, the services that Marx rendered to the socialist propaganda were not confined to the invention of polylogism. Still more important was his doctrine of the inevitability of socialism.

Marx lived in an age in which the doctrine of evolutionary meliorism was almost generally accepted. The invisible hand of Providence leads men, independently of their wills, from lower and less perfect stages to higher and more perfect ones. There prevails in the course of human history an inevitable tendency toward progress and improvement. Each later stage of human affairs is, by virtue of its being a later stage, also a higher and better stage. Nothing is permanent in human conditions except this irresistible urge toward progress. Hegel, who died a few years before Marx entered the scene, had presented this doctrine in his fascinating philosophy of history, and Nietzsche, who entered the scene at the time when Marx withdrew, made it the focal point of his no less fascinating writings. It has been the myth of the last two hundred years.

What Marx did was to integrate the socialist creed into this meliorist doctrine. The coming of socialism is inevitable, and this by itself proves that socialism is a higher and more perfect state of human affairs than the preceding state of capitalism. It is vain to discuss the pros and cons of socialism. Socialism is bound to come "with the inexorability of a law of nature."[3] Only morons can be so stupid as to question whether what is bound to come is more beneficial than what preceded it. Only bribed apologists of the unjust claims of the exploiters can be so insolent as to find any fault with socialism.

If we attribute the epithet Marxian to all those who agree with this doctrine, we must call the immense majority of our contemporaries Marxians. These people agree that the coming of socialism is both absolutely inevitable and highly desirable. The "wave of the future" drives mankind toward socialism. Of course, they disagree with one another as to who is to be entrusted with the captaincy of the socialist ship of state. There are many candidates for this job.

Marx tried to prove his prophecy in a twofold way. The first is the method of Hegelian dialectics. Capitalist private property is the first negation of individual private property and must beget its own negation, viz., the establishment of public property in the means of production.4 Things were as simple as that for the hosts of Hegelian writers who infested Germany in the days of Marx.

The second method is the demonstration of the unsatisfactory conditions brought about by capitalism. Marx's critique of the capitalist mode of production is entirely wrong. Even the most orthodox Marxians are not bold enough to support seriously its essential thesis, namely, that capitalism results in a progressive impoverishment of the wage earners. But if one admits for the sake of argument all the absurdities of the Marxian analysis of capitalism, nothing is yet won for the demonstration of the two theses, viz., that socialism is bound to come and that it is not only a better system than capitalism, but even the most perfect system, the final realization of which will bring to man eternal bliss in his earthly life. All the sophisticated syllogisms of the ponderous volumes published by Marx, Engels, and hundreds of Marxian authors cannot conceal the fact that the only and ultimate source of Marx's prophecy is an alleged inspiration by virtue of which Marx claims to have guessed the plans of the mysterious powers determining the course of history. Like Hegel, Marx was a prophet communicating to the people the revelation that an inner voice had imparted to him.

The outstanding fact in the history of socialism between 1848 and 1920 was that the essential problems concerning its working were hardly ever touched upon. The Marxian taboo branded all attempts to examine the economic problems of a socialist commonwealth as "unscientific." Nobody was bold enough to defy this ban. It was tacitly assumed by both the friends and the foes of socialism that socialism is a realizable system of mankind's economic organization. The vast literature concerning socialism dealt with alleged shortcomings of capitalism and with the general cultural implications of socialism. It never dealt with the economics of socialism as such.

The socialist creed rests upon three dogmas:

First: Society is an omnipotent and ominiscient being, free from human frailty and weakness.

Second: The coming of socialism is inevitable.

Third: As history is a continuous progress from less perfect conditions to more perfect conditions, the coming of socialism is desirable.

For praxeology and economics the only problem to be discussed in regard to socialism is this: Can a socialist system operate as a system of the division of labor?

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3

The Praxeological Character Of Socialism

The essential mark of socialism is that *one will* alone acts. It is immaterial whose will it is. The director may be an anointed king or a dictator, ruling by virtue of his *charisma,* he may be a Führer or a board of Führers appointed by the vote of the people. The main thing is that the employment of all factors of production is directed by one agency only. One will alone chooses, decides, directs, acts, gives orders. All the rest simply obey orders and instructions. Organization and a planned order are substituted for the "anarchy" of production and for various people's initiative. Social cooperation under the division of labor is safeguarded by a system of hegemonic bonds in which a director peremptorily calls upon the obedience of all his wards.

In terming the director society (as the Marxians do), *state* (with a capital S), *government,* or *authority,* people tend to forget that the director is always a human being, not an abstract notion or a mythical collective entity. We may admit that the director or the board of directors are people of superior ability, wise and full of good intentions. But it would be nothing short of idiocy to assume that they are omniscient and infallible.

In a praxeological analysis of the problems of socialism, we are not concerned with the moral and ethical character of the director. Neither do we discuss his value judgments and his choice of ultimate ends. What we are dealing with is merely the question of whether any mortal man, equipped with the logical structure of the human mind, can be equal to the tasks incumbent upon a director of a socialist society.

We assume that the director has at his disposal all the technological knowledge of his age. Moreover, he has a complete inventory of all the material factors of production available and a roster enumerating all manpower employable. In these respects the crowd of experts and specialists which he assembles in his offices provide him with perfect information and answer correctly all questions he may ask them. Their voluminous reports accumulate in huge piles on his desk. But now he must act. He must choose among an infinite variety of projects in such a way that no want which he himself considers more urgent remains unsatisfied because the factors of production required for its satisfaction are employed for the satisfaction of wants which he considers less urgent.

It is important to realize that this problem has nothing at all to do with the valuation of the ultimate ends. It refers only to the means by the employment of which the ultimate ends chosen are to be attained. We assume that the director has made up his mind with regard to the valuation of ultimate ends. We do not question his decision. Neither do we raise the question of whether the people, the wards, approve or disapprove of their director's decisions. We may assume, for the sake of argument, that a mysterious power makes everyone agree with one another and with the director in the valuation of ultimate ends.

Our problem, the crucial and only problem of socialism, is a purely economic problem, and as such refers merely to means and not to ultimate ends.

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CHAPTER 26

The Impossibility Of Economic Calculation Under Socialism

1

The Problem

The director wants to build a house. Now, there are many methods that can be resorted to. Each of them offers, from the point of view of the director, certain advantages and disadvantages with regard to the utilization of the future building, and results in a different duration of the building's serviceableness; each of them requires other expenditures of building materials and labor and absorbs other periods of production. Which method should the director choose? He cannot reduce to a common denominator the items of various materials and various kinds of labor to be expended. Therefore he cannot compare them. He cannot attach either to the waiting time (period of production) or to the duration of serviceableness a definite numerical expression. In short, he cannot, in comparing costs to be expended and gains to be earned, resort to any arithmetical operation. The plans of his architects enumerate a vast multiplicity of various items in kind; they refer to the physical and chemical qualities of various materials and to the physical productivity of various machines, tools, and procedures. But all their statements remain unrelated to each other. There is no means of establishing any connection between them.

Imagine the plight of the director when faced with a project. What he needs to know is whether or not the execution of the project will increase well-being, that is, add something to the wealth available without impairing the satisfaction of wants which he considers more urgent. But none of the reports he receives give him any clue to the solution of this problem.

We may for the sake of argument at first disregard the dilemmas involved in the choice of consumers' goods to be produced. We may assume that this problem is settled. But there is the embarrassing multitude of producers' goods and the infinite variety of procedures that can be resorted to for manufacturing definite consumers' goods. The most advantageous location of each industry and the optimum size of each plant and of each piece of equipment must be determined. One must determine what kind of mechanical power should be employed in each of them, and which of the various formulas for the production of this energy should be applied. All these problems are raised daily in thousands and thousands of cases. Each case offers special conditions and requires an individual solution appropriate to these special data. The number of elements with which the director's decision has to deal is much greater than would be indicated by a merely technological description of the available producers' goods in terms of physics and chemistry. The location of each of them must be taken into consideration as well as the serviceableness of the capital investments made in the past for their utilization. The director does not simply have to deal with coal as such, but with thousands and thousands of pits already in operation in various places, and with the possibilities for digging new pits, with the various methods of mining in each of them, with the different qualities of the coal in various deposits, with the various methods for utilizing the coal for the production of heat, power, and a great number of derivatives. It is permissible to say that the present state of technological knowledge makes it possible to produce almost anything out of almost everything. Our ancestors, for instance, knew only a limited number of employments for wood. Modern technology has added a multitude of possible new employments. Wood can be used for the production of paper, of various textile fibers, of foodstuffs, drugs, and many other synthetic products.

Today two methods are resorted to for providing a city with clean water. Either one brings the water over long distances in aqueducts, an ancient method long practiced, or one chemically purifies the water available in the city's neighborhood. Why does one not produce water synthetically in factories? Modern technology could easily solve the technological problems involved. The average man in his mental inertia is ready to ridicule such projects as sheer lunacy. However, the only reason why the synthetic production of drinking water today—perhaps not at a later day—is out of the question is that economic calculation in terms of money shows that it is a more expensive procedure than other methods. Eliminate economic calculation and you have no means of making a rational choice between the various alternatives.

The socialists, it is true, object that economic calculation is not infallible. They say that the capitalists sometimes make mistakes in their calculation. Of course, this happens and will always happen. For all human action points to the future and the future is always uncertain. The most carefully elaborated plans are frustrated if expectations concerning the future are dashed to the ground. However, this is quite a different problem. Today we calculate from the point of view of our present knowledge and of our present anticipation of future conditions. We do not deal with the problem of whether or not the director will be able to anticipate future conditions. What we have in mind is that the director cannot calculate from the point of view of his own present value judgments and his own present anticipations of future conditions, whatever they may be. If he invests today in the canning industry, it may happen that a change in consumers' tastes or in the hygienic opinions concerning the wholesomeness of canned food will one day turn his investment into a malinvestment. But how can he find out *today* how to build and equip a cannery most economically?

Some railroad lines constructed at the turn of the century would not have been built if people had at that time anticipated the impending advance of motoring and aviation. But those who at that time built railroads knew which of the various possible alternatives for the realization of their plans they had to choose from the point of view of their appraisements and anticipations and of the market prices of their day in which the valuations of the consumers were reflected. It is precisely this insight that the director will lack. He will be like a sailor on the high seas unfamiliar with the methods of navigation, or like a medieval scholar entrusted with the technical operation of a railroad engine.

We have assumed that the director has already made up his mind with regard to the construction of a definite plant or building. However, in order to make such a decision he already needs economic calculation. If a hydroelectric power station is to be built, one must know whether or not this is the most economical way to produce the energy needed. How can he know this if he cannot calculate costs and output?

We may admit that in its initial period a socialist regime could to some extent rely upon the experience of the preceding age of capitalism. But what is to be done later, as conditions change more and more? Of what use could the prices of 1900 be for the director in 1949? And what use can the director in 1980 derive from the knowledge of the prices of 1949?

The paradox of "planning" is that it cannot plan, because of the absence of economic calculation. What is called a planned economy is no economy at all. It is just a system of groping about in the dark. There is no question of a rational choice of means for the best possible attainment of the ultimate ends sought. What is called conscious planning is precisely the elimination of conscious purposive action.

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2

Past Failures To Conceive The Problem

For more than a hundred years the substitution of socialist planning for private enterprise has been the main political issue. Thousands and thousands of books have been published for and against the communist plans. No other subject has been more eagerly discussed in private circles, in the press, in public gatherings, in the meetings of learned societies, in election campaigns, and in parliaments. Wars have been fought and rivers of blood have been shed for the cause of socialism. Yet in all these years the essential question has not been raised.

It is true that some eminent economists—Hermann Heinrich Gossen, Albert Schäffle, Vilfredo Pareto, Nikolaas G. Pierson, Enrico Barone—touched upon the problem. But, with the exception of Pierson, they did not penetrate to the core of the problem, and they all failed to recognize its primordial importance. Neither did they venture to integrate it into the system of the theory of human action. It was these failures which prevented people from paying attention to their observations. They were disregarded and soon fell into oblivion.

It would be a serious mistake to blame the Historical School and Institutionalism for this neglect of mankind's most vital problem. These two lines of thought fanatically disparage economics, the "dismal science," in the interests of their interventionist or socialist propaganda. However, they have not succeeded in suppressing the study of economics entirely. The puzzling thing is not why the detractors of economics failed to recognize the problem, but why the economists were guilty of the same fault.

It is the two fundamental errors of mathematical economics that must be indicted.

The mathematical economists are almost exclusively intent upon the study of what they call economic equilibrium and the static state. Recourse to the imaginary construction of an evenly rotating economy is, as has been pointed out,[1] an indispensable mental tool of economic reasoning. But it is a grave mistake to consider this auxiliary tool as anything else than an imaginary construction, and to overlook the fact that it has not only no counterpart in reality, but cannot even be thought through consistently to its ultimate logical consequences. The mathematical economist, blinded by the prepossession that economics must be constructed according to the pattern of Newtonian mechanics and is open to treatment by mathematical methods, misconstrues entirely the subject matter of his investigations. He no longer deals with human action but with a soulless mechanism mysteriously actuated by forces not open to further analysis. In the imaginary construction of the evenly rotating economy there is, of course, no room for the entrepreneurial function. Thus the mathematical economist eliminates the entrepreneur from his thought. He has no need for this mover and shaker whose never ceasing intervention prevents the imaginary system from reaching the state of perfect equilibrium and static conditions. He hates the entrepreneur as a disturbing element. The prices of the factors of production, as the mathematical economist sees it, are determined by the intersection of two curves, not by human action.

Moreover, in drawing his cherished curves of cost and price, the mathematical economist fails to see that the reduction of costs and prices to homogeneous magnitudes implies the use of a common medium of exchange. Thus he creates the illusion that calculation of costs and prices could be resorted to even in the absence of a common denominator of the exchange ratios of the factors of production.

The result is that from the writings of the mathematical economists the imaginary construction of a socialist commonwealth emerges as a realizable system of cooperation under the division of labor, as a full-fledged alternative to the economic system based on private control of the means of production. The director of the socialist community will be in a position to allocate the various factors of production in a rational way, i.e., on the ground of calculation. Men can have both socialist cooperation under the division of labor and rational employment of the factors of production. They are free to adopt socialism without abandoning economy in the choice of means. Socialism does not enjoin the renunciation of rationality in the employment of the factors of production. It is a variety of *rational* social action.

An apparent verification of these errors was seen in the experience of the socialist governments of Soviet Russia and Nazi Germany. People do not realize that these were not isolated socialist systems. They were operating in an environment in which the price system still worked. They could resort to economic calculation on the ground of the prices established abroad. Without the aid of these prices their actions would have been aimless and planless. Only because they were able to refer to these foreign prices were they able to calculate, to keep books, and to prepare their much talked about plans.

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3

Recent Suggestions For Socialist Economic Calculation

The socialist tracts deal with everything except the essential and unique problem of socialism, viz., economic calculation. It is only in the last years that socialist writers have no longer been able to avoid paying attention to this primordial matter. They have begun to suspect that the Marxian technique of smearing "bourgeois" economics is not a sufficient method for the realization of the socialist utopia. They have tried to substitute a theory of socialism for the scurrilous Hegelian metaphysics of the Marxian doctrine. They have embarked upon designing schemes for socialist economic calculation. Of course, they have lamentably failed in this task. It would hardly be necessary to deal with their spurious suggestions were it not for the fact that such examination offers a good opportunity to bring into relief fundamental features both of the market society and of the imaginary construction of a nonmarket society.

The various schemes proposed can be classified in the following way:

1. Calculation in kind is to be substituted for calculation in terms of money. This method is worthless. One cannot add or subtract numbers of different kinds (heterogeneous quantities).[2]
2. Starting from the ideas of the labor theory of value, the labor-hour is recommended as the unit of calculation. This suggestion does not take into account the original material factors of production and ignores the different qualities of work accomplished in the various labor-hours worked by the same and by different people.
3. The unit is to be a "quantity" of utility. However, acting man does not measure utility. He arranges it in scales of gradation. Market prices are not expressive of equivalence, but of a divergence in the valuation of the two exchanging parties. It is impermissible to neglect the fundamental theorem of modern economics, namely, that the value attached to one unit of a supply of *n 1* units is greater than that attached to one unit of a supply of *n* units.
4. Calculation is to be made possible by the establishment of an artificial quasi-market. This scheme is dealt with in section 5 of this chapter.
5. Calculation is to be made with the aid of the differential equations of mathematical catallactics. This scheme is dealt with in section 6 of this chapter.
6. Calculation is to be made superfluous by resorting to the method of trial and error. This idea is dealt with in section 4 of this chapter.

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4

Trial And Error

The entrepreneurs and capitalists do not have advance assurance about whether their plans are the most appropriate solution for the allocation of factors of production to the various branches of industry. It is only later experience that shows them after the event whether they were right or wrong in their enterprises and investments. The method they apply is the method of trial and error. Why, say some socialists, should not the socialist director resort to the same method?

The method of trial and error is applicable in all cases in which the correct solution is recognizable as such by unmistakable marks not dependent on the method of trial and error itself. If a man mislays his wallet, he may hunt for it in various places. If he finds it, he recognizes it as his property; there is no doubt about the success of the method of trial and error applied; he has solved his problem. When Ehrlich was looking for a remedy for syphilis, he tested hundreds of drugs until he found what he was searching for, a drug that killed the spirochetes without damaging the human body. The mark of the correct solution, the drug number 606, was that it combined these two qualities, as could be learned from laboratory experiment and from clinical experience.

Things are quite different if the only mark of the correct solution is that it has been reached by the application of a method considered appropriate for the solution of the problem. The correct result of a multiplication of two factors is recognizable only as the result of a correct application of the process indicated by arithmetic. One may try to guess the correct result by trial and error. But here the method of trial and error is no substitute for the arithmetical process. It would be quite futile if the arithmetical process did not provide a yardstick for discriminating what is incorrect from what is correct.

If one wants to call entrepreneurial action an application of the method of trial and error, one must not forget that the correct solution is easily recognizable as such; it is the emergence of a surplus of proceeds over costs. Profit tells the entrepreneur that the consumers approve of his ventures; loss, that they disapprove.

The problem of socialist economic calculation is precisely this: that in the absence of market prices for the factors of production, a computation of profit or loss is not feasible.

We may assume that in the socialist commonwealth there is a market for consumers' goods and that money prices for consumers' goods are determined on this market. We may assume that the director assigns periodically to every member a certain amount of money and sells the consumers' goods to those bidding the highest prices. Or we may as well assume that a certain portion of the various consumers' goods in kind is allotted to each member and that the members are free to exchange these goods against other goods on a market in which the transactions are effected through a common medium of exchange, a sort of money. But the characteristic mark of the socialist system is that the producers' goods are controlled by one agency only in whose name the director acts, that they are neither bought nor sold, and that there are no prices for them. Thus there cannot be any question of comparing input and output by the methods of arithmetic.

We do not assert that the capitalist mode of economic calculation guarantees the absolutely best solution of the allocation of factors of production. Such absolutely perfect solutions of any problem are out of reach of mortal men. What the operation of a market not sabotaged by the interference of compulsion and coercion can bring about is merely the best solution accessible to the human mind under the given state of technological knowledge and the intellectual abilities of the age's shrewdest men. As soon as any man discovers a discrepancy between the real state of production and a realizable better[3] state, the profit motive pushes him toward the utmost effort to realize his plans. The sale of his products will show whether he was right or wrong in his anticipations. The market daily tries the entrepreneurs anew and eliminates those who cannot stand the test. It tends to entrust the conduct of business affairs to those men who have succeeded in filling the most urgent wants of the consumers. This is the only important respect in which one can call the market economy a system of trial and error.

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5

The Quasi-market

The distinctive mark of socialism is the oneness and indivisibility of the will directing all production activities within the whole social system. When the socialists declare that "order" and "organization" are to be substituted for the "anarchy" of production, conscious action for the alleged planlessness of capitalism, true cooperation for competition, production for use for production for profit, what they have in mind is always the substitution of the exclusive and monopolistic power of only *one* agency for the infinite multitude of the plans of the individual consumers and those attending to the wishes of the consumers, the entrepreneurs and capitalists. The essence of socialism is the entire elimination of the market and of catallactic competition. The socialist system is a system without a market and market prices for the factors of production and without competition; it means the unrestricted centralization and unification of the conduct of all affairs in the hands of one authority. In the drafting of the unique plan that directs all economic activities the citizens cooperate, if at all, only by electing the director or the board of directors. For the rest they are only subordinates, bound to obey unconditionally the orders issued by the director, and wards of whose well-being the director takes care. All the excellences the socialists ascribe to socialism and all the blessings they expect from its realization are described as the necessary outcome of this absolute unification and centralization.

It is therefore nothing short of a full acknowledgment of the correctness and irrefutability of the economists' analysis and devastating critique of the socialists' plans that the intellectual leaders of socialism are now busy designing schemes for a socialist system in which the market, market prices for the factors of production, and catallactic competition are to be preserved. The overwhelmingly rapid triumph of the demonstration that no economic calculation is possible under a socialist system is without precedent indeed in the history of human thought. The socialists cannot help admitting their crushing final defeat. They no longer claim that socialism is matchlessly superior to capitalism because it brushes away markets, market prices, and competition. On the contrary. They are now eager to justify socialism by pointing out that it is possible to preserve these institutions even under socialism. They are drafting outlines for a socialism in which there are prices and competition.[4]

What these neosocialists suggest is really paradoxical. They want to abolish private control of the means of production, market exchange, market prices, and competition. But at the same time they want to organize the socialist utopia in such a way that people could act *as if* these things were still present. They want people to play market as children play war, railroad, or school. They do not comprehend how such childish play differs from the real thing it tries to imitate.

It was, say these neosocialists, a serious mistake on the part of the older socialists (i.e., of all socialists before 1920) to believe that socialism necessarily requires the abolition of the market and of market exchange and even that this fact is both the essential element and the preeminent feature of a socialist economy. This idea is, as they reluctantly admit, preposterous and its realization would result in a chaotic muddle. But fortunately, they say, there is a better pattern for socialism available. It is possible to instruct the managers of the various production units to conduct the affairs of their unit in the same way they did under capitalism. The manager of a corporation operates in the market society not on his account and at his own peril, but for the benefit of the corporation, i.e., the shareholders. He will go on under socialism in the same way with the same care and attention. The only difference will consist in the fact that the fruits of his endeavors will enrich the whole society, not the shareholders. For the rest he will buy and sell, recruit and pay workers, and try to make profits in the same way he did before. The transition from the managerial system of mature capitalism to the managerial system of the planned socialist commonwealth will be smoothly effected. Nothing will change except the ownership of the capital invested. Society will be substituted for the shareholders, the people will henceforth pocket the dividends. That is all.

The cardinal fallacy implied in this and all kindred proposals is that they look at the economic problem from the perspective of the subaltern clerk whose intellectual horizon does not extend beyond subordinate tasks. They consider the structure of industrial production and the allocation of capital to the various branches and production aggregates as rigid, and do not take into account the necessity of altering this structure in order to adjust it to changes in conditions. What they have in mind is a world in which no further changes occur and economic history has reached its final stage. They fail to realize that the operations of the corporate officers consist merely in the loyal execution of the tasks entrusted to them by their bosses, the shareholders, and that in performing the orders received they are forced to adjust themselves to the structure of the market prices, ultimately determined by factors other than the various managerial operations. The operations of the managers, their buying and selling, are only a small segment of the totality of market operations. The market of the capitalist society also performs all those operations which allocate the capital goods to the various branches of industry. The entrepreneurs and capitalists establish corporations and other firms, enlarge or reduce their size, dissolve them or merge them with other enterprises; they buy and sell the shares and bonds of already existing and of new corporations; they grant, withdraw, and recover credits; in short they perform all those acts the totality of which is called the capital and money market. It is these financial transactions of promoters and speculators that direct production into those channels in which it satisfies the most urgent wants of the consumers in the best possible way. These transactions constitute the market as such. If one eliminates them, one does not preserve any part of the market. What remains is a fragment that cannot exist alone and cannot function as a market.

The role that the loyal corporation manager plays in the conduct of business is much more modest than the authors of these plans assume. His is only a managerial function, a subsidiary assistance granted to the entrepreneurs and capitalists, which refers only to subordinate tasks. It can never become a substitute for the entrepreneurial function.[5] The speculators, promoters, investors and moneylenders, in determining the structure of the stock and commodity exchanges and of the money market, circumscribe the orbit within which definite minor tasks can be entrusted to the manager's discretion. In attending to these tasks the manager must adjust his procedures to the structure of the market created by factors which go far beyond the managerial functions.

Our problem does not refer to the managerial activities; it concerns the allocation of capital to the various branches of industry. The question is: In which branches should production be increased or restricted, in which branches should the objective of production be altered, what new branches should be inaugurated? With regard to these issues it is vain to cite the honest corporation manager and his well-tried efficiency. Those who confuse entrepreneurship and management close their eyes to the economic problem. In labor disputes the parties are not management and labor, but entrepreneurship (or capital) and the salaried and wage-receiving employees. The capitalist system is not a managerial system; it is an entrepreneurial system. One does not detract from the merits of corporation managers if one establishes the fact that it is not their conduct that determines the allocation of the factors of production to the various lines of industry.

Nobody has ever suggested that the socialist commonwealth could invite the promoters and speculators to continue their speculations and then deliver their profits to the common chest. Those suggesting a quasi-market for the socialist system have never wanted to preserve the stock and commodity exchanges, the trading in futures, and the bankers and moneylenders as quasi-institutions. One cannot *play* speculation and investment. The speculators and investors expose their own wealth, their own destiny. This fact makes them responsible to the consumers, the ultimate bosses of the capitalist economy. If one relieves them of this responsibility, one deprives them of their very character. They are no longer businessmen, but just a group of men to whom the director has handed over his main task, the supreme direction of the conduct of affairs. Then they—and not the nominal director—become the true directors and have to face the same problem the nominal director could not solve: the problem of calculation.

In recognition of the fact that such an idea would be simply nonsensical, the advocates of the quasi-market plan sometimes vaguely recommend another way out. The director should act as a bank lending the available funds to the highest bidder. This again is an abortive idea. All those who can bid for these funds have, as is self-evident in a socialist order of society, no property of their own. In bidding they are not restrained by any financial dangers they themselves run in promising too high a rate of interest for the funds borrowed. They do not in the least alleviate the burden of responsibility incumbent upon the director. The insecurity of the funds lent to them is in no way restricted by the partial guarantee which the borrower's own means provide in credit transactions under capitalism. All the hazards of this insecurity fall only upon society, the exclusive owner of all resources available. If the director were without hesitation to allocate the funds available to those who bid most, he would simply put a premium upon audacity, carelessness, and unreasonable optimism. He would abdicate in favor of the least scrupulous visionaries or scoundrels. He must reserve to himself the decision on how society's funds should be utilized. But then we are back again where we started: the director, in his endeavors to direct production activities, is not aided by the division of intellectual labor which under capitalism provides a practicable method for economic calculation.6

The employment of the means of production can be controlled either by private owners or by the social apparatus of coercion and compulsion. In the first case there is a market, there are market prices for all factors of production, and economic calculation is possible. In the second case all these things are absent. It is vain to comfort oneself with the hope that the organs of the collective economy will be "omnipresent" and "omniscient."7 We do not deal in praxeology with the acts of the omnipresent and omniscient Deity, but with the actions of men endowed with a human mind only. Such a mind cannot plan without economic calculation.

A socialist system with a market and market prices is as self-contradictory as is the notion of a triangular square. Production is directed either by profit-seeking businessmen or by the decisions of a director to whom supreme and exclusive power is entrusted. There are produced either those things from the sale of which the entrepreneurs expect the highest profits or those things which the director wants to be produced. The question is: Who should be master, the consumers or the director? With whom should the ultimate decision rest whether a concrete supply of factors of production should be employed for the production of the consumers' good *a* or the consumers' good *b?* Such a question does not allow of any evasive answer. It must be answered in a straightforward and unambiguous way.8

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6

The Differential Equations Of Mathematical Economics

In order to appraise adequately the idea that the differential equations of mathematical economics could be utilized for socialist economic calculation, we must remember what these equations really mean.

In devising the imaginary construction of an evenly rotating economy we assume that all the factors of production are employed in such a way that each of them renders the most highly valued services it can possibly render. No further change in the employment of any of these factors could improve the state of want-satisfaction under prevailing conditions. This situation, in which no further changes in the disposition of the factors of production are resorted to, is described by systems of differential equations. However, these equations do not provide any information about the human actions by means of which the hypothetical state of equilibrium has been reached. All they say is this: If, in this state of static equilibrium, *m* units of a are employed for the production of *p,* and *n* units of *a* for the production of *q,* no further change in the employment of the available units of *a* could result in an increment in want-satisfaction. (Even if we assume that *a* is perfectly divisible and take the unit of *a* as infinitesimal, it would be a serious blunder to assert that the marginal utility of *a* is the same in both employments.)

This state of equilibrium is a purely imaginary construction. In a changing world it can never be realized. It differs from today's state as well as from any other realizable state of affairs.

In the market economy it is entrepreneurial action that again and again reshuffles exchange ratios and the allocation of the factors of production. An enterprising man discovers a discrepancy between the prices of the complementary factors of production and the future prices of the products as he anticipates them, and tries to take advantage of this discrepancy for his own profit. The future price which he has in mind is, to be sure, not the hypothetical equilibrium price. No actor has anything to do with equilibrium and equilibrium prices; these notions are foreign to real life and action; they are auxiliary tools of praxeological reasoning for which there is no mental means to conceive the ceaseless restlessness of action other than to contrast it with the notion of perfect quiet. For the theorists' reasoning every change is a step forward on a road which, provided no further new data appear, finally leads to a state of equilibrium. Neither the theorists, nor the capitalists and entrepreneurs, nor the consumers, are in a position to form, on the ground of their familiarity with present conditions, an opinion about the height of such an equilibrium price. There is no need for such an opinion. What impels a man toward change and innovation is not the vision of equilibrium prices, but the anticipation of the height of the prices of a limited number of articles as they will prevail on the market on the date at which he plans to sell. What the entrepreneur, in embarking upon a definite project, has in mind is only the first steps of a transformation which, provided no changes in the data occur other than those induced by his project, would result in establishing the state of equilibrium.

But for a utilization of the equations describing the state of equilibrium, a knowledge of the gradation of the values of consumers' goods in this state of equilibrium is required. This gradation is one of the elements of these equations assumed as known. Yet the director knows only his present valuations, not also his valuations under the hypothetical state of equilibrium. He believes that, with regard to his present valuations, the allocation of the factors of production is unsatisfactory and wants to change it. But he knows nothing about how he himself will value on the day the equilibrium will be reached. These valuations will reflect the conditions resulting from the successive changes in production he himself inaugurates.

We call the present day D_1 and the day the equilibrium will be established D_n. Accordingly we name the following magnitudes corresponding to these two days: the scale of valuation of the goods of the first order V_1 and V_n, the total supply[9] of all original factors of production O_1 and O_n, the total supply of all produced factors of production P_1 and P_n, and summarize O_1P_1 as M_1 and O_nP_n as M_n. Finally we call the state of technological knowledge, T_1 and T_n. For the solution of the equations a knowledge of V_n, $O_nP_nM_n$, and T_n is required. But what we know today is merely V_1, $O_1P_1M_1$, and T_1.

It would be impermissible to assume that these magnitudes for D_1 are equal to those for D_n, because the state of equilibrium cannot be attained if further changes in the data occur. The absence of further changes in the data which is the condition required for the establishment of equilibrium refers only to such changes as could derange the adjustment of conditions to the operation of those elements which are already operating today. The system cannot attain the state of equilibrium if new elements, penetrating from without, divert it from those movements which tend toward the establishment of equilibrium.[10] But as long as the equilibrium is not yet attained, the system is in a continuous movement which changes the data. The tendency toward the establishment of equilibrium, not interrupted by the emergence of any changes in the data coming from without, is in itself a succession of changes in the data.

P_1 is a set of magnitudes that do not correspond to today's valuations. It is the outcome of actions which were guided by past valuations and faced a state of technological knowledge and of information about available resources of primary factors of production which was different from the present state. One of the reasons why the system is not in equilibrium is precisely the fact that P_1 is not adjusted to present conditions. There are plants, tools, and supplies of other factors of production which would not exist under equilibrium, and other plants, tools, and supplies must be produced in order to establish equilibrium. Equilibrium will emerge only when these disturbing parts of P_1, as far as they are still utilizable, will be worn out and replaced by items which correspond to the state of the other synchronous data, viz., *V, O,* and *T.* What acting man needs to know is not the state of affairs under equilibrium, but information about the most appropriate method of transforming, by successive steps, P_1 into P_n. With regard to this task the equations are useless.

One cannot master these problems by eliminating *P* and relying only upon *O*. It is true that the mode of utilizing the original factors of production uniquely determines the quality and quantity of the produced factors of production, the intermediary products. But the information that could be won in this way refers only to the conditions of equilibrium. It does not tell us anything about the methods and procedures to be resorted to for the realization of equilibrium. Today we are confronted with a supply of P_1 which differs from the state of equilibrium. We must take into account real conditions, i.e., P_1, and not the hypothetical conditions of P_n.

This hypothetical future state of equilibrium will appear when all methods of production have been adjusted to the valuations of the actors and to the state of technological knowledge. Then one will work in the most appropriate locations with the most adequate technological methods. Today's economy is different. It operates with other means which do not correspond to the equilibrium state and cannot be taken into account in a system of equations describing this state in mathematical symbols. The knowledge of conditions which will prevail under equilibrium is useless for the director whose task it is to act today under present conditions. What he must learn is how to proceed in the most economical way with the means available today which are the inheritance of an age with different valuations, a different technological knowledge, and different information about problems of location. He must know which step is the next he must make. In this dilemma the equations provide no help.

Let us assume that an isolated country whose economic conditions are those of Central Europe in the middle of the nineteenth century is ruled by a dictator who is perfectly familiar with the American technology of our day. This director knows by and large to what goal he should lead the economy of the country entrusted to his care. Yet even a full knowledge of today's American conditions could not be of use to him in regard to the problem of transforming by successive steps, in the most appropriate and expedient way, the given economic system into the system aimed at.

Even if, for the sake of argument, we assume that a miraculous inspiration has enabled the director without economic calculation to solve all problems concerning the most advantageous arrangement of all production activities and that the precise image of the final goal he must aim at is present to his mind, there remain essential problems which cannot be dealt with without economic calculation. For the director's task is not to begin from the very bottom of civilization and to start economic history from scratch. The elements with the aid of which he must operate are not only natural resources untouched by previous utilization. There are also the capital goods produced in the past and not convertible or not perfectly convertible for new projects. It is in precisely these artifacts, produced under a constellation in which valuations, technological knowledge and many other things were different from what they are today, that our wealth is embodied. Their structure, quality, quantity, and location is of primary importance in the choice of all further economic operations. Some of them may be absolutely useless for any further employment; they must remain "unused capacity." But the greater part of them must be utilized if we do not want to start anew from the extreme poverty and destitution of primitive man and want to survive the period which separates us from the day on which the reconstruction of the apparatus of production according to the new plans will be accomplished. The director cannot merely erect a new construction without bothering about his wards' fate in the waiting period. He must try to take advantage of every piece of the already available capital goods in the best possible way.

Not only the technocrats, but socialists of all shades of opinion, repeat again and again that what makes the achievement of their ambitious plans realizable is the enormous wealth hitherto accumulated. But in the same breath they disregard the fact that this wealth consists to a great extent in capital goods produced in the past and more or less antiquated from the point of view of our present valuations and technological knowledge. As they see it, the only aim of production is to transform the industrial apparatus in such a way as to make life more abundant for later generations. In their eyes contemporaries are simply a lost generation, people whose only purpose it must be to toil and trouble for the benefit of the unborn. However, real men are different. They want not only to create a better world for their grandsons to live in; they themselves also want to enjoy life. They want to utilize in the most efficient way those capital goods which are now available. They aim at a better future, but they want to attain this goal in the most economical way. For the realization of this desire too they cannot do without economic calculation.

It was a serious mistake to believe that the state of equilibrium could be computed, by means of mathematical operations, on the basis of the knowledge of conditions in a nonequilibrium state. It was no less erroneous to believe that such a knowledge of the conditions under a hypothetical state of equilibrium could be of any use for acting man in his search for the best possible solution of the problems with which he is faced in his daily choices and activities. There is therefore no need to stress the point that the fabulous number of equations which one would have to solve each day anew for a practical utilization of the method would make the whole idea absurd even if it were really a reasonable substitute for the market's economic calculation.[11]

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PART 6

The Hampered Market Economy

CHAPTER 27

The Government And The Market

1

The Idea Of A Third System

Private ownership of the means of production (market economy or capitalism) and public ownership of the means of production (socialism or communism or "planning") can be neatly distinguished. Each of these two systems of society's economic organization is open to a precise and unambiguous description and definition. They can never be confounded with one another; they cannot be mixed or combined; no gradual transition leads from one of them to the other; they are mutually incompatible. With regard to the same factors of production there can only exist private control or public control. If in the frame of a system of social cooperation only some means of production are subject to public ownership while the rest are controlled by private individuals, this does not make for a mixed system combining socialism and private ownership. The system remains a market society, provided the socialized sector does not become entirely separated from the non-socialized sector and lead a strictly autarkic existence. (In this latter case there are two systems independently coexisting side by side—a capitalist and a socialist.) Publicly owned enterprises operating within a system in which there are privately owned enterprises and a market, and socialized countries, exchanging goods and services with nonsocialist countries, are integrated into a system of market economy. They are subject to the law of the market and have the opportunity of resorting to economic calculation.[1]

If one considers the idea of placing by the side of these two systems or between them a third system of human cooperation under the division of labor, one can always start only from the notion of the market economy, never from that of socialism. The notion of socialism with its rigid monism and centralism that vests the powers to choose and to act in *one will* exclusively does not allow of any compromise or concession; this construction is not amenable to any adjustment or alteration. But it is different with the scheme of the market economy. Here the dualism of the market and the government's power of coercion and compulsion suggests various ideas. Is it really peremptory or expedient, people ask, that the government keep itself out of the market? Should it not be a task of government to interfere and to correct the operation of the market? Is it necessary to put up with the alternative of capitalism or socialism?

Are there not perhaps still other realizable systems of social organization which are neither communism nor pure and unhampered market economy?

Thus people have contrived a variety of third solutions, of systems which, it is claimed, are as far from socialism as they are from capitalism. Their authors allege that these systems are nonsocialist because they aim to preserve private ownership of the means of production and that they are not capitalistic because they eliminate the "deficiencies" of the market economy. For a scientific treatment of the problems involved which by necessity is neutral with regard to all value judgments and therefore does not condemn any features of capitalism as faulty, detrimental, or unjust, this emotional recommendation of *interventionism* is of no avail. The task of economics is to analyze and to search for truth. It is not called upon to praise or to disapprove from any standard of preconceived postulates and prejudices. With regard to interventionism it has only one question to ask and to answer: How does it work?

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2

The Intervention

There are two patterns for the realization of socialism.

The first pattern (we may call it the Lenin or the Russian pattern) is purely bureaucratic. All plants, shops, and farms are formally nationalized (*verstaatlicht*); they are departments of the government operated by civil servants. Every unit of the apparatus of production stands in the same relation to the superior central organization as does a local post office to the office of the postmaster general.

The second pattern (we may call it the Hindenburg or German pattern) nominally and seemingly preserves private ownership of the means of production and keeps the appearance of ordinary markets, prices, wages, and interest rates. There are, however, no longer entrepreneurs, but only shop managers (*Betriebsführer* in the terminology of the Nazi legislation). These shop managers are seemingly instrumental in the conduct of the enterprises entrusted to them; they buy and sell, hire and discharge workers and remunerate their services, contract debts and pay interest and amortization. But in all their activities they are bound to obey unconditionally the orders issued by the government's supreme office of production management. This office (the Reichswirtschaftsministerium in Nazi Germany) tells the shop managers what and how to produce, at what prices and from whom to buy, at what prices and to whom to sell. It assigns every worker to his job and fixes his wages. It decrees to whom and on what terms the capitalists must entrust their funds. Market exchange is merely a sham. All the wages, prices, and interest rates are fixed by the government; they are wages, prices, and interest rates in appearance only; in fact they are merely quantitative terms in the government's orders determining each citizen's job, income, consumption, and standard of living. The government directs all production activities. The shop managers are subject to the government, not to the consumers' demand and the market's price structure. This is socialism under the outward guise of the terminology of capitalism. Some labels of the capitalistic market economy are retained, but they signify something entirely different from what they mean in the market economy.

It is necessary to point out this fact in order to prevent a confusion of socialism and interventionism. The system of interventionism or of the hampered market economy differs from the German pattern of socialism by the very fact that it is still a market economy. The authority interferes with the operation of the market economy, but does not want to eliminate the market altogether. It wants production and consumption to develop along lines different from those prescribed by an unhampered market, and it wants to achieve its aim by injecting into the working of the market orders, commands, and prohibitions for whose enforcement the police power and its apparatus of violent compulsion and coercion stand ready. But these are *isolated* acts of intervention. It is not the aim of the government to combine them into an integrated system which determines all prices, wages and interest rates and thus places full control of production and consumption into the hands of the authorities.

The system of the hampered market economy or interventionism aims at preserving the dualism of the distinct spheres of government activities on the one hand and economic freedom under the market system on the other hand. What characterizes it as such is the fact that the government does not limit its activities to the preservation of private ownership of the means of production and its protection against violent or fraudulent encroachments. The government interferes with the operation of business by means of orders and prohibitions.

The intervention is a decree issued directly or indirectly, by the authority in charge of society’s administrative apparatus of coercion and compulsion which forces the entrepreneurs and capitalists to employ some of the factors of production in a way different from what they would have resorted to if they were only obeying the dictates of the market. Such a decree can be either an order to do something or an order not to do something. It is not required that the decree be issued directly by the established and generally recognized authority itself. It may happen that some other agencies arrogate to themselves the power to issue such orders or prohibitions and to enforce them by an apparatus of violent coercion and oppression of their own. If the recognized government tolerates such procedures or even supports them by the employment of its governmental police apparatus, matters stand as if the government itself had acted. If the government is opposed to other agencies’ violent action, but does not succeed in suppressing it by means of its own armed forces, although it would like to suppress it, anarchy results.

It is important to remember that government interference always means either violent action or the threat of such action. The funds that a government spends for whatever purposes are levied by taxation. And taxes are paid because the taxpayers are afraid of offering resistance to the tax gatherers. They know that any disobedience or resistance is hopeless. As long as this is the state of affairs, the government is able to collect the money that it wants to spend. Government is in the last resort the employment of armed men, of policemen, gendarmes, soldiers, prison guards, and hangmen. The essential feature of government is the enforcement of its decrees by beating, killing, and imprisoning. Those who are asking for more government interference are asking ultimately for more compulsion and less freedom.

To draw attention to this fact does not imply any reflection upon government activities. In stark reality, peaceful social cooperation is impossible if no provision is made for violent prevention and suppression of antisocial action on the part of refractory individuals and groups of individuals. One must take exception to the often-repeated phrase that government is an evil, although a necessary and indispensable evil. What is required for the attainment of an end is a means, the cost to be expended for its successful realization. It is an arbitrary value judgment to describe it as an evil in the moral connotation of the term. However, in face of the modern tendencies toward a deification of government and state, it is good to remind ourselves that the old Romans were more realistic in symbolizing the state by a bundle of rods with an ax in the middle than are our contemporaries in ascribing to the state all the attributes of God.

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3

The Delimitation Of Governmental Functions

Various schools of thought parading under the pompous names of philosophy of law and political science indulge in futile and empty brooding over the delimitation of the functions of government. Starting from purely arbitrary assumptions concerning allegedly eternal and absolute values and perennial justice, they arrogate to themselves the office of the supreme judge of earthly affairs. They misconstrue their own arbitrary value judgments derived from intuition as the voice of the Almighty or of the nature of things.

There is, however, no such thing as a perennial standard of what is just and what is unjust. Nature is alien to the idea of right and wrong. "Thou shalt not kill" is certainly not part of natural law. The characteristic feature of natural conditions is that one animal is intent upon killing other animals and that many species cannot preserve their own life except by killing others. The notion of right and wrong is a human device, a utilitarian precept designed to make social cooperation under the division of labor possible. All moral rules and human laws are means for the realization of definite ends. There is no method available for the appreciation of their goodness or badness other than to scrutinize their usefulness for the attainment of the ends chosen and aimed at.

From the notion of natural law some people deduce the justice of the institution of private property in the means of production. Other people resort to natural law for the justification of the abolition of private property in the means of production. As the idea of natural law is quite arbitrary, such discussions are not open to settlement.

State and government are not ends, but means. Inflicting evil upon other people is a source of direct pleasure only to sadists. Established authorities resort to coercion and compulsion in order to safeguard the smooth operation of a definite system of social organization. The sphere in which coercion and compulsion is applied and the content of the laws which are to be enforced by the police apparatus are conditioned by the social order adopted. As state and government are designed to make this social system operate safely, the delimitation of governmental functions must be adjusted to its requirements. The only standard for the appreciation of the laws and the methods for their enforcement is whether or not they are efficient in safeguarding the social order which it is desired to preserve.

The notion of justice makes sense only when referring to a definite system of norms which in itself is assumed to be uncontested and safe against any criticism. Many peoples have clung to the doctrine that what is right and what is wrong is established from the dawn of the remotest ages and for eternity. The task of legislators and courts was not to make laws, but to find out what is right by virtue of the unchanging idea of justice. This doctrine, which resulted in an adamant conservatism and a petrification of old customs and institutions, was challenged by the doctrine of natural right. To the positive laws of the country the notion of a "higher" law, the law of nature, was opposed. From the arbitrary standard of natural law the valid statutes and institutions were called just or unjust. To the good legislator was assigned the task of making the positive laws agree with the natural law.

The fundamental errors involved in these two doctrines have long since been unmasked. For those not deluded by them it is obvious that the appeal to justice in a debate concerning the drafting of new laws is an instance of circular reasoning. *Delege ferenda* there is no such a thing as justice. The notion of justice can logically only be resorted to *de lege lata.* It makes sense only when approving or disapproving concrete conduct from the point of view of the valid laws of the country. In considering changes in the nation's legal system, in rewriting or repealing existing laws and writing new laws, the issue is not justice, but social expediency and social welfare. There is no such thing as an absolute notion of justice not referring to a definite system of social organization. It is not justice that determines the decision in favor of a definite social system. It is, on the contrary, the social system which determines what should be deemed right and what wrong. There is neither right nor wrong outside the social nexus. For the hypothetical isolated and self-sufficient individual the notions of just and unjust are empty. Such an individual can merely distinguish between what is more expedient and what is less expedient for himself. The idea of justice refers always to social cooperation.

It is nonsensical to justify or to reject interventionism from the point of view of a fictitious and arbitrary idea of absolute justice. It is vain to ponder over the just delimitation of the tasks of government from any preconceived standard of perennial values. It is no less impermissible to deduce the proper tasks of government from the very notions of government, state, law and justice. It was precisely this that was absurd in the speculations of medieval scholasticism, of Fichte, Schelling, and Hegel, and the German *Begriffsjurisprudenz.* Concepts are tools of reasoning. They must never be considered as regulative principles dictating modes of conduct.

It is a display of supererogatory mental gymnastics to emphasize that the notions of state and sovereignty logically imply absolute supremacy and thus preclude the idea of any limitations on the state's activities. Nobody questions the fact that a state has the power to establish totalitarianism within the territory in which it is sovereign. The problem is whether or not such a mode of government is expedient from the point of view of the preservation and functioning of social cooperation. With regard to this problem no sophisticated exegesis of concepts and notions can be of any use. It must be decided by praxeology, not by a spurious metaphysics of state and right.

The philosophy of law and political science are at a loss to discover any reason why government should not control prices and not punish those defying the price ceilings decreed, in the same way as it punishes murderers and thieves. As they see it, the institution of private property is merely a revocable favor graciously granted by the almighty sovereign to the wretched individuals. There cannot be any wrong in repealing totally or partially the laws that granted this favor; no reasonable objection can be raised against expropriation and confiscation. The legislator is free to substitute any social system for that of the private ownership of the means of production, just as he is free to substitute another national anthem for that adopted in the past. The formula *car tel est notre bon plaisir* [for such is our good pleasure] is the only maxim of the sovereign lawgiver's conduct.

As against all this formalism and legal dogmatism, there is need to emphasize again that the only purpose of the laws and the social apparatus of coercion and compulsion is to safeguard the smooth functioning of social cooperation. It is obvious that the government has the power to decree maximum prices and to imprison or to execute those selling or buying at a higher price. But the question is whether such a policy can or cannot attain the ends which the government wants to attain by resorting to it. This is a purely praxeological and economic problem. Neither the philosophy of law nor political science can contribute anything to its solution.

The problem of interventionism is not a problem of the correct delimitation of the "natural," "just," and "proper" tasks of state and government. The issue is: How does a system of interventionism work? Can it realize those ends which people, in resorting to it, want to attain?

The confusion and lack of judgment displayed in dealing with the problems of interventionism are amazing indeed. There are, for instance, people who argue thus: It is obvious that traffic regulations on the public roads are necessary. Nobody objects to the government's interference with the car driver's conduct. The advocates of laissez faire contradict themselves in fighting government interference with market prices and yet not advocating the abolition of government traffic regulation.

The fallacy of this argument is manifest. The regulation of traffic on a road is one of the tasks incumbent upon the agency that operates the road. If this agency is the government or the municipality, it is bound to attend to this task. It is the task of a railroad's management to fix the timetable of the trains and it is the task of a hotel's management to decide whether or not there should be music in the dining room. If the government operates a railroad or a hotel, it is the government's task to regulate these things. With a state opera the government decides which operas should be produced and which should not; it would be a *non sequitur,* however, to deduce from this fact that it is also a task of the government to decide these things for a nongovernmental opera.

The interventionist doctrinaires repeat again and again that they do not plan the abolition of private ownership of the means of production, of entrepreneurial activities, and of market exchange. Also the supporters of the most recent variety of interventionism, the German *soziale Marktwirtschaft,* stress that they consider the market economy to be the best possible and most desirable system of society's economic organization, and that they are opposed to the government omnipotence of socialism. But, of course, all these advocates of a middle-of-the-road policy emphasize with the same vigor that they reject Manchesterism and laissez-faire liberalism. It is necessary, they say, that the state interfere with the market phenomena whenever and wherever the "free play of the economic forces" results in conditions that appear as "socially" undesirable. In making this assertion they take it for granted that it is the government that is called upon to determine in every single case whether or not a definite economic fact is to be considered as reprehensible from the "social" point of view and, consequently whether or not the state of the market requires a special act of government interference.

All these champions of interventionism fail to realize that their program thus implies the establishment of full government supremacy in all economic matters and ultimately brings about a state of affairs that does not differ from what is called the German or the Hindenburg pattern of socialism. If it is in the jurisdiction of the government to decide whether or not definite conditions of the economy justify its intervention, no sphere of operation is left to the market. Then it is no longer the consumers who ultimately determine what should be produced, in what quantity, of what quality, by whom, where, and how—but it is the government. For as soon as the outcome brought about by the operation of the unhampered market differs from what the authorities consider "socially" desirable, the government interferes. That means the market is free as long as it does precisely what the government wants it to do. It is "free" to do what the authorities consider to be the "right" things, but not to do what they consider the "wrong" things; the decision concerning what is right and what is wrong rests with the government. Thus the doctrine and the practice of interventionism ultimately tend to abandon what originally distinguished them from outright socialism and to adopt entirely the principles of totalitarian all-around planning.

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4

Righteousness As The Ultimate Standard Of The Individual'S Actions

According to a widespread opinion it is possible, even in the absence of government interference with business, to divert the operation of the market economy from those lines along which it would develop if left to exclusive control by the profit motive. Advocates of a social reform to be accomplished by compliance with the principles of Christianity or with the demands of "true" morality maintain that conscience should also guide well-intentioned people in their dealings on the market. If all people were prepared not only to concern themselves about profit, but no less about their religious and moral obligations, no government compulsion and coercion would be required in order to put things right. What is needed is not a reform of government and the laws of the country, but the moral purification of man, a return to the Lord's commandments and to the precepts of the moral code, a turning away from the vices of greed and selfishness. Then it will be easy to reconcile private ownership of the means of production with justice, righteousness, and fairness. The disastrous effects of capitalism will be eliminated without prejudice to the individual's freedom and initiative. People will dethrone the Moloch capitalism without enthroning the Moloch state.

The arbitrary value judgments which are at the bottom of these opinions need not concern us here. What these critics blame capitalism for is irrelevant; their errors and fallacies are beside the point. What does matter is the idea of erecting a social system on the twofold basis of private property and of moral principles restricting the utilization of private property. The system recommended, say its advocates, will be neither socialism nor capitalism nor interventionism. Not socialism, because it will preserve private ownership of the means of production; not capitalism, because conscience will be supreme and not the urge for profit; not interventionism, because there will be no need for government interference with the market.

In the market economy the individual is free to act within the orbit of private property and the market. His choices are final. For his fellow men his actions are data which they must take into account in their own acting. The coordination of the autonomous actions of all individuals is accomplished by the operation of the market. Society does not tell a man what to do and what not to do. There is no need to enforce cooperation by special orders or prohibitions. Noncooperation penalizes itself. Adjustment to the requirements of society's productive effort and the pursuit of the individual's own concerns are not in conflict. Consequently no agency is required to settle such conflicts. The system can work and accomplish its tasks without the interference of an authority issuing special orders and prohibitions and punishing those who do not comply.

Beyond the sphere of private property and the market lies the sphere of compulsion and coercion; here are the dams which organized society has built for the protection of private property and the market against violence, malice, and fraud. This is the realm of constraint as distinguished from the realm of freedom. Here are rules discriminating between what is legal and what is illegal, what is permitted and what is prohibited. And here is a grim machine of arms, prisons, and gallows and the men operating it, ready to crush those who dare to disobey.

Now, the reformers with whose plans we are concerned suggest that along with the norms designed for the protection and preservation of private property further ethical rules should be ordained. They want to realize in production and consumption things other than those realized under the social order in which the individuals are not checked by any obligation other than that of not infringing upon the persons of their fellow men and upon the right of private property. They want to ban those motives that direct the individual's action in the market economy (they call them selfishness, acquisitiveness, profit-seeking) and to replace them with other impulses (they call them conscientiousness, righteousness, altruism, fear of God, charity). They are convinced that such a moral reform would in itself be sufficient to safeguard a mode of operation of the economic system, more satisfactory from their point of view than that of unhampered capitalism, without any of those special governmental measures which interventionism and socialism require.

The supporters of these doctrines fail to recognize the role which those springs of action they condemn as vicious play in the operation of the market economy. The only reason why the market economy can operate without government orders telling everybody precisely what he should do and how he should do it is that it does not ask anybody to deviate from those lines of conduct which best serve his own interests. What integrates the individual's actions into the whole of the social system of production is the pursuit of his own purposes. In indulging in his "acquisitiveness" each actor contributes his share to the best possible arrangement of production activities. Thus, within the sphere of private property and the laws protecting it against encroachments on the part of violent or fraudulent action, there is no antagonism between the interests of the individual and those of society.

The market economy becomes a chaotic muddle if this predominance of private property which the reformers disparage as selfishness is eliminated. In urging people to listen to the voice of their conscience and to substitute considerations of public welfare for those of private profit, one does not create a working and satisfactory social order. It is not enough to tell a man *not* to buy on the cheapest market and *not* to sell on the dearest market. It is not enough to tell him *not* to strive after profit and *not* to avoid losses. One must establish unambiguous rules for the guidance of conduct in each concrete situation.

Says the reformer: The entrepreneur is rugged and selfish when, taking advantage of his own superiority, he underbids the prices asked by a less efficient competitor and thus forces the man to go out of business. But how should the "altruistic" entrepreneur proceed? Should he under no circumstances sell at a price lower than any competitor? Or are there certain conditions which justify underbidding the competitor's prices?

Says the reformer on the other hand: The entrepreneur is rugged and selfish when, taking advantage of the state of the market, he asks a price so high that poor people are excluded from purchasing the merchandise. But what should the "good" entrepreneur do? Should he give away the merchandise free of charge? If he charges any price, however low, there will always be people who cannot buy at all or not so much as they would buy if the price were still lower. What group of those eager to buy is the entrepreneur free to exclude from getting the merchandise?

There is no need to deal at this point of our investigation with the consequences resulting from any deviation from the height of prices as determined on an unhampered market. If the seller avoids underbidding his less efficient competitor, a part at least of his supply remains unsold. If the seller offers the merchandise at a price lower than that determined on an unhampered market, the supply available is insufficient to enable all those ready to expend this lower price to get what they are asking for. We will analyze later these as well as other consequences of any deviation from the market prices.[2] What we must recognize even at this point is that one cannot content oneself simply by telling the entrepreneur that he should *not* let himself be guided by the state of the market. It is imperative to tell him how far he must go in asking and paying prices. If it is no longer profit-seeking that directs the entrepreneurs' actions and determines what they produce and in what quantities, if the entrepreneurs are no longer bound by the instrumentality of the profit motive to serve the consumers to the best of their abilities, it is necessary to give them definite instructions. One cannot avoid guiding their conduct by specified orders and prohibitions, precisely such decrees as are the mark of government interference with business. Any attempt to render such interference superfluous by attributing primacy to the voice of conscience, to charity and brotherly love, is vain.

The advocates of a Christian social reform pretend that their ideal of greed and profit-seeking tamed and restrained by conscientiousness and compliance with the moral law worked rather well in the past. All the evils of our day are caused by defection from the precepts of the church. If people had not defied the commandments and had not coveted unjust profit, mankind would still enjoy the bliss experienced in the Middle Ages when at least the elite lived up to the principles of the Gospels. What is needed is to bring back those good old days and then to see that no new apostasy deprives men of their beneficent effects.

There is no need to enter into an analysis of the social and economic conditions of the thirteenth century which these reformers praise as the greatest of all periods of history. We are concerned merely with the notion of *just* prices and wage rates which was essential in the social teachings of the doctors of the church and which the reformers want to raise to the position of the ultimate standard of economic conduct.

It is obvious that with theorists this notion of just prices and wage rates always refers and always referred to a definite social order which they considered the best possible order. They recommend the adoption of their ideal scheme and its preservation forever. No further changes are to be tolerated. Any alteration of the best possible state of social affairs can only mean deterioration. The world view of these philosophers does not take into account man's ceaseless striving for improvement of the material conditions of wellbeing. Historical change and a rise in the general standard of living are notions foreign to them. They call "just" that mode of conduct that is compatible with the undisturbed preservation of their utopia, and everything else unjust.

However, the notion of just prices and wage rates as present to the mind of people other than philosophers is very different. When the non-philosopher calls a price just, what he means is that the preservation of this price improves or at least does not impair his own revenues and station in society. He calls unjust any price that jeopardizes his own wealth and station. It is "just" that the prices of those goods and services which he sells rise more and more and that the prices of those goods and services he buys drop more and more. To the farmer no price of wheat, however high, appears unjust. To the wage earner no wage rates, however high, appear unfair. But the farmer is quick to denounce every drop in the price of wheat as a violation of divine and human laws, and the wage earners rise in rebellion when their wages drop. Yet the market society has no means of adjusting production to changing conditions other than the operation of the market. By means of price changes it forces people to restrict the production of articles less urgently asked for and to expand the production of those articles for which consumers' demand is more urgent. The absurdity of all endeavors to stabilize prices consists precisely in the fact that stabilization would prevent any further improvement and result in rigidity and stagnation. The flexibility of commodity prices and wage rates is the vehicle of adjustment, improvement, and progress. Those who condemn changes in prices and wage rates as unjust, and who ask for the preservation of what they call just, are in fact combating endeavors to make economic conditions more satisfactory.

It is not unjust that there has long prevailed a tendency toward such a determination of the prices of agricultural products that the greater part of the population abandoned farming and moved toward the processing industries. But for this tendency, 90 per cent or more of the population would still be occupied in agriculture and the processing industries would have been stunted in their growth. All strata of the population, including the farmers, would be worse off. If the scholastic doctrine of the just price had been put into practice, the thirteenth century's economic conditions would still prevail. Population figures would be much smaller than they are today and the standard of living much lower.

Both varieties of the just price doctrine, the philosophical and the popular, agree in their condemnation of the prices and wage rates as determined on the unhampered market. But this negativism does not in itself provide any answer to the question of what height the just prices and wage rates should attain. If righteousness is to be elevated to the position of the ultimate standard of economic action, one must unambiguously tell every actor what he should do, what prices he should ask, and what prices he should pay in each concrete case, and one must force—by recourse to an apparatus of violent compulsion and coercion—all those venturing disobedience to comply with these orders. One must establish a supreme authority issuing norms and regulating conduct in every respect, altering these norms if need be, interpreting them authentically, and enforcing them. Thus the substitution of social justice and righteousness for selfish profit-seeking requires for its realization precisely those policies of government interference with business which the advocates of the moral purification of mankind want to make superfluous. No deviation from the unhampered market economy is thinkable without authoritarian regimentation. Whether the authority in which these powers are vested is called lay government or theocratical priesthood makes no difference.

The reformers, in exhorting people to turn away from selfishness, address themselves to capitalists and entrepreneurs, and sometimes, although only timidly, to wage earners as well. However, the market economy is a system of consumers' supremacy. The sermonizers should appeal to consumers, not to producers. They should persuade the consumers to renounce preferring better and cheaper merchandise to poorer and dearer merchandise lest they hurt the less efficient producer. They should persuade them to restrict their own purchases in order to provide poorer people with the opportunity to buy more. If one wants the consumers to act in this way, one must tell them plainly what to buy, in what quantity, from whom, and at what prices; and one must provide for enforcing such orders by coercion and compulsion. But then one has adopted exactly that system of authoritarian control which moral reform wants to make unnecessary.

Whatever freedom individuals can enjoy within the framework of social cooperation is conditional upon the concord of private gain and public weal. Within the orbit in which the individual, in pursuing his own wellbeing, advances also—or at least does not impair—the well-being of his fellow men, people going their own ways jeopardize neither the preservation of society nor the concerns of other people. A realm of freedom and individual initiative emerges, a realm in which man is allowed to choose and to act of his own accord. This sphere of freedom, by the socialists and interventionists contemptuously dubbed "economic freedom," is alone what makes any of those conditions possible that are commonly called freedoms within a system of social cooperation under the division of labor. It is the market economy or capitalism with its political corollary (the Marxians would have to say: with its "superstructure"), representative government.

Those who contend that there is a conflict between the acquisitiveness of various individuals or between the acquisitiveness of individuals on the one hand and the commonweal on the other, cannot avoid advocating the suppression of the individuals' right to choose and to act. They must substitute the supremacy of a central board of production management for the discretion of the citizens. In their scheme of the good society there is no room left for private initiative. The authority issues orders and everybody is forced to obey.

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5

The Meaning Of Laissez Faire

In eighteenth-century France the saying *laissez faire, laissez passer* was the formula into which some of the champions of the cause of liberty compressed their program. Their aim was the establishment of the unhampered market society. In order to attain this end they advocated the abolition of all laws preventing more industrious and more efficient people from outdoing less industrious and less efficient competitors and restricting the mobility of commodities and of men. It was this that the famous maxim was designed to express.

In our age of passionate longing for government omnipotence the formula laissez faire is in disrepute. Public opinion now considers it a manifestation both of moral depravity and of the utmost ignorance.

As the interventionist sees things, the alternative is "automatic forces" or "conscious planning."3 It is obvious, he implies, that to rely upon automatic processes is sheer stupidity. No reasonable man can seriously recommend doing nothing and letting things go as they do without interference on the part of purposive action. A plan, by the very fact that it is a display of conscious action, is incomparably superior to the absence of any planning. Laissez faire is said to mean: Let the evils last, do not try to improve the lot of mankind by reasonable action.

This is utterly fallacious talk. The argument advanced for planning is entirely derived from an impermissible interpretation of a metaphor. It has no foundation other than the connotations implied in the term "automatic" which it is customary to apply in a metaphorical sense for the description of the market process.4 Automatic, says the Concise *Oxford Dictionary,*5 means "unconscious, unintelligent, merely mechanical." Automatic, says *Webster's Collegiate Dictionary,*6 means "not subject to the control of the will, . . . performed without active thought and without conscious intention or direction." What a triumph for the champion of planning to play this trump card!

The truth is that the alternative is not between a dead mechanism or a rigid automatism on one hand and conscious planning on the other hand. The alternative is not plan or no plan. The question is whose planning? Should each member of society plan for himself, or should a benevolent government alone plan for them all? The issue is not *automatism versus conscious action;* it is *autonomous action of each individual versus the exclusive action of the government. It is freedom versus government omnipotence.*

Laissez faire does not mean: Let soulless mechanical forces operate. It means: Let each individual choose how he wants to cooperate in the social division of labor; let the consumers determine what the entrepreneurs should produce. Planning means: Let the government alone choose and enforce its rulings by the apparatus of coercion and compulsion.

Under laissez faire, says the planner, it is not those goods which people “really” need that are produced, but those goods from the sale of which the highest returns are expected. It is the objective of planning to direct production toward the satisfaction of the “true” needs. But who is to decide what the “true” needs are?

Thus, for instance, Professor Harold Laski, the former chairman of the British Labor Party, would determine as the objective of the planned direction of investment “that the use of the investor’s savings will be in housing rather than in cinemas.”[7] It is beside the point whether or not one agrees with the professor’s view that better houses are more important than moving pictures. It is a fact that the consumers, in spending part of their money for admission to the movies, have made another choice. If the masses of Great Britain, the same people whose votes swept the Labor Party into power, were to stop patronizing the moving pictures and to spend more for comfortable homes and apartments, profit-seeking business would be forced to invest more in building homes and apartment houses and less in the production of expensive pictures. It was Mr. Laski’s desire to defy the wishes of the consumers and to substitute his own will for that of the consumers. He wanted to do away with the democracy of the market and to establish the absolute rule of the production tsar. Perhaps he believed that he was right from a higher point of view, and that as a superman he was called upon to impose his own valuations on the masses of inferior men. But then he ought to have been frank enough to say so plainly.

All this passionate praise of the supereminence of government action is but a poor disguise for the individual interventionist’s *self-deification.* The great god State is a great god only because it is expected to do exclusively what the individual advocate of interventionism wants to see achieved. Only that plan is genuine which the individual planner fully approves. All other plans are simply counterfeit. In saying “plan” what the author of a book on the benefits of planning has in mind is, of course, his own plan alone. He does not take into account the possibility that the plan which the government puts into practice may differ from his own plan. The various planners agree only with regard to their rejection of laissez faire, i.e., the individuals’ discretion to choose and to act. They entirely disagree with regard to the choice of the unique plan to be adopted. To every exposure of the manifest and incontestable defects of interventionist policies the champions of interventionism react in the same way. These faults, they say, were the results of spurious interventionism; what we are advocating is good interventionism, not bad interventionism. And, of course, good interventionism is the professor’s own brand.

Laissez faire means: Let the common man choose and act; do not force him to yield to a dictator.

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Direct Government Interference With Consumption

In investigating the economic problems of interventionism we do not have to deal with those actions of the government whose aim it is to influence immediately the consumer's choice of consumers' goods. Every act of government interference with business must indirectly affect consumption. As the government's interference alters the market data, it must also alter the valuations and the conduct of the consumers. But if the aim of the government is merely to force the consumers directly to consume goods other than what they would have consumed in the absence of the government's decree, no special problems emerge to be scrutinized by economics. It is beyond doubt that a strong and ruthless police apparatus has the power to enforce such decrees.

In dealing with the choices of the consumers we do not ask what motives induced a man to buy *a* and not to buy *b*. We merely investigate what effects on the determination of market prices and thereby on production were brought about by the concrete conduct of the consumers. These effects do not depend on the considerations which led individuals to buy *a* and not to buy *b;* they depend only on the real acts of buying and abstention from buying. It is immaterial for the determination of the prices of gas masks whether people buy them of their own accord or because the government forces everybody to have a gas mask. What alone counts is the size of the demand.

Governments which are eager to keep up the outward appearance of freedom even when curtailing freedom disguise their direct interference with consumption under the cloak of interference with business. The aim of American prohibition was to prevent the individual residents of the country from drinking alcoholic beverages. But the law hypocritically did not make drinking as such illegal and did not penalize it. It merely prohibited the manufacture, the sale and the transportation of intoxicating liquors, the business transactions which precede the act of drinking. The idea was that people indulge in the vice of drinking only because unscrupulous businessmen prevail upon them. It was, however, manifest that the objective of prohibition was to encroach upon the individuals' freedom to spend their dollars and to enjoy their lives according to their own fashion. The restrictions imposed upon business were only subservient to this ultimate end.

The problems involved in direct government interference with consumption are not catallactic problems. They go far beyond the scope of catallactics and concern the fundamental issues of human life and social organization. If it is true that government derives its authority from God and is entrusted by Providence to act as the guardian of the ignorant and stupid populace, then it is certainly its task to regiment every aspect of the subject's conduct. The Godsent ruler knows better what is good for his wards than they do themselves. It is his duty to guard them against the harm they would inflict upon themselves if left alone.

Self-styled "realistic" people fail to recognize the immense importance of the principles implied. They contend that they do not want to deal with the matter from what, they say, is a philosophic and academic point of view. Their approach is, they argue, exclusively guided by practical considerations. It is a fact, they say, that some people harm themselves and their innocent families by consuming narcotic drugs. Only doctrinaires could be so dogmatic as to object to the government's regulation of the drug traffic. Its beneficent effects cannot be contested.

However, the case is not so simple as that. Opium and morphine are certainly dangerous, habit-forming drugs. But once the principle is admitted that it is the duty of government to protect the individual against his own foolishness, no serious objections can be advanced against further encroachments. A good case could be made out in favor of the prohibition of alcohol and nicotine. And why limit the government's benevolent providence to the protection of the individual's body only? Is not the harm a man can inflict on his mind and soul even more disastrous than any bodily evils? Why not prevent him from reading bad books and seeing bad plays, from looking at bad paintings and statues and from hearing bad music? The mischief done by bad ideologies, surely, is much more pernicious, both for the individual and for the whole society, than that done by narcotic drugs.

These fears are not merely imaginary specters terrifying secluded doctrinaires. It is a fact that no paternal government, whether ancient or modern, ever shrank from regimenting its subjects' minds, beliefs, and opinions. If one abolishes man's freedom to determine his own consumption, one takes all freedoms away. The naïve advocates of government interference with consumption delude themselves when they neglect what they disdainfully call the philosophical aspect of the problem. They unwittingly support the case of censorship, inquisition, religious intolerance, and the persecution of dissenters.

In dealing with the catallactics of interventionism we do not discuss these political consequences of direct government interference with the citizens' consumption. We are exclusively concerned with those acts of interference which aim at forcing the entrepreneurs and capitalists to employ the factors of production in a way different from what they would have done if they merely obeyed the dictates of the market. In doing this, we do not raise the question of whether such interference is good or bad from any preconceived point of view. We merely ask whether or not it can attain those ends which those advocating and resorting to it are trying to attain.

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Corruption

An analysis of interventionism would be incomplete if it were not to refer to the phenomenon of corruption.

There are hardly any acts of government interference with the market process that, seen from the point of view of the citizens concerned, would not have to be qualified either as confiscations or as gifts. As a rule, one individual or a group of individuals is enriched at the expense of other individuals or groups of individuals. But in many cases, the harm done to some people does not correspond to any advantage for other people.

There is no such thing as a just and fair method of exercising the tremendous power that interventionism puts into the hands of the legislature and the executive. The advocates of interventionism pretend to substitute for the—as they assert, "socially" detrimental—effects of private property and vested interests the unlimited discretion of the perfectly wise and disinterested legislator and his conscientious and indefatigable servants, the bureaucrats. In their eyes the common man is a helpless infant, badly in need of a paternal guardian to protect him against the sly tricks of a band of rogues. They reject all traditional notions of law and legality in the name of a "higher and nobler" idea of justice. Whatever they themselves do is always right because it hurts those who selfishly want to retain for themselves what, from the point of view of this higher concept of justice, ought to belong to others.

The notions of selfishness and unselfishness as employed in such reasoning are self-contradictory and vain. As has been pointed out, every action aims at the attainment of a state of affairs that suits the actor better than the state that would prevail in the absence of this action. In this sense every action is to be qualified as selfish. The man who gives alms to hungry children does it, either because he values his own satisfaction expected from this gift higher than any other satisfaction he could buy by spending this amount of money, or because he hopes to be rewarded in the beyond. The politician is, in this sense, always selfish no matter whether he supports a popular program in order to get an office or whether he firmly clings to his own—unpopular—convictions and thus deprives himself of the benefits he could reap by betraying them.

In the terminology of anticapitalism the words *selfish* and *unselfish* are used to classify people from the point of view of a doctrine that considers equality of wealth and income as the only natural and fair state of social conditions, that brands those who own or earn more than the average as exploiters, and that condemns entrepreneurial activities as detrimental to the commonweal. To be in business, to depend directly on the approval or disapproval of one's actions by the consumers, to woo the patronage of the buyers, and to earn profit if one succeeds in satisfying them better than one's competitors do is, from the point of view of officialdom's ideology, selfish and shameful. Only those on the government's payroll are rated as unselfish and noble.

Unfortunately the officeholders and their staffs are not angelic. They learn very soon that their decisions mean for the businessmen either considerable losses or—sometimes—considerable gains. Certainly there are also bureaucrats who do not take bribes; but there are others who are anxious to take advantage of any "safe" opportunity of "sharing" with those whom their decisions favor.

In many fields of the administration of interventionist measures, favoritism simply cannot be avoided. Take, for example, the case of export or import licenses. Such a license has for the licensee a definite cash value. To whom ought the government grant a license and to whom should it be denied? There is no neutral or objective yardstick available to make the decision free from bias and favoritism. Whether or not money changes hands in the affair does not matter. The scandal is the same when the license is given to people who have rendered or are expected to render other kinds of valuable services (e.g., in casting their votes) to the people upon whom the decision depends.

Corruption is a regular effect of interventionism. It may be left to the historians and to the lawyers to deal with the problems involved.[8]

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CHAPTER 28

Interference By Taxation

1

The Neutral Tax

To keep the social apparatus of coercion and compulsion running requires expenditure of labor and commodities. Under a liberal system of government these expenditures are small compared with the sum of the individuals' incomes. The more the government expands the sphere of its activities, the more its budget increases.

If the government itself owns and operates plants, farms, forests, and mines, it might consider covering a part or the whole of its financial needs from interest and profit earned. But government operation of business enterprises as a rule is so inefficient that it results in losses rather than in profits. Governments must resort to taxation, i.e., they must raise revenues by forcing the subjects to surrender a part of their wealth or income.

A neutral mode of taxation is conceivable that would not divert the operation of the market from the lines in which it would develop in the absence of any taxation. However, the vast literature on problems of taxation as well as the policies of governments have hardly ever given thought to the problem of the *neutral* tax. They have been more eager to find the *just* tax.

The neutral tax would affect the conditions of the citizens only to the extent required by the fact that a part of the labor and material goods available is absorbed by the government apparatus. In the imaginary construction of the evenly rotating economy the treasury continually levies taxes and spends the whole amount raised, neither more nor less, for defraying the costs incurred by the activities of the government's officers. A part of each citizen's income is spent for public expenditure. If we assume that in such an evenly rotating economy there prevails perfect income equality in such a way that every household's income is proportional to the number of its members, both a head tax and a proportional income tax would be neutral taxes. Under these assumptions there would be no difference between them. A part of each citizen's income would be absorbed by public expenditure, and no secondary effects of taxation would emerge.

The changing economy is entirely different from this imaginary construction of an evenly rotating economy with income equality. Continuous change and the inequality of wealth and income are essential and necessary features of the changing market economy, the only real and working system of the market economy. In the frame of such a system no tax can be neutral. The very idea of a neutral tax is as unrealizable as that of neutral money. But, of course, the reasons for this inescapable non-neutrality are different in the case of taxes from what they are in the case of money.

A head tax that taxes every citizen equally and uniformly without any regard to the size of his income and wealth, falls more heavily upon those with more moderate means than upon those with more ample means. It restricts the production of the articles consumed by the masses more sharply than that of the articles mainly consumed by the wealthier citizens. On the other hand, it tends to curtail saving and capital accumulation less than a more burdensome taxation of the wealthier citizens does. It does not slow down the tendency toward a drop in the marginal productivity of capital goods as against the marginal productivity of labor to the same extent as does taxation discriminating against those with higher income and wealth, and consequently it does not to the same extent retard the tendency toward a rise in wage rates.

The actual fiscal policies of all countries are today exclusively guided by the idea that taxes should be apportioned according to each citizen's "ability to pay." In the considerations which finally resulted in the general acceptance of the ability-to-pay principle there was some dim conception that taxing the well-to-do more heavily than those with moderate means renders a tax somewhat more neutral. However this may be, it is certain that any reference to tax neutrality was very soon entirely discarded. The ability-to-pay principle has been raised to the dignity of a postulate of social justice. As people see it today, the fiscal and budgetary objectives of taxation are of secondary importance only. The primary function of taxation is to reform social conditions according to justice. From this point of view, a tax appears as the more satisfactory the less neutral it is and the more it serves as a device for diverting production and consumption from those lines into which the unhampered market would have directed them.

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2

The Total Tax

The idea of social justice implied in the ability-to-pay principle is that of perfect financial equality of all citizens. As long as any inequality of income and wealth remains it can as plausibly be argued that these larger incomes and fortunes, however small their absolute amount, indicate some excess of ability to be levied upon, as it can be argued that any existing inequalities of income and wealth indicate differences in ability. The only logical stopping place of the ability-to-pay doctrine is at the complete equalization of incomes and wealth by confiscation of all incomes and fortunes above the lowest amount in the hands of anyone.[1]

The notion of the total tax is the antithesis of the notion of the neutral tax. The total tax completely taxes away—confiscates—all incomes and estates. Then the government, out of the community chest thus filled, gives to everybody an allowance for defraying the costs of his sustenance. Or, what comes to the same thing, the government in taxing leaves free that amount which it considers everybody's fair share and completes the shares of those who have less up to the amount of their fair share.

The idea of the total tax cannot be thought out to its ultimate logical consequences. If the entrepreneurs and capitalists do not derive any personal benefit or damage from their utilization of the means of production, they become indifferent with regard to the choice between various modes of conduct. Their social function fades away, and they become disinterested irresponsible administrators of public property. They are no longer bound to adjust production to the wishes of the consumers. If only the income is taxed away while the capital stock itself is left free, an incentive is offered to the owners to consume parts of their wealth and thus to hurt the interests of everyone. A total income tax would be a very inept means for the transformation of capitalism into socialism. If the total tax affects wealth no less than income, it is no longer a tax, i.e., a device for collecting government revenue within a market economy. It becomes a measure for the transition to socialism. As soon as it is consummated, socialism has been substituted for capitalism.

Even when looked upon as a method for the realization of socialism, the total tax is disputable. Some socialists launched plans for a prosocialist tax reform. They recommended either a 100 per cent estate and gift tax or taxing away totally the rent of land or all unearned income—i.e., in the socialist terminology, all revenue not derived from manual labor performed. The examination of these projects is superfluous. It is enough to know that they are utterly incompatible with the preservation of the market economy.

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3

Fiscal And Nonfiscal Objectives Of Taxation

The fiscal and nonfiscal objectives of taxation do not agree with one another.

Consider, for instance, excise duties on liquor. If one considers them as a source of government revenue, the more they yield the better they appear. Of course, as the duty must enhance the price of the beverage, it restricts sales and consumption. It is necessary to find out by testing under what rate of duty the yield becomes highest. But if one looks at liquor taxes as a means of reducing the consumption of liquor as much as possible, the rate is better the higher it is. Pushed beyond a certain limit, the tax makes consumption drop considerably, and also the revenue concomitantly. If the tax fully attains its nonfiscal objective of weaning people entirely from drinking alcoholic beverages, the revenue is zero. It no longer serves any fiscal purpose; its effects are merely prohibitive. The same is valid not only with regard to all kinds of indirect taxation but no less for direct taxation. Discriminating taxes levied upon corporations and big business would, if raised above a certain limit, result in the total disappearance of corporations and big business. Capital levies, inheritance and estate taxes, and income taxes are similarly self-defeating if carried to extremes.

There is no solution for the irreconcilable conflict between the fiscal and the nonfiscal ends of taxation. The power to tax involves, as Chief Justice Marshall pertinently observed, the power to destroy. This power can be used for the destruction of the market economy, and it is the firm resolution of many governments and parties to use it for this purpose. With the substitution of socialism for capitalism, the dualism of the coexistence of two distinct spheres of action disappears. The government swallows the whole orbit of the individual's autonomous actions and becomes totalitarian. It no longer depends for its financial support on the means exacted from the citizens. There is no longer any such thing as a separation of public funds and private funds.

Taxation is a matter of the market economy. It is one of the characteristic features of the market economy that the government does not interfere with the market phenomena and that its technical apparatus is so small that its maintenance absorbs only a modest fraction of the total sum of the individual citizens' incomes. Then taxes are an appropriate vehicle for providing the funds needed by the government. They are appropriate because they are low and do not perceptibly disarrange production and consumption. If taxes grow beyond a moderate limit, they cease to be taxes and turn into devices for the destruction of the market economy.

This metamorphosis of taxes into weapons of destruction is the mark of present-day public finance. We do not deal with the quite arbitrary value judgments concerning the problems of whether heavy taxation is a curse or a benefit and whether the expenditures financed by the tax yield are or are not wise and beneficial.[2] What matters is that the heavier taxation becomes, the less compatible it is with the preservation of the market economy. There is no need to raise the question of whether or not it is true that "no country was ever yet ruined by large expenditures of money by the public and for the public."[3] It cannot be denied that the market economy can be ruined by large public expenditures and that it is the intention of many people to ruin it in this way.

Businessmen complain about the oppressiveness of heavy taxes. Statesmen are alarmed about the danger of "eating the seedcorn." Yet, the true crux of the taxation issue is to be seen in the paradox that the more taxes increase, the more they undermine the market economy and concomitantly the system of taxation itself. Thus the fact becomes manifest that ultimately the preservation of private property and confiscatory measures are incompatible. Every specific tax, as well as a nation's whole tax system, becomes self-defeating above a certain height of the rates.

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4

The Three Classes Of Tax Interventionism

The various methods of taxation which can be used for the regulation of the economy—i.e., as instruments of an interventionist policy—can be classified in three groups:

> 1. The tax aims at totally suppressing or at restricting the production of definite commodities. It thus indirectly interferes with consumption too. It does not matter whether this end is aimed at by the imposition of special taxes or by exempting certain products from a general tax imposed upon all other products or upon those products which the consumers would have preferred in the absence of fiscal discrimination. Tax exemption is employed as an instrument of interventionism in the case of customs duties. The domestic product is not burdened by the tariff which affects only the merchandise imported from abroad. Many countries resort to tax discrimination in regulating domestic production. They try, for instance, to encourage the production of wine, a product of small or medium-size grape growers, as against the production of beer, a product of big-size breweries, by submitting beer to a more burdensome excise tax than wine.
> 2. The tax expropriates a part of income or wealth.
> 3. The tax expropriates income and wealth entirely.

We do not have to deal with the third class, as it is merely a means for the realization of socialism and as such is outside the scope of interventionism.

The first class is in its effects not different from the restrictive measures dealt with in the following chapter.

The second class encompasses confiscatory measures dealt with in Chapter 32.

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CHAPTER 29

Restriction Of Production

1

The Nature Of Restriction

We shall deal in this chapter with those measures which are directly and primarily intended to divert production (in the broadest meaning of the word, including commerce and transportation) from the ways it would take in the unhampered market economy. Each authoritarian interference with business diverts production, of course, from the lines it would take if it were only directed by the demand of the consumers as manifested on the market. The characteristic mark of restrictive interference with production is that the diversion of production is not merely an unavoidable and unintentional secondary effect, but precisely what the authority wants to bring about. Like any other act of intervention, such restrictive measures affect consumption also. But this again, in the case of the restrictive measures we are dealing with in this chapter, is not the primary end the authority aims at. The government wants to interfere with production. The fact that its measure influences the ways of consumption also is, from its point of view, either altogether contrary to its intentions or at least an unwelcome consequence with which it puts up because it is unavoidable and is considered as a minor evil when compared with the consequences of nonintervention.

Restriction of production means that the government either forbids or makes more difficult or more expensive the production, transportation, or distribution of definite articles, or the application of definite modes of production, transportation, or distribution. The authority thus eliminates some of the means available for the satisfaction of human wants. The effect of its interference is that people are prevented from using their knowledge and abilities, their labor and their material means of production in the way in which they would earn the highest returns and satisfy their needs as much as possible. Such interference makes people poorer and less satisfied.

This is the crux of the matter. All the subtlety and hair-splitting wasted in the effort to invalidate this fundamental thesis are vain. On the unhampered market there prevails an irresistible tendency to employ every factor of production for the best possible satisfaction of the most urgent needs of the consumers. If the government interferes with this process, it can only impair satisfaction; it can never improve it.

The correctness of this thesis has been proved in an excellent and irrefutable manner with regard to the historically most important class of government interference with production, the barriers to international trade. In this field the teachings of the classical economists, especially those of Ricardo, are final and settle the issue forever.

All that a tariff can achieve is to divert production from those locations in which the output per unit of input is higher to locations in which it is lower. It does not increase production; it curtails it.

People expatiate on alleged government encouragement of production. However, government does not have the power to encourage one branch of production except by curtailing other branches. It withdraws the factors of production from those branches in which the unhampered market would employ them and directs them into other branches. It little matters what kind of administrative procedures the government resorts to for the realization of this effect. It may subsidize openly or disguise the subsidy in enacting tariffs and thus forcing its subjects to defray the costs. What alone counts is the fact that people are forced to forego some satisfactions which they value more highly and are compensated only by satisfactions which they value less. At the bottom of the interventionist argument there is always the idea that the government or the state is an entity outside and above the social process of production, that it owns something which is not derived from taxing its subjects, and that it can spend this mythical something for definite purposes. This is the Santa Claus fable raised by Lord Keynes to the dignity of an economic doctrine and enthusiastically endorsed by all those who expect personal advantage from government spending. As against these popular fallacies there is need to emphasize the truism that a government can spend or invest only what it takes away from its citizens and that its additional spending and investment curtails the citizens' spending and investment to the full extent of its quantity.

While government has no power to make people more prosperous by interference with business, it certainly does have the power to make them less satisfied by restriction of production.

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2

The Price Of Restriction

The fact that restricting production invariably involves a curtailment of the individual citizens' satisfaction does not mean that such restriction is necessarily to be regarded as a damage. A government does not wantonly resort to restrictive measures. It wants to attain certain ends and considers the restriction as the appropriate means for the realization of its plan. The appraisal of restrictive policies depends therefore on the answer to two questions: Is the means chosen by the government fitted to attain the end sought? Is the realization of this end a compensation for the individual citizens' privation? In raising these questions we look upon restriction of production as we look upon taxes. Payment of taxes also directly curtails the taxpayer's satisfaction. But it is the price he pays for the services which government renders to society and to each of its members. As far as the government fulfills its social functions and the taxes do not exceed the amount required for securing the smooth operation of the government apparatus, they are necessary costs and repay themselves.

The adequacy of this mode of dealing with restrictive measures is especially manifest in all those cases in which restriction is resorted to as a substitute for taxation. The bulk of expenditure for national defense is defrayed by the treasury out of the public revenue. But occasionally another procedure is chosen. It happens sometimes that the nation's preparedness to repel aggression depends on the existence of certain branches of industry which would be absent in the unhampered market. These industries must be subsidized, and the subsidies granted are to be considered as any other armaments expenditure. Their character remains the same if the government grants them indirectly by the imposition of an import duty for the products concerned. The difference is only that then the consumers are directly burdened with the costs incurred, while in the case of a government subsidy they defray these costs indirectly by paying higher taxes.

In enacting restrictive measures governments and parliaments have hardly ever been aware of the consequences of their meddling with business. Thus, they have blithely assumed that protective tariffs are capable of raising the nation's standard of living, and they have stubbornly refused to admit the correctness of the economic teachings concerning the effects of protectionism. The economists' condemnation of protectionism is irrefutable and free of any party bias. For the economists do not say that protection is bad from any preconceived point of view. They show that protection cannot attain those ends which the governments as a rule want to attain by resorting to it. They do not question the ultimate end of the government's action; they merely reject the means chosen as inappropriate to realize the ends aimed at.

Most popular among all restrictive measures are those styled prolabor legislation. Here too the governments and public opinion badly misjudge the effects. They believe that restricting the hours of work and prohibiting child labor exclusively burdens the employers and is a “social gain” for the wage earners. However, this is true only to the extent that such laws reduce the supply of labor and thus raise the marginal productivity of labor as against the marginal productivity of capital. But the drop in the supply of labor results also in a decrease in the total amount of goods produced and thereby in the average per capita consumption. The total cake shrinks, but the portion of the smaller cake which goes to the wage earners is proportionately higher than what they received from the bigger cake; concomitantly the portion of the capitalists drops.[1] It depends on the concrete data of each case whether or not this outcome improves or impairs the real wage rates of the various groups of wage earners.

The popular appraisal of prolabor legislation was based on the error that wage rates have no causal relation whatever to the value that the workers’ labor adds to the material. Wage rates, says the “iron law,” are determined by the minimum amount of indispensable necessities of life; they can never rise above the subsistence level. The difference between the value produced by the worker and the wages paid to him goes to the exploiting employer. If this surplus is curtailed by restricting the working hours, the wage earner is relieved of a part of his toil and trouble, his wages remain unchanged, and the employer is deprived of a part of his unfair profit. The restriction of total output curtails only the income of the exploiting bourgeois.

It has been pointed out already that the role which prolabor legislation played in the evolution of Western capitalism was until a few years ago much less important than would be suggested by the vehemence with which the problems involved have been publicly discussed. Labor legislation, for the most part, merely provided a legal recognition of changes in conditions already consummated by the rapid evolution of business.[2] But in the countries which were slow in adopting capitalistic modes of production and are backward in developing modern methods of processing and manufacturing, the problem of labor legislation is crucial. Deluded by the spurious doctrines of interventionism, the politicians of these nations believe that they can improve the lot of the destitute masses by copying the labor legislation of the most advanced capitalistic countries. They look upon the problems involved as if they were merely to be treated from what is erroneously called the “human angle” and fail to recognize the real issue.

It is a sad fact indeed that in Asia many millions of tender children are destitute and starving, that wages are extremely low when compared with American or Western European standards, that hours of work are long, and that sanitary conditions in the workshops are deplorable. But there is no means of eliminating these evils other than to work, to produce, and to save more and thus to accumulate more capital. This is indispensable for any lasting improvement. The restrictive measures advocated by self-styled philanthropists and humanitarians would be futile. They would not only fail to improve conditions, they would make things a good deal worse. If the parents are too poor to feed their children adequately, prohibition of child labor condemns the children to starvation. If the marginal productivity of labor is so low that a worker can earn in ten hours only wages which are substandard when compared with American wages, one does not benefit the laborer by decreeing the eight-hour day.

The problem under discussion is not the desirability of improving the wage earners' material well-being. The advocates of what are miscalled prolabor laws intentionally confuse the issue in repeating again and again that more leisure, higher real wages, and freeing children and married women from the necessity of seeking jobs would make the families of the workers happier. They resort to falsehood and mean calumny in calling those who oppose such laws as detrimental to the vital interests of the wage earners "labor-baiters" and "enemies of labor." The disagreement does not refer to the ends sought; it concerns solely the means to be applied for their realization. The question is not whether or not improvement of the masses' welfare is desirable. It is exclusively whether or not government decrees restricting the hours of work and the employment of women and children are the right means for raising the workers' standard of living. This is a purely catallactic problem to be solved by economics. Emotional talk is beside the point. It is a poor disguise for the fact that these self-righteous advocates of restriction are unable to advance any tenable objections to the economists' well-founded argumentation.

The fact that the standard of living of the average American worker is incomparably more satisfactory than that of the average Hindu worker, that in the United States hours of work are shorter and that the children are sent to school and not to the factories, is not an achievement of the government and of the laws of the country. It is the outcome of the fact that the capital invested per head of the employees is much greater than in India and that consequently the marginal productivity of labor is much higher. This is not the merit of "social policies"; it is the result of the laissez faire methods of the past which abstained from sabotaging the evolution of capitalism. It is this laissez faire that the Asiatics must adopt if they want to improve the lot of their peoples.

The poverty of Asia and other backward countries is due to the same causes which made conditions unsatisfactory in the early periods of Western capitalism. While population figures increased rapidly, restrictive policies delayed the adjustment of production methods to the needs of the growing number of mouths. It is to the imperishable credit of the laissez faire economists, whom the typical textbooks of our universities dismiss as pessimists and apologists of the unfair greed of exploiting bourgeois, that they paved the way for economic freedom which raised the average standard of living to an unprecedented height.

Economics is not dogmatic, as the self-styled "unorthodox" advocates of government omnipotence and totalitarian dictatorship contend. Economics neither approves nor disapproves of government measures restricting production and output. It merely considers it its duty to clarify the consequences of such measures. The choice of policies to be adopted devolves upon the people. But in choosing they must not disregard the teachings of economics if they want to attain the ends sought.

There are certainly cases in which people may consider definite restrictive measures as justified. Regulations concerning fire prevention are restrictive and raise the cost of production. But the curtailment of total output they bring about is the price to be paid for avoidance of greater disaster. The decision about each restrictive measure is to be made on the ground of a meticulous weighing of the costs to be incurred and the prize to be obtained. No reasonable man could possibly question this rule.

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3

Restriction As A Privilege

Every disarrangement of the market data affects various individuals and groups of individuals in a different way. For some people it is a boon, for others a blow. Only after a while, when production is adjusted to the emergence of the new datum, are these effects exhausted. Thus a restrictive measure, while placing the immense majority at a disadvantage, may temporarily improve some people's position. For those favored the measure is tantamount to the acquisition of a privilege. They are asking for such measures because they want to be privileged.

Here again the most striking example is provided by protectionism. The imposition of a duty on the importation of a commodity burdens the consumers. But to the domestic producers it is a boon. From their point of view decreeing new tariffs and raising already existing tariffs is an excellent thing.

The same is valid with regard to many other restrictive measures. If the government restricts—either by direct restriction or by fiscal discrimination—big business and corporations, the competitive position of small-size enterprises is strengthened. If it restricts the operation of big stores and chain stores, the small shopkeepers rejoice.

It is important to realize that what those benefited by these measures consider an advantage for themselves lasts only for a limited time. In the long run the privilege accorded to a definite class of producers loses its power to create specific gains. The privileged branch attracts newcomers, and their competition tends to eliminate the specific gains derived from the privilege. Thus the eagerness of the law's pet children to acquire privileges is insatiable. They continue to ask for new privileges because the old ones lose their power.

On the other hand, the repeal of a restrictive measure to the existence of which the structure of production has already been adjusted means a new disarrangement of the market data, favors the short-run interests of some people and hurts the short-run interests of other people. Let us illustrate the issue by referring to a tariff item. Ruritania years ago, let us say in 1920, decreed a tariff on the importation of leather. This was a boon for the enterprises which at the moment happened to be engaged in the tanning industry. But then later the size of the industry expanded and the windfall gains which the tanners enjoyed in 1920 and in the following years petered out. What remains is merely the fact that a part of the world's leather production is shifted from locations in which the output per unit of input is higher, to locations in Ruritania in which production requires higher costs. The residents of Ruritania pay higher prices for leather than they would pay in the absence of the tariff. As a greater part of Ruritania's capital and labor is employed in the tanneries than would be the case under free trade for leather, some other domestic industries shrank or were at least prevented from growing. Less leather is imported from abroad and a smaller amount of Ruritanian products is exported as payment for leather imported. The volume of Ruritania's foreign trade is curtailed. Not a single soul in the whole world derives any advantage from the preservation of the old tariff. On the contrary, everyone is hurt by the drop in the total output of mankind's industrial effort. If the policy adopted by Ruritania with regard to leather were to be adopted by all nations and with regard to every kind of merchandise in the most rigid way so as to abolish international trade altogether and to make every nation perfectly autarkic, all people would have to forego entirely the advantages which the international division of labor gives them.

It is obvious that the repeal of the Ruritanian tariff on leather must in the long run benefit everybody, Ruritanians as well as foreigners. However, in the short run it would hurt the interests of the capitalists who have invested in Ruritanian tanneries. It would no less hurt the short-run interests of the Ruritanian workers specialized in tannery work. A part of them would have either to emigrate or to change their occupation. These capitalists and workers passionately fight all attempts to lower the leather tariff or to abolish it altogether.

This shows clearly why it is politically extremely difficult to brush away measures restricting production once the structure of business has been adjusted to their existence. Although their effects are pernicious to everybody, their disappearance is in the short run disadvantageous to special groups. These special groups interested in the preservation of the restrictive measures are, of course, only minorities. In Ruritania only the small fraction of the population engaged in the tanneries can suffer from the abolition of the tariff on leather. The immense majority are buyers of leather and leather goods and would be benefited by a drop in their prices. Outside the boundaries of Ruritania, only those people would be hurt who are engaged in those industries which will shrink because the leather industry will expand.

The last objection advanced by the opponents of free trade runs this way: Granted that only those Ruritanians engaged in tanning hides are immediately interested in the preservation of the tariff on leather. But every Ruritanian belongs to one of the many branches of production. If each domestic product is protected by the tariff, the transition to free trade hurts the interests of each industry and thereby those of all specialized groups of capital and labor the sum of which is the whole nation. It follows that repealing the tariff would in the short run be prejudicial to all citizens. And it is short-run interests only that count.

This argument involves a threefold error. First, it is not true that all branches of industry would be hurt by the transition to free trade. On the contrary. Those branches in which the comparative costs of production are lowest will expand under free trade. Their short-run interests would be favored by the abolition of the tariff. The tariff on those products they themselves turn out is of no advantage for them, as they could not only survive, but expand under free trade. The tariff on those products for which the comparative cost of production is higher in Ruritania than abroad hurts them by directing capital and labor, which otherwise would have fertilized them, into those other branches.

Second, the short-run principle is entirely fallacious. In the short run every change in the market data hurts those who did not anticipate it in time. A consistent champion of the short-run principle must advocate perfect ridigity and immutability of all data and oppose any change, including any therapeutical and technological improvement.3 Ifinacting people were always to prefer the avoidance of an evil in the nearer future to the avoidance of an evil in the remoter future, they would come down to the animal level. It is the very essence of human action as distinct from animal behavior that it consciously renounces some temporally nearer satisfaction in order to reap some greater but temporally remoter satisfaction.4

Finally, if the problem of the abolition of Ruritania's comprehensive tariff system is under discussion, one must not forget the fact that the short-run interests of those engaged in tanning are hurt only by the abolition of one of the items of the tariff while they are favored by the abolition of the other items concerning the products of the industries in which comparative cost is high. It is true that wage rates of the tannery workers will drop for some time as against those in other branches and that some time will elapse until the appropriate long-run proportion between wage rates in the various branches of Ruritanian production will be established. But concomitantly with the merely temporary drop in their earnings, these workers will experience a drop in the prices of many articles they are buying. And this tendency toward an improvement in their conditions is not a phenomenon only of the period of transition. It is the consummation of the lasting blessings of free trade which, in shifting every branch of industry to the location in which comparative cost is lowest, increases the productivity of labor and the total quantity of goods produced. It is the lasting long-run boon which free trade secures to every member of the market society.

The opposition to the abolition of tariff protection would be reasonable from the personal point of view of those engaged in the leather industry if the tariff on leather were the only tariff. Then one could explain their attitude as dictated by status interests, the interests of a caste which would be temporarily hurt by the abolition of a privilege although its mere preservation no longer confers any benefit on them. But in this hypothetical case the opposition of the tanners would be hopeless. The majority of the nation would overrule it. What strengthens the ranks of the protectionists is the fact that the tariff on leather is no exception, that many branches of industry are in a similar position and are fighting the abolition of tariff items concerning their own branch. This is, of course, not an alliance based on each group's special group interests. If everybody is protected to the same extent, everybody not only loses as consumer as much as he gains as producer. Everybody, moreover, is harmed by the general drop in the productivity of labor which the shifting of industries from more favorable to less favorable locations brings about. Conversely the abolition of all tariff items would benefit everybody in the long run, while the short-run harm which the abolition of some special tariff item brings to the special interests of the group concerned is already in the short run at least partly compensated by the consequences of the abolition of the tariff on the products the members of this group are buying and consuming.

Many people look upon tariff protection as if it were a privilege accorded to their nation's wage earners, procuring them, for the full duration of its existence, a higher standard of living than they would enjoy under free trade. This argument is advanced not only in the United States, but in every country in the world in which average real wage rates are higher than in some other country.

Now, it is true that under perfect mobility of capital and labor there would prevail all over the world a tendency toward an equalization of the price paid for labor of the same kind and quality.5 Yet, even if there were free trade for products, this tendency is absent in our real world of migration barriers and institutions hindering foreign investment of capital. The marginal productivity of labor is higher in the United States than it is in India because capital invested per head of the working population is greater, and because Indian workers are prevented from moving to America and competing on the American labor market. There is no need, in dealing with the explanation of this difference, to investigate whether natural resources are or are not more abundant in America than in India and whether or not the Indian worker is racially inferior to the American worker. However this may be, these facts, namely, the institutional checks upon the mobility of capital and labor, suffice to account for the absence of the equalization tendency. As the abolition of the American tariff could not affect these two facts, it could not impair the standard of living of the American wage earner in an adverse sense.

On the contrary. Given a state of affairs in which the mobility of capital and labor is restricted, the transition to free trade for products must necessarily raise the American standard of life. Those industries in which American costs are higher (American productivity is lower) would shrink and those in which costs are lower (productivity is higher) would expand.

Under free trade the Swiss watchmakers would expand their sales on the American market and the sales of their American competitors would shrink. But this is only a part of the consequences of free trade. Selling and producing more, the Swiss would earn and buy more. It does not matter whether they themselves buy more of the products of other American industries or whether they increase their domestic purchases and those in other countries, for instance, in France. Whatever happens, the equivalent of the additional dollars they earned must finally go to the United States and increase the sales of some American industries. If the Swiss do not give away their products as a gift, they must spend these dollars in buying.

The popular opinion to the contrary is due to the illusory idea that America could expand its purchases of imported products by reducing the total sum of its citizens' cash holdings. This is the notorious fallacy according to which people buy without regard to the size of their cash holdings, and according to which the very existence of cash holdings is simply the outcome of the fact that something is left over because there is nothing more to buy. We have already shown why this Mercantilist doctrine is entirely wrong.6

What the tariff really brings about in the field of wage rates and the wage earners' standard of living is something quite different.

In a world in which there is free trade for commodities, while the migration of workers and foreign investment are restricted, there prevails a tendency toward an establishment of a definite relation between the wages paid for the same kind and quality of labor in various countries. There cannot prevail a tendency toward an equalization of wage rates. But the final price to be paid for labor in various countries is in a certain numerical relation. This final price is characterized by the fact that all those eager to earn wages get a job and all those eager to employ workers are able to hire as many hands as they want. There is "full employment."

Let us assume that there are two countries only—Ruritania and Laputania. In Ruritania the final wage rate is double what it is in Laputania. Now the government of Ruritania resorts to one of those measures which are erroneously styled "prolabor." It burdens the employers with an additional expenditure the size of which is proportional to the number of workers employed. For example, it reduces the hours of work without permitting a corresponding drop in weekly wage rates. The result is a drop in the quantity of goods produced and a rise in the price of the unit of every good. The individual worker enjoys more leisure, but his standard of living is curtailed. What else could a general decrease in the quantity of goods available bring about?

This outcome is an internal event in Ruritania. It would emerge also in the absence of any foreign trade. The fact that Ruritania is not autarkic, but buys from and sells to Laputania, does not alter its essential features. But it implicates Laputania. As the Ruritanians produce and consume less, they will buy less from Laputania. In Laputania there will not be a general drop in production. But some industries which produced for export to Ruritania will henceforth have to produce for the domestic Laputanian market. Laputania will see the volume of its foreign trade drop; it will become, willy-nilly, more autarkic. This is a blessing in the eyes of the protectionists. In truth, it means deterioration in the standard of living; production at higher costs is substituted for that at lower costs. What Laputania experiences is the same thing that the residents of an autarkic country would experience if an act of God were to curtail the productivity of one of the country's industries. As far as there is division of labor, everybody is affected by a drop in the amount other people contribute to supplying the market.

However, these inexorable final international consequences of Ruritania's new pro-labor law will not affect the various branches of Laputania's industry in the same way. A sequence of steps is needed in both countries until at last a perfect adjustment of production to the new state of data is brought about. These short-run effects are different from the long-run effects. They are more spectacular than the long-run effects. While hardly anybody can fail to notice the short-run effects, the long-run effects are recognized only by economists. While it is not difficult to conceal the long-run effects from the public, something must be done about the easily recognizable short-run effects lest the enthusiasm for such allegedly pro-labor legislation fade away.

The first short-run effect to appear is the weakening of the competitive power of some Ruritanian branches of production as against those of Laputania. As prices rise in

Ruritania, it becomes possible for some Laputanians to expand their sales in Ruritania. This is a temporary effect only; in the end the total sales of all Laputanian industries in Ruritania will drop. It is possible that in spite of this general drop in the amount of Laputanian exports to Ruritania, some of the Laputanian industries will expand their sales in the long run. (This depends on the new configuration of comparative costs.) But there is no necessary interconnection between these short-run and long-run effects. The adjustments of the period of transition create kaleidoscopically changing situations which may differ entirely from the final outcome. Yet the short-sighted public's attention is completely absorbed by these short-run effects. They hear the businessmen affected complain that the new Ruritanian law gives to Laputanians the opportunity to undersell both in Ruritania and in Laputania. They see that some Ruritanian businessmen are forced to restrict their production and to discharge workers. And they begin to suspect that something may be wrong with the teachings of the self-styled "unorthodox friends of labor."

But the picture is different if there is in Ruritania a tariff high enough to prevent Laputanians from even temporarily expanding their sales on the Ruritanian market. Then the most spectacular shortrun effects of the new measure are masked in such a way that the public does not become aware of them. The long-run effects, of course, cannot be avoided. But they are brought about by another sequence of short-run effects which is less offensive because less visible. The talk about alleged "social gains" produced by the shortening of the hours of work is not exploded by the immediate emergence of effects which everyone, and most of all the discharged workers, consider undesirable.

The main function of tariffs and other protectionist devices today is to disguise the real effects of interventionist policies designed to raise the standard of living of the masses. Economic nationalism is the necessary complement of these popular policies which pretend to improve the wage earners' material well-being while they are in fact impairing it.[7]

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4

Restriction As An Economic System

There are, as has been shown, cases in which a restrictive measure can attain the end sought by its application. If those resorting to such a measure think that the attainment of this goal is more important than the disadvantages brought about by the restriction—i.e., the curtailment in the quantity of material goods available for consumption—the recourse to restriction is justified from the point of view of their value judgments. They incur costs and pay a price in order to get something that they value more than what they had to expend or to forego. Nobody, and certainly not the theorist, is in a position to argue with them about the propriety of their value judgments.

The only adequate mode of dealing with measures restricting production is to look at them as sacrifices made for the attainment of a definite end. They are quasi-expenditures and quasi-consumption. They are an employment of things that could be produced and consumed in one way for the realization of certain other ends. These things are prevented from coming into existence, but this quasi-consumption is precisely what satisfies the authors of these measures better than the increase in goods available which the omission of the restriction would have produced.

With certain restrictive measures this point of view is universally adopted. If a government decrees that a piece of land should be kept in its natural state as a national park and should be withheld from any other utilization, nobody would classify such a venture as anything else than an expenditure. The government deprives the citizens of the increment in various products which the cultivation of this land could bring about, in order to provide them with another satisfaction.

It follows that restriction of production can never play any role other than that of an ancillary complement of a system of production. One cannot construct a system of economic action out of such restrictive measures alone. No complex of such measures can be linked together into an integrated economic system. They cannot form a system of production. They belong in the sphere of consumption, not in the sphere of production.

In scrutinizing the problems of interventionism we are intent upon examining the claims of the advocates of government interference with business that their system offers an alternative to other economic systems. No such claim can reasonably be raised with regard to measures restricting production. The best they can attain is curtailment of output and satisfaction. Wealth is produced by expending a certain quantity of factors of production. Curtailing this quantity does not increase, but decreases, the amount of goods produced. Even if the ends aimed at by shortening the hours of work could be attained by such a decree, it would not be a measure of production. It is invariably a way of cutting down output.

Capitalism is a system of social production. Socialism, say the socialists, is also a system of social production. But with regard to measures restricting production, even the interventionists cannot raise a similar claim. They can only say that under capitalism too much is produced and that they want to prevent the production of this surplus in order to realize other ends. They themselves must confess that there are limits to the application of restriction.

Economics does not contend that restriction is a bad system of production. It asserts that it is not at all a system of production but rather a system of quasi-consumption. Most of the ends the interventionists want to attain by restriction cannot be attained this way. But even where restrictive measures are fit to attain the ends sought, they are only restrictive.8

The enormous popularity which restriction enjoys in our day is due to the fact that people do not recognize its consequences. In dealing with the problem of shortening the hours of work by government decree, the public is not aware of the fact that total output must drop and that it is very probable that the wage earners' standard of living will be potentially lowered too. It is a dogma of present-day "unorthodoxy" that such a "pro-labor" measure is a "social gain" for the workers and that the costs of these gains fall entirely upon the employers. Whoever questions this dogma is branded as a "sycophantic" apologist of the unfair pretensions of rugged exploiters, and pitilessly persecuted. It is insinuated that he wants to reduce the wage earners to the poverty and the long working hours of the early stages of modern industrialism.

As against all this slander it is important to emphasize again that what produces wealth and well-being is production and not restriction. That in the capitalist countries the average wage earner consumes more goods and can afford to enjoy more leisure than his ancestors, and that he can support his wife and children and need not send them to work, is not an achievement of governments and labor unions. It is the outcome of the fact that profit-seeking business has accumulated and invested more capital and thus increased the marginal productivity of labor.

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CHAPTER 30

Interference With The Structure Of Prices

1

The Government And The Autonomy Of The Market

Interference with the structure of the market means that the authority aims at fixing prices for commodities and services and interest rates at a height different from what the unhampered market would have determined. It decrees, or empowers—either tacitly or expressly—definite groups of people to decree prices and rates which are to be considered either as maxima or as minima, and it provides for the enforcement of such decrees by coercion and compulsion.

In resorting to such measures the government wants to favor either the buyer—as in the case of maximum prices—or the seller—as in the case of minimum prices. The maximum price is designed to make it possible for the buyer to procure what he wants at a price lower than that of the unhampered market. The minimum price is designed to make it possible for the seller to dispose of his merchandise or his services at a price higher than that of the unhampered market. It depends on the political balance of forces which groups the authority wants to favor. At times governments have resorted to maximum prices, at other times to minimum prices for various commodities. At times they have decreed maximum wage rates, at other times minimum wage rates. It is only with regard to interest that they have never had recourse to minimum rates; when they have interfered, they have always decreed maximum interest rates. They have always looked askance upon saving, investing, and moneylending.

If this interference with commodity prices, wage rates, and interest rates includes all prices, wage rates, and interest rates, it is tantamount to the full substitution of socialism (of the German pattern) for the market economy. Then the market, interpersonal exchange, private ownership of the means of production, entrepreneurship, and private initiative, virtually disappear altogether. No individual any longer has the opportunity to influence the process of production of his own accord; every individual is bound to obey the orders of the supreme board of production management. What in the complex of these orders are called prices, wage rates, and interest rates are no longer prices, wage rates, and interest rates in the catallactic sense of these terms. They are merely quantitative determinations fixed by the director without reference to a market process. If the governments resorting to price control and the reformers advocating price control were always intent upon the establishment of socialism of the German pattern, there would be no need for economics to deal with price control separately. All that has to be said with reference to such price control is already contained in the analysis of socialism.

Many advocates of government interference with prices have been and are very much confused with regard to this issue. They have failed to recognize the fundamental difference between a market economy and a nonmarket society. The haziness of their ideas has been reflected in vague and ambiguous language and in a bewildering terminology.

There were and are advocates of price control who have declared that they want to preserve the market economy. They are outspoken in their assertion that government fixing of prices, wage rates, and interest rates can attain the ends the government wants to attain by their promulgation without abolishing altogether the market and private ownership of the means of production. They even declare that price control is the best or the only means of preserving the system of private enterprise and of preventing the coming of socialism. They become very indignant if somebody questions the correctness of their doctrine and shows that price control, if it is not to make things worse from the point of view of the governments and the interventionist doctrinaires, must finally result in socialism. They protest that they are neither socialists nor communists, and that they aim at economic freedom and not at totalitarianism.

It is the tenets of these interventionists that we have to examine. The problem is whether it is possible for the police power to attain the ends it wants to attain by fixing prices, wage rates, and interest rates at a height different from what the unhampered market would have determined. It is beyond doubt that a strong and resolute government has the power to decree such maximum or minimum rates and to take revenge upon the disobedient. But the question is whether or not the authority can attain those ends which it wants to attain by resorting to such decrees.

History is a long record of price ceilings and anti-usury laws. Again and again emperors, kings, and revolutionary dictators have tried to meddle with the market phenomena. Severe punishment was inflicted on refractory dealers and farmers. Many people fell victim to persecutions which met with the enthusiastic approval of the masses. Nonetheless, all these endeavors failed. The explanation which the writings of lawyers, theologians and philosophers provided for the failure was in full agreement with the ideas held by the rulers and the masses. Man, they said, is intrinsically selfish and sinful, and the authorities were unfortunately too lax in enforcing the law. What was needed was more firmness and peremptoriness on the part of those in power.

Cognizance of the issue involved was first reached with regard to a special problem. Various governments long practiced currency debasement. They substituted baser and cheaper metals for a part of the gold or silver which the coins previously contained, or they reduced the weight and the size of the coins. But they retained for the debased coins the customary names of the old ones and they decreed that they should be given and received at the nominal par. Then later the governments tried to enjoin on their subjects analogous constraint with regard to the exchange ratio between gold and silver and that between metallic money and credit money or fiat money. In searching for the causes which made all such decrees abortive, the forerunners of economic thought had already discovered by the last centuries of the Middle Ages the regularity which was later called Gresham's Law. There was still a long way to go from this isolated insight to the point where the philosophers of the eighteenth century became aware of the interconnectedness of all market phenomena.

In describing the results of their reasoning the classical economists and their successors sometimes resorted to idiomatic expressions which could easily be misinterpreted by those who wanted to misinterpret them. They occasionally spoke of the "impossibility" of price control. What they really meant was not that such decrees are impossible, but that they cannot attain those ends which the governments are trying to attain and that they make things worse, not better. They concluded that such decrees are contrary to purpose and inexpedient.

It is necessary to see clearly that the problem of price control is not merely *one* of the problems to be dealt with by economics, not a problem with regard to which there can arise disagreement among various economists. The issue involved is rather: Is there any such thing as economics? Is there any regularity in the sequence and interconnectedness of the market phenomena? He who answers these two questions in the negative denies the very possibility, rationality and existence of economics as a branch of knowledge. He returns to the beliefs held in the ages which preceded the evolution of economics. He declares to be untrue the assertion that there is any economic law and that prices, wage rates, and interest rates are uniquely determined by the data of the market. He contends that the police have the power to determine these market phenomena *ad libitum.* An advocate of socialism need not necessarily negate economics; his postulates do not necessarily imply the indeterminateness of the market phenomena. But the interventionist, in advocating price control, cannot help nullifying the very existence of economics. Nothing is left of economics if one denies the law of the market.

The German Historical School was consistent in its radical condemnation of economics and in its endeavors to substitute *wirtschaftliche Staatswissenschaften* (the economic aspects of political science) for economics. So were many adepts of British Fabianism and American Institutionalism. But those authors who do not totally reject economics and yet assert that price control can attain the ends sought lamentably contradict themselves. It is logically impossible to reconcile the point of view of the economist and that of the interventionist. If prices are uniquely determined by the market data, they cannot be freely manipulated by government compulsion. The government's decree is just a new datum, and its effects are determined by the operation of the market. It need not necessarily produce those results which the government wants to realize in resorting to it. It may happen that the final outcome of the interference is, from the point of view of the government's intention, even more undesirable than the previous state of affairs which the government wanted to alter.

One does not invalidate these propositions by putting the term economic law in quotation marks and by finding fault with the notion of the law. In speaking of the laws of nature we have in mind the fact that there prevails an inexorable interconnectedness of physical and biological phenomena and that acting man must submit to this regularity if he wants to succeed. In speaking of the laws of human action we refer to the fact that such an inexorable interconnectedness of phenomena is present also in the field of human action as such and that acting man must recognize this regularity too if he wants to succeed. The reality of the laws of praxeology is revealed to man by the same signs that reveal the reality of natural law, namely, the fact that his power to attain chosen ends is restricted and conditioned. In the absence of laws man would either be omnipotent and would never feel any uneasiness which he could not remove instantly and totally, or he could not act at all.

These laws of the universe must not be confused with the man-made laws of the country and with man-made moral precepts. The laws of the universe about which physics, biology, and praxeology provide knowledge are independent of the human will, they are primary ontological facts rigidly restricting man's power to act. The moral precepts and the laws of the country are means by which men seek to attain certain ends. Whether or not these ends can really be attained this way depends on the laws of the universe. The man-made laws are suitable if they are fit to attain these ends and contrary to purpose if they are not. They are open to examination from the point of view of their suitableness or unsuitableness. With regard to the laws of the universe any doubt of their suitableness is supererogatory and vain. They are what they are and take care of themselves. Their violation penalizes itself. But the man-made laws need to be enforced by special sanctions.

Only the insane venture to disregard physical and biological laws. But it is quite common to disdain praxeological laws. Rulers do not like to admit that their power is restricted by any laws other than those of physics and biology. They never ascribe their failures and frustrations to the violation of economic law.

Foremost in the repudiation of economic knowledge was the German Historical School. It was an unbearable idea to those professors that their lofty idols, the Hohenzollern Electors of Brandenburg and Kings of Prussia, should have lacked omnipotence. To refute the teachings of the economists, they buried themselves in old documents and compiled numerous volumes dealing with the history of the administration of these glorious princes. This, they wrote, is a realistic approach to the problems of state and government. Here you find unadulterated facts and real life, not the bloodless abstractions and faulty generalizations of the British doctrinaires. In truth, all that these ponderous tomes report is a long record of policies and measures which failed precisely because of their neglect of economic law. No more instructive case history could ever be written than these volumes of Prussian documents, the *Acta Borussica.*

However, economics cannot acquiesce in such exemplification. It must enter into a precise scrutiny of the mode in which the market reacts to government interference with the price structure.

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2

The Market'S Reaction To Government Interference

The characteristic feature of the market price is that it tends to equalize supply and demand. The size of the demand coincides with the size of supply not only in the imaginary construction of the evenly rotating economy. The notion of the plain state of rest as developed by the elementary theory of prices is a faithful description of what comes to pass in the market at every instant. Any deviation of a market price from the height at which supply and demand are equal is—in the unhampered market—self-liquidating.

But if the government fixes prices at a height different from what the market would have fixed if left alone, this equilibrium of demand and supply is disturbed. Then there are—with maximum prices—potential buyers who cannot buy although they are ready to pay the price fixed by the authority, or even a higher price. Then there are—with minimum prices—potential sellers who cannot sell although they are ready to sell at the price fixed by the authority, or even at a lower price. The price can no longer segregate those potential buyers and sellers who can buy or sell from those who cannot. A different principle for the allocation of the goods and services concerned and for the selection of those who are to receive portions of the supply available necessarily comes into operation. It may be that only those are in a position to buy who come first, or only those to whom particular circumstances (such as personal connections) assign a privileged position, or only those ruthless fellows who chase away their rivals by resorting to intimidation or violence. If the authority does not want chance or violence to determine the allocation of the supply available and conditions to become chaotic, it must itself regulate the amount which each individual is permitted to buy. It must resort to rationing.[1]

But rationing does not affect the core of the issue. The allocation of portions of the supply already produced and available to the various individuals eager to obtain a quantity of the goods concerned is only a secondary function of the market. Its primary function is the direction of production. It directs the employment of the factors of production into those channels in which they satisfy the most urgent needs of the consumers. If the government's price ceiling refers only to one consumers' good or to a limited amount of consumers' goods while the prices of the complementary factors of production are left free, production of the consumers' goods concerned will drop. The marginal producers will discontinue producing them lest they suffer losses. The not absolutely specific factors of production will be employed to a greater extent for the production of other goods not subject to price ceilings. A greater part of the absolutely specific factors of production will remain unused than would have remained in the absence of price ceilings. There emerges a tendency to shift production activities from the production of the goods affected by the maximum prices into the production of other goods. This outcome is, however, manifestly contrary to the intentions of the government. In resorting to price ceilings the authority wanted to make the commodities concerned more easily accessible to the consumers. It considered precisely those commodities so vital that it singled them out for a special measure in order to make it possible even for poor people to be amply supplied with them. But the result of the government's interference is that production of these commodities drops or stops altogether. It is a complete failure.

It would be vain for the government to try to remove these undesired consequences by decreeing maximum prices likewise for the factors of production needed for the production of the consumers' goods the prices of which it has fixed. Such a measure would be successful only if all factors of production required were absolutely specific. As this can never be the case, the government must add to its first measure, fixing the price of only one consumers' good below the potential market price, more and more price ceilings, not only for all other consumers' goods and for all material factors of production, but no less for labor. It must compel every entrepreneur, capitalist, and employee to continue producing at the prices, wage rates, and interest rates which the government has fixed, to produce those quantities which the government orders them to produce, and to sell the products to those people—producers or consumers—whom the government determines. If one branch of production were to be exempt from this regimentation, capital and labor would flow into it; production would be restricted precisely in those other—regimented—branches which the government considered so important that it interfered with the conduct of their affairs.

Economics does not say that isolated government interference with the prices of only one commodity or a few commodities is unfair, bad, or unfeasible. It says that such interference produces results contrary to its purpose, that it makes conditions worse, not better, *from the point of view of the government and those backing its interference.* Before the government interfered, the goods concerned were, in the eyes of the government, too dear. As a result of the maximum price their supply dwindles or disappears altogether. The government interfered because it considered these commodities especially vital, necessary, indispensable. But its action curtailed the supply available. It is therefore, from the point of view of the government, absurd and nonsensical.

If the government is unwilling to acquiesce in this undesired and undesirable outcome and goes further and further, if it fixes the prices of all goods and services of all orders and obliges all people to continue producing and working at these prices and wage rates, it eliminates the market altogether. Then the planned economy, socialism of the German *Zwangswirtschaft* pattern, is substituted for the market economy. The consumers no longer direct production by their buying and abstention from buying; the government alone directs it.

There are only two exceptions to the rule that maximum prices restrict supply and thus bring about a state of affairs which is contrary to the aims sought by their imposition. One refers to absolute rent, the other to monopoly prices.

The maximum price results in a restriction of supply because the marginal producers suffer losses and must discontinue production. The nonspecific factors of production are employed for the production of other products not subject to price ceilings. The utilization of the absolutely specific factors of production shrinks. Under unhampered market conditions they would have been utilized up to the limit determined by the absence of an opportunity to use the nonspecific among the complementary factors for the satisfaction of more urgent wants. Now only a smaller part of the available supply of these absolutely specific factors can be utilized; concomitantly that part of the supply that remains unused increases. But if the supply of these absolutely specific factors is so scanty that under the prices of the unhampered market their total supply was utilized, a margin is given within which the government's interference does not curtail the supply of the product. The maximum price does not restrict production as long as it has not entirely absorbed the absolute rent of the marginal supplier of the absolutely specific factor. But at any rate it results in a discrepancy between the demand for and the supply of the product.

Thus the amount by which the urban rent of a piece of land exceeds the agricultural rent provides a margin in which rent control can operate without restricting the supply of rental space. If the maximum rents are graduated in such a way as never to take away from any proprietor so much that he prefers to use the land for agriculture rather than for the construction of buildings, they do not affect the supply of apartments and business premises. However, they increase the demand for such apartments and premises and thus create the very shortage that the governments pretend to fight by their rent ceilings. Whether or not the authorities resort to rationing the space available is catallactically of minor importance. At any rate, their price ceilings do not abolish the catallactic phenomenon of the urban rent. They merely transfer the rent from the landlord's income into the tenant's income.

In practice, of course, governments resorting to rent restriction never adjust their ceilings to these considerations. They either rigidly freeze gross rents as they prevailed on the eve of their interference or allow only a limited addition to these gross rents. As the proportion between the two items included in the gross rent, urban rent proper and price paid for the utilization of the superstructure, varies according to the special circumstances of each dwelling, the effect of rent ceilings is also very different. In some cases the expropriation of the owner to the benefit of the lessee involves only a fraction of the difference between the urban rent and the agricultural rent; in other cases it far exceeds this difference. But however this may be, the rent restriction creates a housing shortage. It increases demand without increasing supply.

If maximum rents are decreed not only for already available rental space, but also for buildings still to be constructed, the construction of new buildings is no longer remunerative. It either stops altogether or slumps to a low level; the shortage is perpetuated. But even if rents in new buildings are left free, construction of new buildings drops. Prospective investors are deterred because they take into account the danger that the government will at a later date declare a new emergency and expropriate a part of their revenues in the same way as it did with the old buildings.

The second exception refers to monopoly prices. The difference between a monopoly price and the competitive price of the commodity in question provides a margin in which maximum prices could be enforced without defeating the ends sought by the government. If the competitive price is *p* and the lowest among the possible monopoly prices *m,* a ceiling price of *c, c* being higher than *p* and lower than *m,* would make it disadvantageous for the seller to raise the price above *p*. The maximum price could reestablish the competitive price and increase demand, production, and the supply offered for sale. A dim cognizance of this concatenation is at the bottom of some suggestions asking for government interference in order to preserve competition and to make it operate as beneficially as possible.

We may for the sake of argument pass over the fact that all such measures would appear as paradoxical with regard to all those instances of monopoly prices which are the outcome of government interference. If the government objects to monopoly prices for new inventions, it should stop granting patents. It would be absurd to grant patents and then to deprive them of any value by forcing the patentee to sell at the competitive price. If the government does not approve of cartels, it should rather abstain from all measures (such as import duties) which provide business with the opportunity to erect combines.

Things are different in those rare instances in which monopoly prices come into existence without assistance from the governments. Here governmental maximum prices could reestablish competitive conditions if it were possible to find out by academic computation at which height a nonexisting competitive market would have determined the price. That all endeavors to construct nonmarket prices are vain has been shown.[2] The unsatisfactory results of all attempts to determine what the fair or correct price for the services of public utilities should be are well known to all experts.

Reference to these two exceptions explains why in some very rare cases maximum prices, when applied with very great caution within a narrow margin, do not restrict the supply of the commodity or the service concerned. It does not affect the correctness of the general rule that maximum prices bring about a state of affairs which, from the point of view of the government decreeing them, is more undesirable than conditions as they would have been in the absence of price control.

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Observations On The Causes Of The Decline Of Ancient Civilization

Knowledge of the effects of government interference with market prices makes us comprehend the economic causes of a momentous historical event, the decline of ancient civilization.

It may be left undecided whether or not it is correct to call the economic organization of the Roman Empire capitalism. At any rate it is certain that the Roman Empire in the second century, the age of the Antonines, the "good" emperors, had reached a high stage of the social division of labor and of interregional commerce. Several metropolitan centers, a considerable number of middle-sized towns, and many small towns were the seats of a refined civilization. The inhabitants of these urban agglomerations were supplied with food and raw materials not only from the neighboring rural districts, but also from distant provinces. A part of these provisions flowed into the cities as revenue of their wealthy residents who owned landed property. But a considerable part was bought in exchange for the rural population's purchases of the products of the city-dwellers' processing activities. There was an extensive trade between the various regions of the vast empire. Not only in the processing industries, but also in agriculture there was a tendency toward further specialization. The various parts of the empire were no longer economically self-sufficient. They were interdependent.

What brought about the decline of the empire and the decay of its civilization was the disintegration of this economic interconnectedness, not the barbarian invasions. The alien aggressors merely took advantage of an opportunity which the internal weakness of the empire offered to them. From a military point of view the tribes which invaded the empire in the fourth and fifth centuries were not more formidable than the armies which the legions had easily defeated in earlier times. But the empire had changed. Its economic and social structure was already medieval.

The freedom that Rome granted to commerce and trade had always been restricted. With regard to the marketing of cereals and other vital necessities it was even more restricted than with regard to other commodities. It was deemed unfair and immoral to ask for grain, oil, and wine, the staples of these ages, more than the customary prices, and the municipal authorities were quick to check what they considered profiteering. Thus the evolution of an efficient wholesale trade in these commodities was prevented. The policy of the *annona,* which was tantamount to a nationalization or municipalization of the grain trade, aimed at filling the gaps. But its effects were rather unsatisfactory. Grain was scarce in the urban agglomerations, and the agriculturists complained about the unremunerativeness of grain growing.[3] The interference of the authorities upset the adjustment of supply to the rising demand.

The showdown came when in the political troubles of the third and fourth centuries the emperors resorted to currency debasement. With the system of maximum prices the practice of debasement completely paralyzed both the production and the marketing of the vital foodstuffs and disintegrated society's economic organization. The more eagerness the authorities displayed in enforcing the maximum prices, the more desperate became the conditions of the urban masses dependent on the purchase of food. Commerce in grain and other necessities vanished altogether. To avoid starving, people deserted the cities, settled on the countryside, and tried to grow grain, oil, wine, and other necessities for themselves. On the other hand, the owners of the big estates restricted their excess production of cereals and began to produce in their farmhouses—the *villae* —the products of handicraft which they needed. For their big-scale farming, which was already seriously jeopardized because of the inefficiency of slave labor, lost its rationality completely when the opportunity to sell at remunerative prices disappeared. As the owner of the estate could no longer sell in the cities, he could no longer patronize the urban artisans either. He was forced to look for a substitute to meet his needs by employing handicraftsmen on his own account in his *villa.* He discontinued big-scale farming and became a landlord receiving rents from tenants or sharecroppers. These *coloni* were either freed slaves or urban proletarians who settled in the villages and turned to tilling the soil. A tendency toward the establishment of autarky of each landlord's estate emerged. The economic function of the cities, of commerce, trade, and urban handicrafts, shrank. Italy and the provinces of the empire returned to a less advanced state of the social division of labor. The highly developed economic structure of ancient civilization retrograded to what is now known as the manorial organization of the Middle Ages.

The emperors were alarmed with that outcome which undermined the financial and military power of their government. But their counteraction was futile as it did not affect the root of the evil. The compulsion and coercion to which they resorted could not reverse the trend toward social disintegration which, on the contrary, was caused precisely by too much compulsion and coercion. No Roman was aware of the fact that the process was induced by the government's interference with prices and by currency debasement. It was vain for the emperors to promulgate laws against the city-dweller who *relicta civitate rus habitare maluerit* [deserted the cities, preferring to live in the country].4 The system of the *leiturgia,* the public services to be rendered by the wealthy citizens, only accelerated the retrogression of the division of labor. The laws concerning the special obligations of the shipowners, the *navicularii,* were no more successful in checking the decline of navigation than the laws concerning grain dealing in checking the shrinkage in the cities' supply of agricultural products.

The marvelous civilization of antiquity perished because it did not adjust its moral code and its legal system to the requirements of the market economy. A social order is doomed if the actions which its normal functioning requires are rejected by the standards of morality, are declared illegal by the laws of the country, and are prosecuted as criminal by the courts and the police. The Roman Empire crumbled to dust because it lacked the spirit of liberalism and free enterprise. The policy of interventionism and its political corollary, the Führer principle, decomposed the mighty empire as they will by necessity always disintegrate and destroy any social entity.

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Minimum Wage Rates

The very essence of the interventionist politicians' wisdom is to raise the price of labor either by government decree or by violent action or the threat of such action on the part of labor unions. To raise wage rates above the height at which the unhampered market would determine them is considered a postulate of the eternal laws of morality as well as indispensable from the economic point of view. Whoever dares to challenge this ethical and economic dogma is scorned both as depraved and ignorant. Many of our contemporaries look upon people who are foolhardy enough "to cross a picket line" as primitive tribesmen looked upon those who violated the precepts of taboo conceptions. Millions are jubilant if such *scabs* receive their well-deserved punishment from the hands of the strikers while the police, the public attorneys, and the penal courts preserve a lofty neutrality or openly side with the strikers.

The market wage rate tends toward a height at which all those eager to earn wages get jobs and all those eager to employ workers can hire as many as they want. It tends toward the establishment of what is nowadays called full employment. Where there is neither government nor union interference with the labor market, there is only voluntary or catallactic unemployment. But as soon as external pressure and compulsion, be it on the part of the government or on the part of the unions, tries to fix wage rates *at a higher point,* institutional unemployment emerges. While there prevails on the unhampered labor market a tendency for catallactic unemployment to disappear, institutional unemployment cannot disappear as long as the government or the unions are successful in the enforcement of their *fiat.* If the minimum wage rate refers only to a part of the various occupations while other sectors of the labor market are left free, those losing their jobs on its account enter the free branches of business and increase the supply of labor in them. When unionism was restricted to skilled labor mainly, the wage rise achieved by the unions did not lead to institutional unemployment. It merely lowered the height of wage rates in those branches in which there were no efficient unions or no unions at all. The corollary of the rise in wages for organized workers was a drop in wages for unorganized workers. But with the spread of government interference with wages and with government support of unionism, conditions have changed. Institutional unemployment has become a chronic or permanent mass phenomenon.

Writing in 1930, Lord Beveridge, later an advocate of government and union meddling with the labor market, pointed out that the potential effect of "a high-wages policy" in causing unemployment is "not denied by any competent authority."[5] In fact, to deny this effect is tantamount to a complete disavowal of any regularity in the sequence and interconnectedness of market phenomena. Those earlier economists who sympathized with the unions were fully aware of the fact that unionization can achieve its ends only when restricted to a minority of workers. They approved of unionism as a device beneficial to the group interests of a privileged labor aristocracy, and did not concern themselves about its consequences for the rest of the wage earners.6 No one has ever succeeded in the effort to demonstrate that unionism could improve the conditions and raise the standard of living of *all* those eager to earn wages.

It is important to remember also that Karl Marx did not contend that unions could raise the average standard of wages. As he saw it, "the general tendency of capitalistic production is not to raise, but to sink the average standard of wages." Such being the tendency of things, all that unionism can achieve with regard to wages is "making the best of the occasional chances for their temporary improvement."7 The unions counted for Marx only as far as they attacked "the very system of wage slavery and present-day methods of production."8 They should understand that "instead of the *conservative* motto, *A fair day's wages for a fair day's work!* they ought to inscribe on their banner the *revolutionary* watchword, *Abolition of the wages system."*9 Consistent Marxians always opposed attempts to impose minimum wage rates as detrimental to the interests of the whole labor class. From the beginning of the modern labor movement there was always an antagonism between the unions and the revolutionary socialists. The older British and American unions were exclusively dedicated to the enforcement of higher wage rates. They looked askance upon socialism, "utopian" as well as "scientific." In Germany there was a rivalry between the adepts of the Marxian creed and the union leaders. Finally, in the last decades preceding the outbreak of the first World War, the unions triumphed. They virtually converted the Social Democratic Party to the principles of interventionism and unionism. In France, Georges Sorel aimed at imbuing the unions with that spirit of ruthless aggression and revolutionary bellicosity which Marx wanted to impart to them. There is today in every nonsocialist country a manifest conflict between two irreconcilable factions within the unions. One group considers unionism a device for the improvement of the workers' conditions within the frame of capitalism. The other group wants to drive the unions into the ranks of militant communism and approves of them only as far as they are the pioneers of a violent overthrow of the capitalistic system.

The problems of labor unionism have been obfuscated and utterly confused by pseudo-humanitarian blather. The advocates of minimum wage rates, whether decreed and enforced by the government or by violent union action, contend that they are fighting for the improvement of the conditions of the working masses. They do not permit anyone to question their dogma that minimum wage rates are the only appropriate means of raising wage rates permanently and for all those eager to earn wages. They pride themselves on being the only true friends of "labor," of the "common man," of "progress," and of the eternal principles of "social justice."

However, the problem is precisely whether there is any means for raising the standard of living of all those eager to work other than raising the marginal productivity of labor by accelerating the increase of capital as compared with population. The union doctrinaires are intent upon obscuring this primary issue. They never refer to the only point that matters, viz., the relation between the number of workers and the quantity of capital goods available. But certain policies of the unions involve a tacit acknowledgment of the correctness of the catallactic theorems concerning the determination of wage rates. Unions are anxious to cut down the supply of labor by anti-immigration laws and by preventing outsiders and newcomers from competing in the unionized sectors of the labor market. They are opposed to the export of capital. These policies would be nonsensical if it were true that the per capita quota of capital available is of no importance for the determination of wage rates.

The essence of the union doctrine is implied in the slogan *exploitation.* According to the union variety of the exploitation doctrine, which differs from the Marxian creed, labor is the only source of wealth, and expenditure of labor the only real cost. By rights, all proceeds from the sale of products should belong to the workers. The manual worker has a fair claim to the "whole produce of labor." The wrong that the capitalistic mode of production does to the worker is seen in the fact that it permits landowners, capitalists, and entrepreneurs to withhold a part of the workers' portion. The share which goes to these parasites is called unearned income. The workers are right in their endeavors to raise wage rates step by step to such a height that finally nothing will be left for the support of a class of idle and socially useless exploiters. In aiming at this end, the unions pretend to continue the battle which earlier generations fought for the emancipation of slaves and serfs and for the abolition of the imposts, tributes, tithes, and unpaid statute labor with which the peasantry was burdened for the benefit of aristocratic landlords. The labor movement is a struggle for freedom and equality, and for the vindication of the inalienable rights of man. Its ultimate victory is beyond doubt, for it is the inevitable trend of historical evolution to wipe out all class privileges and to establish firmly the realm of freedom and equality. The attempts of reactionary employers to halt progress are doomed.

Such are the tenets of present-day social doctrine. It is true that some people, although in perfect agreement with its philosophical ideas, support the practical conclusions derived by the radicals only with certain reservations and qualifications. These moderates do not propose to abolish "management's" share altogether; they would be satisfied with cutting it down to a "fair" amount. As the opinions concerning the fairness of the revenues of the entrepreneurs and capitalists vary widely, the difference between the point of view of the radicals and that of the moderates is of little moment. The moderates also endorse the principle that real wage rates should always rise and never drop. In both world wars few voices in the United States disputed the claim of the unions that the wage earners' take-home pay, even in a national emergency, should go up faster than the cost of living.

As the union doctrine sees it, there is no harm in confiscating the specific revenue of the capitalists and entrepreneurs partially or altogether. In dealing with this issue they speak of profits in the sense in which the classical economists applied this term. They do not distinguish between entrepreneurial profit, interest on the capital employed and compensation for the technical services rendered by the entrepreneur. We will deal later with the consequences resulting from the confiscation of interest and profits and with the syndicalist elements involved in the "ability to pay" principle and in profit-sharing schemes.[10] We have examined the purchasing power argument as advanced in favor of a policy of raising wage rates above the potential market rates.[11] What remains is to scrutinize the purport of the alleged Ricardo effect.

Ricardo is the author of the proposition that a rise in wages will encourage capitalists to substitute machinery for labor and vice versa.12 Hence, conclude the union apologists, a policy of raising wage rates, irrespective of what they would have been on the unhampered labor market, is always beneficial. It generates technological improvement and raises the productivity of labor. Higher wages always pay for themselves. In forcing the reluctant employers to raise wage rates, the unions become the pioneers of progress and prosperity.

Many economists approve of the Ricardian proposition although few of them are consistent enough to endorse the inference the union apologists draw from it. The Ricardo effect is by and large a stockin-trade of popular economics. Nonetheless, the theorem involved is one of the worst economic fallacies.

The confusion starts with the misinterpretation of the statement that machinery is "substituted" for labor. What happens is that labor is rendered more efficient by the aid of machinery. The same input of labor leads to a greater quantity or a better quality of products. The employment of machinery itself does not *directly* result in a reduction of the number of hands employed in the production of the article A concerned. What brings about this secondary effect is the fact that—other things being equal—an increase in the available supply of A lowers the marginal utility of a unit of A as against that of the units of other articles and that therefore labor is withdrawn from the production of A and employed in the turning out of other articles. The technological improvement in the production of A makes it possible to realize certain projects which could not be executed before because the workers required were employed for the production of A for which consumers' demand was more urgent. The reduction of the number of workers in the A industry is caused by the increased demand of these other branches to which the opportunity to expand is offered. Incidentally, this insight explodes all talk about technological unemployment.

Tools and machinery are primarily not labor-saving devices, but means to increase output per unit of input. They appear as labor-saving devices if looked upon exclusively from the point of view of the individual branch of business concerned. Seen from the point of view of the consumers and the whole of society, they appear as instruments that raise the productivity of human effort. They increase supply and make it possible to consume more material goods and to enjoy more leisure. Which goods will be consumed in greater quantity and to what extent people will prefer to enjoy more leisure depends on people's value judgments.

The employment of more and better tools is feasible only to the extent that the capital required is available. Saving—that is, a surplus of production over consumption—is the indispensable condition of every further step toward technological improvement. Mere technological knowledge is of no use if the capital needed is lacking. Indian businessmen are familiar with American ways of production. What prevents them from adopting the American methods is not the lowness of Indian wages, but lack of capital.

On the other hand, capitalist saving necessarily causes employment of additional tools and machinery. The role that plain saving, i.e., the piling up of stocks of consumers' goods as a reserve for rainy days, plays in the market economy is negligible. Under capitalism saving is as a rule capitalist saving. The excess of production over consumption is invested either directly in the saver's own business or farm or indirectly in other peoples' enterprises through the instrumentality of savings deposits, common and preferred stock, bonds, debentures, and mortgages.13 To the extent to which people keep their consumption below their net income, additional capital is created and at the same time employed for the expansion of the capital equipment of the apparatus of production. As has been pointed out, this outcome cannot be affected by any synchronous tendency toward an increase in cash holdings.14 On the one hand, what is unconditionally needed for the employment of more and better tools is additional accumulation of capital. On the other hand, there is no employment available for additional capital other than that provided by the application of more and better tools.

Ricardo's proposition and the union doctrine derived from it turn things upside down. A tendency toward higher wage rates is not the cause, but the effect, of technological improvement. Profit-seeking business is compelled to employ the most efficient methods of production. What checks a businessman's endeavors to improve the equipment of his firm is only lack of capital. If the capital required is not available, no meddling with wage rates can provide it.

All that minimum wage rates can accomplish with regard to the employment of machinery is to shift additional investment from one branch into another. Let us assume that in an economically backward country, Ruritania, the stevedores' union succeeds in forcing the entrepreneurs to pay wage rates which are comparatively much higher than those paid in the rest of the country's industries. Then it may result that the most profitable employment for additional capital is to utilize mechanical devices in the loading and unloading of ships. But the capital thus employed is withheld from other branches of Ruritania's business in which, in the absence of the union's policy, it would have been employed in a more profitable way. The effect of the high wages of the stevedores is not an increase, but a drop in Ruritania's total production.15

Real wage rates can rise only to the extent that, other things being equal, capital becomes more plentiful. If the government or the unions succeed in enforcing wage rates which are higher than those the unhampered labor market would have determined, the supply of labor exceeds the demand for labor. Institutional unemployment emerges.

Firmly committed to the principles of interventionism, governments try to check this undesired result of their interference by resorting to those measures which are nowadays called full-employment policy: unemployment doles, arbitration of labor disputes, public works by means of lavish public spending, inflation, and credit expansion. All these remedies are worse than the evil they are designed to remove.

Assistance granted to the unemployed does not dispose of unemployment. It makes it easier for the unemployed to remain idle. The nearer the allowance comes to the height at which the unhampered market would have fixed the wage rate, the less incentive it offers to the beneficiary to look for a new job. It is a means of making unemployment last rather than of making it disappear. The disastrous financial implications of unemployment benefits are manifest.

Arbitration is not an appropriate method for the settlement of disputes concerning the height of wage rates. If the arbitrators' award fixes wage rates exactly at the potential market rate or below that rate, it is supererogatory. If it fixes wage rates above the potential market rate, the consequences are the same that any other mode of fixing minimum wage rates above the market height brings about, viz., institutional unemployment. It does not matter to what pretext the arbitrator resorts in order to justify his decision. What matters is not whether wages are "fair" or "unfair" by some arbitrary standard, but whether they do or do not bring about an excess of supply of labor over demand for labor. It may seem fair to some people to fix wage rates at such a height that a great part of the potential labor force is doomed to lasting unemployment. But nobody can assert that it is expedient and beneficial to society.

If government spending for public works is financed by taxing the citizens or borrowing from them, the citizens' power to spend and invest is curtailed to the same extent as that of the public treasury expands. No additional jobs are created.

But if the government finances its spending program by inflation—by an increase in the quantity of money and by credit expansion—it causes a general cash-induced rise in the prices of all commodities and services. If in the course of such an inflation the rise in wage rates sufficiently lags behind the rise in the prices of commodities, institutional unemployment may shrink or disappear altogether. But what makes it shrink or disappear is precisely the fact that such an outcome is tantamount to a drop in *real* wage rates. Lord Keynes considered credit expansion an efficient method for the abolition of unemployment; he believed that "gradual and automatic lowering of real wages as a result of rising prices" would not be so strongly resisted by labor as any attempt to lower money wage rates.[16] However, the success of such a cunning plan would require an unlikely degree of ignorance and stupidity on the part of the wage earners. As long as workers believe that minimum wage rates benefit them, they will not let themselves be cheated by such clever tricks.

In practice all these devices of an alleged full employment policy finally lead to the establishment of socialism of the German pattern. As the members of an arbitration court whom the employers have appointed and those whom the unions have appointed never agree with regard to the fairness of a definite rate, the decision virtually devolves upon the members appointed by the government. The power to determine the height of wage rates is thus vested in the government.

The more public works expand and the more the government undertakes in order to fill the gap left by the alleged "private enterprise's inability to provide jobs for all," the more the realm of private enterprise shrinks. Thus we are again faced with the alternative of capitalism or socialism. There cannot be any question of a lasting policy of minimum wage rates.

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The Catallactic Aspects Of Labor Unionism

The only catallactic problem with regard to labor unions is the question of whether or not it is possible to raise by pressure and compulsion the wage rates of all those eager to earn wages above the height the unhampered market would have determined.

In all countries the labor unions have actually acquired the privilege of violent action. The governments have abandoned in their favor the essential attribute of government, the exclusive power and right to resort to violent coercion and compulsion. Of course, the laws which make it a criminal offense for any citizen to resort—except in case of self-defense—to violent action have not been formally repealed or amended. However, actually labor union violence is tolerated within broad limits. The labor unions are practically free to prevent by force anybody from defying their orders concerning wage rates and other labor conditions. They are free to inflict with impunity bodily evils upon strikebreakers and upon entrepreneurs and mandataries of entrepreneurs who employ strikebreakers. They are free to destroy property of such employers and even to injure customers patronizing their shops. The authorities, with the approval of public opinion, condone such acts. The police do not stop such offenders, the state attorneys do not arraign them, and no opportunity is offered to the penal courts to pass judgment on their actions. In excessive cases, if the deeds of violence go too far, some lame and timid attempts at repression and prevention are ventured. But as a rule they fail. Their failure is sometimes due to bureaucratic inefficiency or to the insufficiency of the means at the disposal of the authorities, but more often to the unwillingness of the whole governmental apparatus to interfere successfully.[17]

Such has been the state of affairs for a long time in all nonsocialist countries. The economist in establishing these facts neither blames nor accuses. He merely explains what conditions have given to the unions the power to enforce their minimum wage rates and what the real meaning of the term collective bargaining is.

As union advocates explain the term collective bargaining, it merely means the substitution of a union's bargaining for the individual bargaining of the individual workers. In the fully developed market economy bargaining concerning those commodities and services of which homogeneous items are frequently bought and sold in great quantities is not effected by the manner in which nonfungible commodities and services are traded. The buyer or seller of fungible consumers' goods or of fungible services fixes a price tentatively and adjusts it later according to the response his offer meets from those interested until he is in a position to buy or to sell as much as he plans. Technically no other procedure is feasible. The department store cannot haggle with its patrons. It fixes the price of an article and waits. If the public does not buy sufficient quantities, it lowers the price. A factory that needs five hundred welders fixes a wage rate which, as it expects, will enable it to hire five hundred men. If only a minor number turns up, it is forced to allow a higher rate. Every employer must raise the wages he offers up to the point at which no competitor lures the workers away by overbidding. What makes the enforcement of minimum wage rates futile is precisely the fact that with wages raised above this point competitors do not turn up with a demand for labor big enough to absorb the whole supply.

If the unions were really bargaining agencies, their collective bargaining could not raise the height of wage rates above the point of the unhampered market. As long as there still are unemployed workers available, there is no reason for an employer to raise his offer. Real collective bargaining would not differ catallactically from the individual bargaining. It would, like individual bargaining, give a virtual voice to those job-seekers who have not yet found the jobs they are looking for.

However, what is euphemistically called collective bargaining by union leaders and "pro-labor" legislation is of a quite different character. It is bargaining at the point of a gun. It is bargaining between an armed party, ready to use its weapons, and an unarmed party under duress. It is not a market transaction. It is a dictate forced upon the employer. And its effects do not differ from those of a government decree for the enforcement of which the police power and the penal courts are used. It produces institutional unemployment.

The treatment of the problems involved by public opinion and the vast number of pseudo-economic writings is utterly misleading. The issue is not the right to form associations. It is whether or not any association of private citizens should be granted the privilege of resorting with impunity to violent action. It is the same problem that relates to the activities of the Ku Klux Klan.

Neither is it correct to look upon the matter from the point of view of a "right to strike." The problem is not the right to strike, but the right—by intimidation or violence—to force other people to strike, and the further right to prevent anybody from working in a shop in which a union has called a strike. When the unions invoke the right to strike in justification of such intimidation and deeds of violence, they are on no better ground than a religious group would be in invoking the right of freedom of conscience as a justification of persecuting dissenters.

When in the past the laws of some countries denied to employees the right to form unions, they were guided by the idea that such unions have no objective other than to resort to violent action and intimidation. When the authorities in the past sometimes directed their armed forces to protect the employers, their mandataries, and their property against the onslaught of strikers, they were not guilty of acts hostile to "labor." They simply did what every government considers its main duty. They tried to preserve their exclusive right to resort to violent action.

There is no need for economics to enter into an examination of the problems of jurisdictional strikes and of various laws, especially of the American New Deal, which were admittedly loaded against the employers and assigned a privileged position to the unions. There is only one point that matters. If a government decree or labor union pressure and compulsion fix wage rates above the height of the potential market rates, institutional unemployment results.

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CHAPTER 31

Currency And Credit Manipulation

1

The Government And The Currency

Media of exchange and money are market phenomena. What makes a thing a medium of exchange or money is the conduct of parties to market transactions. An occasion for dealing with monetary problems appears to the authorities in the same way in which they concern themselves with all other objects exchanged, namely, when they are called upon to decide whether or not the failure of one of the parties to an act of exchange to comply with his contractual obligations justifies compulsion on the part of the government apparatus of violent oppression. If both parties discharge their mutual obligations instantly and synchronously, as a rule no conflicts arise which would induce one of the parties to apply to the judiciary. But if one or both parties' obligations are temporally deferred, it may happen that the courts are called to decide how the terms of the contract are to be complied with. If payment of a sum of money is involved, this implies the task of determining what meaning is to be attached to the monetary terms used in the contract.

Thus it devolves upon the laws of the country and upon the courts to define what the parties to the contract had in mind when speaking of a sum of money and to establish how the obligation to pay such a sum is to be settled in accordance with the terms agreed upon. They have to determine what is and what is not legal tender. In attending to this task the laws and the courts do not *create* money. A thing becomes money only by virtue of the fact that those exchanging commodities and services commonly use it as a medium of exchange. In the unhampered market economy the laws and the judges in attributing legal tender quality to a certain thing merely establish what, according to the usages of trade, was intended by the parties when they referred in their deal to a definite kind of money. They interpret the customs of the trade in the same way in which they proceed when called to determine what is the meaning of any other terms used in contracts.

Mintage has long been a prerogative of the rulers of the country. However, this government activity had originally no objective other than the stamping and certifying of weights and measures. The authority's stamp placed upon a piece of metal was supposed to certify its weight and fineness. When later princes resorted to substituting baser and cheaper metals for a part of the precious metals while retaining the customary face and name of the coins, they did it furtively and in full awareness of the fact that they were engaged in a fraudulent attempt to cheat the public. As soon as people found out these artifices, the debased coins were dealt with at a discount as against the old better ones. The governments reacted by resorting to compulsion and coercion. They made it illegal to discriminate in trade and in the settlement of deferred payments between "good" money and "bad" money and decreed maximum prices in terms of "bad" money. However, the result obtained was not that which the governments aimed at. Their decrees failed to stop the process which adjusted commodity prices (in terms of the debased currency) to the actual state of the money relation. Moreover, the effects appeared which Gresham's Law describes.

The history of government interference with currency is, however, not merely a record of debasement practices and of abortive attempts to avoid their inescapable catallactic consequences. There were governments that did not look upon their mintage prerogative as a means of cheating that part of the public who placed confidence in their rulers' integrity and who, out of ignorance, were ready to accept the debased coins at their face value. These governments considered the manufacturing of coins not as a source of surreptitious fiscal lucre but as a public service designed to safeguard a smooth functioning of the market. But even these governments—out of ignorance and dilettantism—often resorted to measures which were tantamount to interference with the price structure, although they were not deliberately planned as such. As two precious metals were used side by side as money, authorities naïvely believed that it was their task to unify the currency system by decreeing a rigid exchange ratio between gold and silver. The bimetallic system proved a complete failure. It did not bring about bimetallism, but an alternating standard. That metal which, compared with the instantaneous state of the fluctuating market exchange rate between gold and silver, was overvalued in the legally fixed ratio, predominated in domestic circulation, while the other metal disappeared. Finally the governments abandoned their vain attempts and acquiesced in monometallism. The silver purchase policy that the United States practiced for many decades was virtually no longer a device of monetary policy. It was merely a scheme for raising the price of silver for the benefit of the owners of silver mines, their employees, and the states within the boundaries of which the mines were located. It was a poorly disguised subsidy. Its monetary significance consisted merely in the fact that it was financed by issuing additional dollar bills whose legal tender quality does not differ essentially from that of the Federal Reserve notes, although they bear the practically meaningless imprint "Silver Certificate."

Yet economic history also provides instances of well-designed and successful monetary policies on the part of governments whose only intention was to equip their countries with a smoothly working currency system. Laissez-faire liberalism did not abolish the traditional government prerogative of mintage. But in the hands of liberal governments the character of this state monopoly was completely altered. The ideas which considered it an instrument of interventionist policies were discarded. No longer was it used for fiscal purposes or for favoring some groups of the people at the expense of other groups. The government's monetary activities aimed at one objective only: to facilitate and to simplify the use of the medium of exchange which the conduct of the people had made money. A nation's currency system, it was agreed, should be sound. The principle of soundness meant that the standard coins—i.e., those to which unlimited legal tender power was assigned by the laws—should be properly assayed and stamped bars of bullion coined in such a way as to make the detection of clipping, abrasion, and counterfeiting easy. To the government's stamp no function was attributed other than to certify the weight and the fineness of the metal contained. Pieces worn by usage or in any other way reduced in weight beyond the very narrow limits of tolerated allowance lost their legal tender quality; the authorities themselves withdrew such pieces from circulation and reminted them. For the receiver of an undefaced coin there was no need to resort to the scales and to the acid test in order to know its weight and content. On the other hand, individuals were entitled to bring bullion to the mint and to have it transformed into standard coins either free of charge or against payments of a seigniorage generally not surpassing the actual expenses of the process. Thus the various national currencies became genuine gold currencies. Stability in the exchange ratio between the domestic legal tender and that of all other countries which had adopted the same principles of sound money was brought about. The international gold standard came into being without intergovernmental treaties and institutions.

In many countries the emergence of the gold standard was effected by the operation of Gresham's Law. The role that government policies played in this process in Great Britain consisted merely in ratifying the results brought about by the operation of Gresham's Law; it transformed a *de facto* state of affairs into a legal state. In other countries governments deliberately abandoned bimetallism just at the moment when the change in the market ratio between gold and silver would have brought about a substitution of a *de facto* silver currency for the then prevailing *de facto* gold currency. With all these nations the formal adoption of the gold standard required no other contribution on the part of the administration and the legislature than the enactment of laws.

It was different in those countries which wanted to substitute the gold standard for a—*de facto* or *de jure* —silver or paper currency. When the German Reich in the 'seventies of the nineteenth century wanted to adopt the gold standard, the nation's currency was silver. It could not realize its plan by simply imitating the procedure of those countries in which the enactment of the gold standard was merely a ratification of the actual state of affairs. It had to replace the standard silver coins in the hands of the public with gold coins. This was a time-absorbing and complicated financial operation involving vast government purchases of gold and sales of silver. Conditions were similar in those countries which aimed at the substitution of gold for credit money or fiat money.

It is important to realize these facts because they illustrate the difference between conditions as they prevailed in the liberal age and those prevailing today in the age of interventionism.

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The Interventionist Aspect Of Legal Tender Legislation

The simplest and oldest variety of monetary interventionism is debasement of coins or diminution of their weight or size for the sake of debt abatement. The authority assigns to the cheaper currency units the full legal tender power previously granted to the better units. All deferred payments can be legally discharged by payment of the amount due in the meaner coins according to their face value. Debtors are favored at the expense of creditors. But at the same time future credit transactions are made more onerous for debtors. A tendency for gross market rates of interest to rise ensues as the parties take into account the chances for a repetition of such measures of debt abatement. While debt abatement improves the conditions of those who were already indebted at the moment, it impairs the position of those eager or obliged to contract new debts.

The antitype of debt abatement—debt aggravation through monetary measures—has also been practiced, though rarely. However, it has never deliberately been planned as a device to favor the creditors at the expense of the debtors. Whenever it came to pass, it was the unintentional effect of monetary changes considered as peremptory from other points of view. In resorting to such monetary changes governments put up with their effects upon deferred payments either because they considered the measures unavoidable or because they assumed that creditors and debtors, in determining the terms of the contract, had already foreseen these changes and duly taken them into account. The best examples are provided by British events after the Napoleonic wars and again after the first World War. In both instances Great Britain some time after the end of hostilities returned, by means of a deflationary policy, to the prewar gold parity of the pound sterling. The idea of engineering the substitution of the gold standard for the war-time credit-money standard by acquiescing in the change in the market exchange ratio between the pound and gold, which had already taken place, and of adopting this ratio as the new legal parity, was rejected. This second alternative was scorned as a kind of national bankruptcy, as a partial repudiation of the public debt, and as a malicious infringement upon the rights of all those whose claims had originated in the period preceding the suspension of the unconditional convertibility of the banknotes of the Bank of England. People labored under the delusion that the evils caused by inflation could be cured by a subsequent deflation. Yet the return to the prewar gold parity could not indemnify the creditors for the damage they had suffered as far as the debtors had repaid their old debts during the period of money depreciation. Moreover, it was a boon to all those who had lent during this period and a blow to all those who had borrowed. But the statesmen who were responsible for the deflationary policy were not aware of the import of their action. They failed to see consequences which were, even in their eyes, undesirable, and if they had recognized them in time, they would not have known how to avoid them. Their conduct of affairs really favored the creditors at the expense of the debtors, especially the holders of the government bonds at the expense of the taxpayers. In the ’twenties of the nineteenth century it aggravated seriously the distress of British agriculture and a hundred years later the plight of British export trade. Nonetheless, it would be a mistake to call these two British monetary reforms the consummation of an interventionism intentionally aiming at debt aggravation. Debt aggravation was merely the unintentional outcome of a policy aiming at other ends.

Whenever debt abatement is resorted to, its authors protest that the measure will never be repeated. They emphasize that extraordinary conditions which will never again present themselves have created an emergency which makes indispensable recourse to noxious devices, absolutely reprehensible under any other circumstances. Once and never again, they declare. It is easy to conceive why the authors and supporters of debt abatement are compelled to make such promises. If total or partial nullification of the creditors' claims becomes a regular policy, lending of money will stop altogether. The stipulation of deferred payments depends on the expectation that no such nullification will be decreed.

It is therefore not permissible to look upon debt abatement as a device of a system of economic policies which could be considered as an alternative to any other system of society's permanent economic organization. It is by no means a tool of constructive action. It is a bomb that destroys and can do nothing but destroy. If it is applied only once, a reconstruction of the shattered credit system is still possible. But if the blows are repeated, total destruction results.

It is not correct to look upon inflation and deflation exclusively from the point of view of their effects upon deferred payments. It has been shown that cash-induced changes in purchasing power do not affect the prices of the various commodities and services at the same time and to the same extent, and what role this unevenness plays in the market.[1] But if one regards inflation and deflation as means of rearranging the relations between creditors and debtors, one cannot fail to realize that the ends sought by the government resorting to them are attained only in a very imperfect degree and that, besides, consequences appear which, from the government's point of view, are highly unsatisfactory. As is the case with every other variety of government interference with the price structure, the results obtained not only are contrary to the intentions of the government but produce a state of affairs which, in the opinion of the government, is more undesirable than conditions on the unhampered market.

As far as a government resorts to inflation in order to favor the debtors at the expense of the creditors, it succeeds only with regard to those deferred payments which were stipulated before. Inflation does not make it cheaper to contract new loans; it makes it, on the contrary, more expensive by the appearance of a positive price premium. If inflation is pushed to its ultimate consequences, it makes any stipulation of deferred payments in terms of the inflated currency cease altogether.

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The Evolution Of Modern Methods Of Currency Manipulation

A metallic currency is not subject to government manipulation. Of course, the government has the power to enact legal tender laws. But then the operation of Gresham's Law brings about results which may frustrate the aims sought by the government. Seen from this point of view, a metallic standard appears as an obstacle to all attempts to interfere with the market phenomena by monetary policies.

In examining the evolution which gave governments the power to manipulate their national currency systems, we must begin by mentioning one of the most serious shortcomings of the classical economists. Both Adam Smith and David Ricardo looked upon the costs involved in the preservation of a metallic currency as a waste. As they saw it, the substitution of paper money for metallic money would make it possible to employ capital and labor, required for the production of the quantity of gold and silver needed for monetary purposes, for the production of goods which could directly satisfy human wants. Starting from this assumption, Ricardo elaborated his famous *Proposals for an Economical and Secure Currency,* first published in 1816. Ricardo's plan fell into oblivion. It was not until many decades after his death that several countries adopted its basic principles under the label *gold exchange standard* in order to reduce the alleged waste involved in the operation of the gold standard nowadays decried as "classical" or "orthodox."

Under the classical gold standard a part of the cash holdings of individuals consists in gold coins. Under the gold exchange standard the cash holdings of individuals consist entirely in money-substitutes. These money-substitutes are redeemable at the legal par in gold or foreign exchange of countries under the gold standard or the gold exchange standard. But the arrangement of monetary and banking institutions aims at preventing the public from withdrawing gold from the Central Bank for domestic cash holdings. The first objective of redemption is to secure the stability of foreign exchange rates.

In dealing with problems of the gold exchange standard all economists—including the author of this book—failed to realize the fact that it places in the hands of governments the power to manipulate their nations' currency easily. Economists blithely assumed that no government of a civilized nation would use the gold exchange standard intentionally as an instrument of inflationary policy. Of course, one must not exaggerate the role that the gold exchange standard played in the inflationary ventures of the last decades. The main factor was the proinflationary ideology. The gold exchange standard was merely a convenient vehicle for the realization of the inflationary plans. Its absence did not hinder the adoption of inflationary measures. The United States was in 1933 by and large still under the classical gold standard. This fact did not stop the New Deal's inflationism. The

United States at one stroke—by confiscating its citizens' gold holdings—abolished the classical gold standard and devalued the dollar against gold.

The new variety of the gold exchange standard as it developed in the years between the first and the second World Wars may be called the flexible gold exchange standard or, for the sake of simplicity, the *flexible standard.* Under this system the Central Bank or the Foreign Exchange Equalization Account (or whatever the name of the equivalent governmental institution may be) freely exchanges the money-substitutes which are the country's national legal tender either against gold or against foreign exchange, and vice versa. The ratio at which these exchange deals are transacted is not invariably fixed, but subject to changes. The parity is flexible, as people say. This flexibility, however, is almost always a downward flexibility. The authorities used their power to lower the equivalence of the national currency in terms of gold and of those foreign currencies whose equivalence against gold did not drop; they never ventured to raise it. If the parity against another nation's currency was raised, the change was only the consummation of a drop that had occurred in that other currency's equivalence (in terms of gold or of other nations' currencies which had remained unchanged). Its aim was to bring the appraisal of this definite foreign currency into agreement with the appraisal of gold and the currencies of other foreign nations.

If the downward jump of the parity is very conspicuous, it is called a devaluation. If the alteration of the parity is not so great, editors of financial reports describe it as a weakening in the international appraisal of the currency concerned.2 In both cases it is usual to refer to the event by declaring that the country concerned has "raised the price of gold."

The characterization of the flexible standard from the catallactic point of view must not be confused with its description from the legal point of view. The catallactic aspects of the issue are not affected by the constitutional problems involved. It is immaterial whether the power to alter the parity is vested in the legislative or in the administrative branch of the government. It is immaterial whether the authorization given to the administration is unlimited or, as was the case in the United States under New Deal legislation, limited by a terminal point beyond which the officers are not free to devalue further. What counts alone for the economic treatment of the matter is that the principle of flexible parities has been substituted for the principle of the rigid parity. Whatever the constitutional state of affairs may be, no government could embark upon "raising the price of gold" if public opinion were opposed to such a manipulation. If, on the other hand, public opinion favors such a step, no legal technicalities could check it altogether or even delay it for a short time. What happened in Great Britain in 1931, in the United States in 1933, and in France and Switzerland in 1936 clearly shows that the apparatus of representative government is able to work with the utmost speed if public opinion endorses the so-called experts' opinion concerning the expediency and necessity of a currency's devaluation.

One of the main objectives of currency devaluation—whether large-scale or small-scale—is, as will be shown in the next section, to rearrange foreign trade conditions. These effects upon foreign trade make it impossible for a small nation to take its own course in currency manipulation irrespective of what those countries are doing with whom its trade relations are closest. Such nations are forced to follow in the wake of a foreign country's monetary policies. As far as monetary policy is concerned they voluntarily become satellites of a foreign power. By keeping their own country's currency rigidly at par against the currency of a monetary "suzerain-country," they follow all the alterations which the "suzerain" brings about in its own currency's parity against gold and the other nations' currencies. They join a monetary *bloc* and integrate their country into a monetary *area.* The most talked about bloc or area is the sterling bloc or area.

The flexible standard must not be confused with conditions in those countries in which the government has merely proclaimed an official parity of its domestic currency against gold and foreign exchange without making this parity effective. The characteristic feature of the flexible standard is that any amount of domestic money-substitutes can in fact be exchanged at the parity chosen against gold or foreign exchange, and vice versa. At this parity the Central Bank (or whatever the name of the government agency entrusted with the task may be) buys and sells any amount of domestic currency and of foreign currency of at least one of those countries which themselves are either under the gold standard or under the flexible standard. The domestic banknotes are really redeemable.

In the absence of this essential feature of the flexible standard, decrees proclaiming a definite parity have a quite different meaning and bring about quite different effects.[3]

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The Objectives Of Currency Devaluation

The flexible standard is an instrument for the engineering of inflation. The only reason for its acceptance was to make reiterated inflationary moves technically as simple as possible for the authorities.

In the boom period that ended in 1929 labor unions had succeeded in almost all countries in enforcing wage rates higher than those which the market, if manipulated only by migration barriers, would have determined. These wage rates already produced in many countries institutional unemployment of a considerable amount while credit expansion was still going on at an accelerated pace. When finally the inescapable depression came and commodity prices began to drop, the labor unions, firmly supported by the governments, even by those disparaged as anti-labor, clung stubbornly to their high-wages policy. They either flatly denied permission for any cut in nominal wage rates or conceded only insufficient cuts. The result was a tremendous increase in institutional unemployment. (On the other hand, those workers who retained their jobs improved their standard of living as their hourly real wages went up.) The burden of unemployment doles became unbearable. The millions of unemployed were a serious menace to domestic peace. The industrial countries were haunted by the specter of revolution. But union leaders were intractable, and no statesman had the courage to challenge them openly.

In this plight the frightened rulers bethought themselves of a makeshift long since recommended by inflationist doctrinaires. As unions objected to an adjustment of wages to the state of the money relation and commodity prices, they chose to adjust the money relation and commodity prices to the height of wage rates. As they saw it, it was not wage rates that were too high; their own nation’s monetary unit was overvalued in terms of gold and foreign exchange and had to be readjusted. Devaluation was the panacea.

The objectives of devaluation were:

> 1. To preserve the height of nominal wage rates or even to create the conditions required for their further increase, while real wage rates should rather sink.
> 2. To make commodity prices, especially the prices of farm products, rise in terms of domestic money or, at least, to check their further drop.
> 3. To favor the debtors at the expense of the creditors.
> 4. To encourage exports and to reduce imports.
> 5. To attract more foreign tourists and to make it more expensive (in terms of domestic money) for the country’s own citizens to visit foreign countries.

However, neither the governments nor the literary champions of their policy were frank enough to admit openly that one of the main purposes of devaluation was a reduction in the height of real wage rates. They preferred for the most part to describe the objective of devaluation as the removal of an alleged "fundamental disequilibrium" between the domestic and the international "level" of prices. They spoke of the necessity of lowering domestic costs of production. But they were anxious not to mention that one of the two cost items they expected to lower by devaluation was real wage rates, the other being interest stipulated on long-term business debts and the principal of such debts.

It is impossible to take seriously the arguments advanced in favor of devaluation. They were utterly confused and contradictory. For devaluation was not a policy that originated from a cool weighing of the pros and cons. It was a capitulation of governments to union leaders who did not want to lose face by admitting that their wage policy had failed and had produced institutional unemployment on an unprecedented scale. It was a desperate makeshift of weak and inept statesmen who were motivated by their wish to prolong their tenure of office. In justifying their policy, these demagogues did not bother about contradictions. They promised the processing industries and the farmers that devaluation would make prices rise. But at the same time they promised the consumers that rigid price control would prevent any increase in the cost of living.

After all, the governments could still excuse their conduct by referring to the fact that under the given state of public opinion, entirely under the sway of the doctrinal fallacies of labor unionism, no other policy could be resorted to. No such excuse can be advanced for those authors who hailed the flexibility of foreign exchange rates as the perfect and most desirable monetary system. While governments were still anxious to emphasize that devaluation was an emergency measure not to be repeated again, these authors proclaimed the flexible standard as the most appropriate monetary system and were eager to demonstrate the alleged evils inherent in stability of foreign exchange rates. In their blind zeal to please the governments and the powerful pressure groups of unionized labor and farming, they overstated tremendously the case of flexible parities. But the drawbacks of standard flexibility became manifest very soon. The enthusiasm for devaluation vanished quickly. In the years of the second World War, hardly more than a decade after the day when Great Britain had set the pattern for the flexible standard, even Lord Keynes and his adepts discovered that stability of foreign exchange rates has its merits. One of the avowed objectives of the International Monetary Fund is to stabilize foreign exchange rates.

If one looks at devaluation not with the eyes of an apologist of government and union policies, but with the eyes of an economist, one must first of all stress the point that all its alleged blessings are temporary only. Moreover, they depend on the condition that only one country devalues while the other countries abstain from devaluing their own currencies. If the other countries devalue in the same proportion, no changes in foreign trade appear. If they devalue to a greater extent, all these transitory blessings, whatever they may be, favor them exclusively. A general acceptance of the principles of the flexible standard must therefore result in a race between the nations to outbid one another. At the end of this competition is the complete destruction of all nations' monetary systems.

The much talked about advantages which devaluation secures in foreign trade and tourism, are entirely due to the fact that the adjustment of domestic prices and wage rates to the state of affairs created by devaluation requires some time. As long as this adjustment process is not yet completed, exporting is encouraged and importing is discouraged. However, this merely means that in this interval the citizens of the devaluating country are getting less for what they are selling abroad and paying more for what they are buying abroad; concomitantly they must restrict their consumption. This effect may appear as a boon in the opinion of those for whom the balance of trade is the yardstick of a nation's welfare. In plain language it is to be described in this way: The British citizen must export more British goods in order to buy that quantity of tea which he received before the devaluation for a smaller quantity of exported British goods.

The devaluation, say its champions, reduces the burden of debts. This is certainly true. It favors debtors at the expense of creditors. In the eyes of those who still have not learned that under modern conditions the creditors must not be identified with the rich nor the debtors with the poor, this is beneficial. The actual effect is that the indebted owners of real estate and farm land and the shareholders of indebted corporations reap gains at the expense of the majority of people whose savings are invested in bonds, debentures, savings-bank deposits, and insurance policies.

There are also foreign loans to be considered. When Great Britain, the United States, France, Switzerland and some other European creditor countries devalued their currencies, they made a gift to their foreign debtors.

One of the main arguments advanced in favor of the flexible standard is that it lowers the rate of interest on the domestic money market. Under the classical gold standard and the rigid gold exchange standard, it is said, a country must adjust the domestic rate of interest to conditions on the international money market. Under the flexible standard it is free to follow in the determination of interest rates a policy exclusively guided by considerations of its own domestic welfare.

The argument is obviously untenable with regard to those countries in which the total amount of debts to foreign countries exceeds the total amount of loans granted to foreign countries. When in the course of the nineteenth century some of these debtor nations adopted a sound money policy, their firms and citizens could contract foreign debts in terms of their national currency. This opportunity disappeared altogether with the change in these countries' monetary policies. No foreign banker would contract a loan in Italian lire or try to float an issue of lire bonds. As far as foreign credits are concerned, no change in a debtor country's domestic currency conditions can be of any avail. As far as domestic credits are concerned, devaluation abates only the already previously contracted debts. It enhances the gross market rate of interest of new debts as it makes a positive price premium appear.

This is valid also with regard to interest rate conditions in the creditor nations. There is no need to add anything to the demonstration that interest is not a monetary phenomenon and cannot in the long run be affected by monetary measures.

It is true that the devaluations which were resorted to by various governments between 1931 and 1938 made real wage rates drop in some countries and thus reduced the amount of institutional unemployment. The historian in dealing with these devaluations may therefore say that they were a success as they prevented a revolutionary upheaval of the daily increasing masses of unemployed and as, under the prevailing ideological conditions, no other means could be resorted to in this critical situation. But the historian will no less have to add that the remedy did not affect the root causes of institutional unemployment, the faulty tenets of labor unionism. Devaluation was a cunning device to elude the sway of the union doctrine. It worked because it did not impair the prestige of unionism. But precisely because it left the popularity of unionism untouched, it could work only for a short time. Union leaders learned to distinguish between nominal wage rates and real wage rates. Today their policy aims at raising real wage rates. They can no longer be cheated by a drop in the monetary unit's purchasing power. Devaluation has worn out its usefulness as a device for reducing institutional unemployment.

Cognizance of these facts provides a key for a correct appraisal of the role which Lord Keynes's doctrines played in the years between the first and second World Wars. Keynes did not add any new idea to the body of inflationist fallacies, a thousand times refuted by economists. His teachings were even more contradictory and inconsistent than those of his predecessors who, like Silvio Gesell, were dismissed as monetary cranks. He merely knew how to cloak the plea for inflation and credit expansion in the sophisticated terminology of mathematical economics. The interventionist writers were at a loss to advance plausible arguments in favor of the policy of reckless spending; they simply could not find a case against the economic theorem concerning institutional unemployment. In this juncture they greeted the "Keynesian Revolution" with the verses of Wordsworth: "Bliss was it in that dawn to be alive, but to be young was very heaven."[4] It was, however, a short-run heaven only. We may admit that for the British and American governments in the 'thirties no way was left other than that of currency devaluation, inflation and credit expansion, unbalanced budgets, and deficit spending. Governments cannot free themselves from the pressure of public opinion. They cannot rebel against the preponderance of generally accepted ideologies, however fallacious. But this does not excuse the officeholders who could resign rather than carry out policies disastrous for the country. Still less does it excuse authors who tried to provide a would-be scientific justification for the crudest of all popular fallacies, viz., inflationism.

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Credit Expansion

It has been pointed out that it would be an error to look upon credit expansion exclusively as a mode of government interference with the market. The fiduciary media did not come into existence as instruments of government policies deliberately aiming at high prices and high nominal wage rates, at lowering the market rate of interest and at debt abatement. They evolved out of the regular business of banking. When the bankers, whose receipts for call money deposited were dealt with by the public as money-substitutes, began to lend a part of the funds deposited with them, they had nothing else in view than their own business. They considered it harmless not to keep the whole equivalent of the receipts issued as a cash reserve in their vaults. They were confident that they would always be in a position to comply with their obligations and, without delay, redeem the notes issued even if they were to lend a part of the deposits. Banknotes became fiduciary media within the operation of the unhampered market economy. The begetter of credit expansion was the banker, not the authority.

But today credit expansion is exclusively a government practice. As far as private banks and bankers are instrumental in issuing fiduciary media, their role is merely ancillary and concerns only technicalities. The governments alone direct the course of affairs. They have attained full supremacy in all matters concerning the size of circulation credit. While the size of the credit expansion that private banks and bankers are able to engineer on an unhampered market is strictly limited, the governments aim at the greatest possible amount of credit expansion. Credit expansion is the governments' foremost tool in their struggle against the market economy. In their hands it is the magic wand designed to conjure away the scarcity of capital goods, to lower the rate of interest or to abolish it altogether, to finance lavish government spending, to expropriate the capitalists, to contrive everlasting booms, and to make everybody prosperous.

The inescapable consequences of credit expansion are shown by the theory of the trade cycle. Even those economists who still refuse to acknowledge the correctness of the monetary or circulation credit theory of the cyclical fluctuations of business have never dared to question the conclusiveness and irrefutability of what this theory asserts with regard to the necessary effects of credit expansion. These economists too must admit and do admit that the upswing is invariably conditioned by credit expansion, that it could not come into being and continue without credit expansion, and that it turns into depression when the further progress of credit expansion stops. Their explanation of the trade cycle in fact boils down to the assertion that what first generates the upswing is not credit expansion, but other factors. The credit expansion which even in their opinion is an indispensable requisite of the general boom, is, they say, not the outcome of a policy deliberately aiming at low interest rates and at encouraging additional investment for which the capital goods needed are lacking. It is something which, without active interference on the part of the authorities, in a miraculous way always appears whenever these other factors begin their operation.

It is obvious that these economists contradict themselves in opposing plans to eliminate the fluctuations of business by abstention from credit expansion. The supporters of the naïve inflationist view of history are consistent when they infer from their—of course, utterly fallacious and contradictory—tenets that credit expansion is the economic panacea. But those who do not deny that credit expansion brings about the boom that is the indispensable condition of the depression disagree with their own doctrine in fighting the proposals to curb credit expansion. Both the spokesmen of the governments and the powerful pressure groups and the champions of the dogmatic "unorthodoxy" that dominates the university departments of economics agree that one should try to avert the recurrence of depressions and that the realization of this end requires the prevention of booms. They cannot advance tenable arguments against the proposals to abstain from policies encouraging credit expansion. But they stubbornly refuse to listen to any such idea. They passionately disparage the plans to prevent credit expansion as devices which would perpetuate depressions. Their attitude clearly demonstrates the correctness of the statement that the trade cycle is the product of policies intentionally aimed at lowering the rate of interest and engendering artificial booms.

It is a fact that today measures aimed at lowering the rate of interest are generally considered highly desirable and that credit expansion is viewed as the efficacious means for the attainment of this end. It is this prepossession that impels all governments to fight the gold standard. All political parties and all pressure groups are firmly committed to an easy money policy.[5]

The objective of credit expansion is to favor the interests of some groups of the population at the expense of others. This is, of course, the best that interventionism can attain when it does not hurt the interests of all groups. But while making the whole community poorer, it may still enrich some strata. Which groups belong to the latter class depends on the special data of each case.

The idea which generated what is called *qualitative credit control* is to channel the additional credit in such a way as to concentrate the alleged blessings of credit expansion upon certain groups and to withhold them from other groups. The credits should not go to the stock exchange, it is argued, and should not make stock prices soar. They should rather benefit the "legitimate productive activity" of the processing industries, of mining, of "legitimate commerce," and, first of all, of farming. Other advocates of qualitative credit control want to prevent the additional credits from being used for investment in fixed capital and thus immobilized. They are to be used, instead, for the production of liquid goods. According to these plans the authorities give the banks concrete directions concerning the types of loans they should grant or are forbidden to grant.

However, all such schemes are vain. Discrimination in lending is no substitute for checks placed on credit expansion, the only means that could really prevent a rise in stock exchange quotations and an expansion of investment in fixed capital. The mode in which the additional amount of credit finds its way into the loan market is only of secondary importance. What matters is that there is an inflow of newly created credit. If the banks grant more credits to the farmers, the farmers are in a position to repay loans received from other sources and to pay cash for their purchases. If they grant more credits to business as circulating capital, they free funds which were previously tied up for this use. In any case they create an abundance of disposable money for which its owners try to find the most profitable investment. Very promptly these funds find outlets in the stock exchange or in fixed investment. The notion that it is possible to pursue a credit expansion without making stock prices rise and fixed investment expand is absurd.[6]

The typical course of events under credit expansion was until a few decades ago determined by two facts: that it was credit expansion under the gold standard, and that it was not the outcome of concerted action on the part of the various national governments and the central banks whose conduct these governments directed. The first of these facts meant that governments were not prepared to abandon the convertibility of their country's banknotes according to the rigidly fixed parity. The second fact resulted in a lack of quantitative uniformity in the size of credit expansion. Some countries got ahead of other countries and their banks were faced with the danger of a serious external drain upon their reserves in gold and foreign exchange. In order to preserve their own solvency, these banks were forced to take recourse to drastic credit restriction. Thus they created the panic and inaugurated the depression on the domestic market. The panic very soon spread to other countries. Businessmen in these other countries became frightened and increased their borrowing in order to strengthen their liquid funds for all possible contingencies. It was precisely this increased demand for new credits which impelled the monetary authorities of their own countries, already alarmed by the crisis in the first country, also to resort to contraction. Thus within a few days or weeks the depression became an international phenomenon.

The policy of devaluation has to some extent altered this typical sequence of events. Menaced by an external drain, the monetary authorities do not always resort to credit restriction and to raising the rate of interest charged by the central banking system. They devalue. Yet devaluation does not solve the problem. If the government does not care how far foreign exchange rates may rise, it can for some time continue to cling to credit expansion. But one day the crack-up boom will annihilate its monetary system. On the other hand, if the authority wants to avoid the necessity of devaluing again and again at an accelerated pace, it must arrange its domestic credit policy in such a way as not to outrun in credit expansion the other countries against which it wants to keep its domestic currency at par.

Many economists take it for granted that the attempts of the authorities to expand credit will always bring about the same almost regular alternation between periods of booming trade and of subsequent depression. They assume that the effects of credit expansion will in the future not differ from those that have been observed since the end of the eighteenth century in Great Britain and since the middle of the nineteenth century in Western and Central Europe and in North America. But we may wonder whether conditions have not changed. The teachings of the monetary theory of the trade cycle are today so well known even outside of the circle of economists, that the naïve optimism which inspired the entrepreneurs in the boom periods of the past has given way to a certain skepticism. It may be that businessmen will in the future react to credit expansion in a manner other than they have in the past. It may be that they will avoid using for an expansion of their operations the easy money available because they will keep in mind the inevitable end of the boom. Some signs forebode such a change. But it is too early to make a definite statement.

In another direction the monetary theory of the trade cycle has certainly affected the course of events. Although no official—whether he works in the bureaus of a government's financial services or of a central bank, or whether he teaches at a neo-orthodox university—is prepared to admit it, public opinion by and large no longer denies the two main theses of the circulation credit theory: viz., that the cause of the depression is the preceding boom and that this boom is engendered by credit expansion. The awareness of these facts alarms the financial press as soon as the first signs of the boom appear. Then even the authorities begin to talk about the necessity of preventing a further rise in prices and profits, and they really begin to restrict credit. The boom comes to an early end; a recession starts. The result has been that in the last decade the length of the cycle was considerably cut down. There was still an alternation of boom and slump, but the phases lasted a shorter time and succeeded one another more frequently. This is a far cry from the "classical" period of the ten and a half years of William Stanley Jevon's crop cycle. And, most important, as the boom comes to an earlier end, the amount of malinvestment is smaller and in consequence the following depression is milder too.

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The Chimera Of Contracyclical Policies

An essential element of the "unorthodox" doctrines, advanced both by all socialists and by all interventionists, is that the recurrence of depressions is a phenomenon inherent in the very operation of the market economy. But while the socialists contend that only the substitution of socialism for capitalism can eradicate the evil, the interventionists ascribe to the government the power to correct the operation of the market economy in such a way as to bring about what they call "economic stability." These interventionists would be right if their antidepression plans were to aim at a radical abandonment of credit expansion policies. However, they reject this idea in advance. What they want is to expand credit more and more and to prevent depressions by the adoption of special "contracyclical" measures.

In the context of these plans the government appears as a deity that stands and works outside the orbit of human affairs, that is independent of the actions of its subjects, and has the power to interfere with these actions from without. It has at its disposal means and funds that are not provided by the people and can be freely used for whatever purposes the rulers are prepared to employ them for. What is needed to make the most beneficent use of this power is merely to follow the advice given by the experts.

The most advertised among these suggested remedies is contracyclical timing of public works and expenditure on public enterprises. The idea is not so new as its champions would have us believe. When depression came in the past, public opinion always asked the government to embark upon public works in order to create jobs and to stop the drop in prices. But the problem is how to finance these public works. If the government taxes the citizens or borrows from them, it does not add anything to what the Keynesians call the aggregate amount of spending. It restricts the private citizen's power to consume or to invest to the same extent that it increases its own. If, however, the government resorts to the cherished inflationary methods of financing, it makes things worse, not better. It may thus delay for a short time the outbreak of the slump. But when the unavoidable payoff does come, the crisis is the heavier the longer the government has postponed it.

The interventionist experts are at a loss to grasp the real problems involved. As they see it, the main thing is "to plan public capital expenditure well in advance and to accumulate a shelf of fully worked out capital projects which can be put into operation at short notice." This, they say, "is the right policy and one which we recommend all countries should adopt."[7] However, the problem is not to elaborate projects, but to provide the material means for their execution. The interventionists believe that this could be easily achieved by holding back government expenditure in the boom and increasing it when the depression comes.

Now, restriction of government expenditure may certainly be a good thing. But it does not provide the funds a government needs for a later expansion of its expenditure. An individual may conduct his affairs in this way. He may accumulate savings when his income is high and spend them later when his income drops. But it is different with a nation or all nations together. The treasury may hoard a considerable part of the lavish revenue from taxes which flows into the public exchequer as a result of the boom. As far and as long as it withholds these funds from circulation, its policy is really deflationary and contracyclical and may to this extent weaken the boom created by credit expansion. But when these funds are spent again, they alter the money relation and create a cash-induced tendency toward a drop in the monetary unit's purchasing power. By no means can these funds provide the capital goods required for the execution of the shelved public works.

The fundamental error of these projects consists in the fact that they ignore the shortage of capital goods. In their eyes the depression is merely caused by a mysterious lack of the people's propensity both to consume and to invest. While the only real problem is to produce more and to consume less in order to increase the stock of capital goods available, the interventionists want to increase both consumption and investment. They want the government to embark upon projects which are unprofitable precisely because the factors of production needed for their execution must be withdrawn from other lines of employment in which they would fulfill wants the satisfaction of which the consumers consider more urgent. They do not realize that such public works must considerably intensify the real evil, the shortage of capital goods.

One could, of course, think of another mode for the employment of the savings the government makes in the boom period. The treasury could invest its surplus in buying large stocks of all those materials which it will later, when the depression comes, need for the execution of the public works planned and of the consumers' goods which those occupied in these public works will ask for. But if the authorities were to act in this way, they would considerably intensify the boom, accelerate the outbreak of the crisis, and make its consequences more serious.[8]

All this talk about contracyclical government activities aims at one goal only, namely, to divert the public's attention from cognizance of the real cause of the cyclical fluctuations of business. All governments are firmly committed to the policy of low interest rates, credit expansion, and inflation. When the unavoidable aftermath of these short-term policies appears, they know only of one remedy—to go on in inflationary ventures.

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Foreign Exchange Control And Bilateral Exchange Agreements

If a government fixes the parity of its domestic credit or fiat money against gold or foreign exchange at a higher point than the market—that is, if it fixes maximum prices for gold and foreign exchange below the potential market price—the effects appear which Gresham's Law describes. A state of affairs results which—very inadequately—is called a scarcity of foreign exchange.

It is the characteristic mark of an economic good that the supply available is not so plentiful as to make any intended utilization of it possible. An object that is not in short supply is not an economic good; no prices are asked or paid for it. As money must necessarily be an economic good, the notion of a money that would not be scarce is absurd. What those governments who complain about a scarcity of foreign exchange have in mind is, however, something different. It is the unavoidable outcome of their policy of price fixing. It means that at the price arbitrarily fixed by the government demand exceeds supply. If the government, having by means of inflation reduced the purchasing power of the domestic monetary unit against gold, foreign exchange, and commodities and services, abstains from any attempt at controlling foreign exchange rates, there cannot be any question of a scarcity in the sense in which the government uses this term. He who is ready to pay the market price would be in a position to buy as much foreign exchange as he wants.

But the government is resolved not to tolerate any rise in foreign exchange rates (in terms of the inflated domestic currency). Relying upon its magistrates and constables, it prohibits any dealings in foreign exchange on terms different from the ordained maximum price.

As the government and its satellites see it, the rise in foreign exchange rates was caused by an unfavorable balance of payments and by the purchases of speculators. In order to remove the evil, the government resorts to measures restricting the demand for foreign exchange. Only those people should henceforth have the right to buy foreign exchange who need it for transactions of which the government approves. Commodities the importation of which is superfluous in the opinion of the government should no longer be imported. Payment of interest and principal on debts due to foreigners is prohibited. Citizens must no longer travel abroad. The government does not realize that such measures can never "improve" the balance of payments. If imports drop, exports drop concomitantly. The citizens who are prevented from buying foreign goods, from paying back foreign debts, and from traveling abroad will not keep the amount of domestic money thus left to them in their cash holdings. They will increase their buying either of consumers' or of producers' goods and thus bring about a further tendency for domestic prices to rise. But the more prices rise, the more will exports be checked.

Now the government goes a step further. It nationalizes foreign exchange transactions. Every citizen who acquires—through exporting, for example—an amount of foreign exchange, is bound to sell it at the official rate to the office of foreign exchange control. If this provision, which is tantamount to an export duty, were to be effectively enforced, export trade would shrink greatly or cease altogether. The government certainly does not like this result. But neither does it want to admit that its interference has utterly failed to achieve the ends sought and has produced a state of affairs which is, from the government's own point of view, much worse even than the previous state of affairs. So the government resorts to a makeshift. It subsidizes the export trade to such an extent that the losses which its policy inflicts upon the exporters are compensated.

On the other hand, the government bureau of foreign exchange control, stubbornly clinging to the fiction that foreign exchange rates have not "really" risen and that the official rate is an effective rate, sells foreign exchange to importers at this official rate. If this policy were to be really followed, it would be equivalent to paying bonuses to the merchants concerned. They would reap windfall profits in selling the imported commodity on the domestic market. Thus the authority resorts to further makeshifts. It either raises import duties or levies special taxes on the importers or burdens their purchases of foreign exchange in some other way.

Then, of course, foreign exchange control works. But it works only because it virtually acknowledges the market rate of foreign exchange. The exporter gets for his proceeds in foreign exchange the official rate plus the subsidy, which together equal the market rate. The importer pays for foreign exchange the official rate plus a special premium, tax, or duty, which together equal the market rate. The only people who are too dull to grasp what is really going on and let themselves be fooled by the bureaucratic terminology, are the authors of books and articles on new methods of monetary management and on new monetary experience.

The monopolization of buying and selling of foreign exchange by the government vests the control of foreign trade in the authorities. It does not affect the determination of foreign exchange rates. It does not matter whether or not the government makes it illegal for the press to publish the real and effective rates of foreign exchange. As far as foreign trade is still carried on, only these real and effective rates are in force.

In order to conceal better the true state of affairs, governments are intent upon eliminating all reference to the real foreign exchange rate. Foreign trade, they think, should no longer be transacted by the intermediary of money. It should be barter. They enter into barter and clearing agreements with foreign governments. Each of the two contracting countries should sell to the other country a quantity of goods and services and receive in exchange a quantity of other goods and services. In the text of these treaties any reference to the real market rates of foreign exchange is carefully avoided. However, both parties calculate their sales and their purchases in terms of the world market prices expressed in gold. These clearing and barter agreements substitute bilateral trade between two countries for the triangular or multilateral trade of the liberal age. But they in no way affect the fact that a country's national currency has lost a part of its purchasing power against gold, foreign exchange, and commodities.

As a policy of foreign trade nationalization, foreign exchange control is a step on the way toward a substitution of socialism for the market economy. From any other point of view it is abortive. It can certainly neither in the short run nor in the long run affect the determination of the rate of foreign exchange.

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CHAPTER 32

Confiscation And Redistribution

1

The Philosophy Of Confiscation

Interventionism is guided by the idea that interfering with property rights does not affect the size of production. The most naïve manifestation of this fallacy is presented by confiscatory interventionism. The yield of production activities is considered a given magnitude independent of the merely accidental arrangements of society's social order. The task of the government is seen as the "fair" distribution of this national income among the various members of society.

The interventionists and the socialists contend that all commodities are turned out by a social process of production. When this process comes to an end and its fruits ripen, a second social process, that of distribution of the yield, follows and allots a share to each. The characteristic feature of the capitalist order is that the shares allotted are unequal. Some people—the entrepreneurs, the capitalists, and the landowners—appropriate to themselves more than they should. Accordingly, the portions of other people are curtailed. Government should by rights expropriate the surplus of the privileged and distribute it among the underprivileged.

Now in the market economy this alleged dualism of two independent processes, that of production and that of distribution, does not exist. There is only one process going on. Goods are not first produced and then distributed. There is no such thingas an appropriation ofportions out ofastock ofownerless goods. The products come into existence as somebody's property. If one wants to distribute them, one must first confiscate them. It is certainly very easy for the governmental apparatus of compulsion and coercion to embark upon confiscation and expropriation. But this does not prove that a durable system of economic affairs can be built upon such confiscation and expropriation.

When the Vikings turned their backs upon a community of autarkic peasants whom they had plundered, the surviving victims began to work, to till the soil, and to build again. When the pirates returned after some years, they again found things to seize. But capitalism cannot stand such reiterated predatory raids. Its capital accumulation and investments are founded upon the expectation that no such expropriation will occur. If this expectation is absent, people will prefer to consume their capital instead of safeguarding it for the expropriators. This is the inherent error of all plans that aim at combining private ownership and reiterated expropriation.

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2

Land Reform

The social reformers of older days aimed at the establishment of a community of autarkic farmers only. The shares of land allotted to each member were to be equal. In the imagination of these utopians there is no room for division of labor and specialization in processing trades. It is a serious mistake to call such a social order *agrarian socialism.* It is merely a juxtaposition of economically self-sufficient households.

In the market economy the soil is a means of production like any other material factor of production. Plans aiming at a more or less equal distribution of the soil among the farming population are, under the conditions of the market economy, merely plans for granting privileges to a group of less efficient producers at the expense of the immense majority of consumers. The operation of the market tends to eliminate all those farmers whose cost of production is higher than the marginal costs needed for the production of that amount of farm products the consumers are ready to buy. It determines the size of the farms as well as the methods of production applied. If the government interferes in order to make a different arrangement of the conditions of farming prevail, it raises the average price of farm products. If under competitive conditions *m* farmers, each of them operating a 1,000-acre farm, produce all those farm products the consumers are ready to acquire, and the government interferes in order to substitute 5 *m* farmers, each of them operating a 200-acre farm, for *m*, the previous numbers of farmers, the consumers foot the bill.

It is vain to justify such land reforms by referring to natural law and other metaphysical ideas. The simple truth is that they enhance the price of agricultural products and that they also impair nonagricultural production. As more manpower is needed to turn out a unit of farm produce, more people are employed in farming and less are left for the processing industries. The total amount of commodities available for consumption drops and a certain group of people is favored at the expense of the majority.

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3

Confiscatory Taxation

Today the main instrument of confiscatory interventionism is taxation. It does not matter whether the objective of estate and income taxation is the allegedly social motive of equalizing wealth and income or whether the primary motive is that of revenue. What alone counts is the resulting effect.

The average man looks at the problems involved with unveiled envy. Why should anybody be richer than he himself is? The lofty moralist conceals his resentment in philosophical disquisitions. He argues that a man who owns ten millions cannot be made happier by an increment of ninety millions more. Inversely, a man who owns a hundred millions does not feel any impairment of happiness if his wealth is reduced to a bare ten millions only. The same reasoning holds good for excessive incomes.

To judge in this way means to judge from an individualistic point of view. The yardstick applied is the supposed sentiments of individuals. Yet the problems involved are social problems; they must be appraised with regard to their social consequences. What matters is neither the happiness of any Croesus nor his personal merits or demerits; it is society and the productivity of human effort.

A law that prohibits any individual from accumulating more than ten millions or from making more than one million a year restricts the activities of precisely those entrepreneurs who are most successful in filling the wants of consumers. If such a law had been enacted in the United States fifty years ago, many who are multimillionaires today would live in more modest circumstances. But all those new branches of industry which supply the masses with articles unheard of before would operate, if at all, on a much smaller scale, and their products would be beyond the reach of the common man. It is manifestly contrary to the interest of the consumers to prevent the most efficient entrepreneurs from expanding the sphere of their activities up to the limit to which the public approves of their conduct of business by buying their products. Here again the issue is who should be supreme, the consumers or the government? In the unhampered market the behavior of consumers, their buying or abstention from buying, ultimately determines each individual's income and wealth. Should one vest in the government the power to overrule the consumers' choices?

The incorrigible statolatrist objects. In his opinion what motivates the activities of the great entrepreneur is not the lust for wealth, but the lust for power. Such a "royal merchant" would not restrict his activities if he had to deliver all the surplus earned to the tax collector. His lust for power cannot be weakened by any considerations of mere moneymaking. Let us, for the sake of argument, accept this psychology. But on what else is the power of a businessman founded than on his wealth? How would Rockefeller and Ford have been in a position to acquire "power" if they had been prevented from acquiring wealth? After all, those statolatrists are on comparatively better grounds who want to prohibit the accumulation of wealth precisely because it gives a man economic power.1

Taxes are necessary. But the system of discriminatory taxation universally accepted under the misleading name of progressive taxation of income and inheritance is not a mode of taxation. It is rather a mode of disguised expropriation of the successful capitalists and entrepreneurs. Whatever the governments' satellites may advance in its favor, it is incompatible with the preservation of the market economy. It can at best be considered a means of bringing about socialism. Looking backward on the evolution of income tax rates from the beginning of the Federal income tax in 1913 until the present day, one can hardly believe that the tax will not soon absorb 100 per cent of all the surplus above the average height of the common man's wages.

Economics is not concerned with the spurious metaphysical doctrines advanced in favor of tax progression, but with its repercussions on the operation of the market economy. The interventionist authors and politicians look at the problems involved from the angle of their arbitrary notions of what is "socially desirable." As they see it, "the purpose of taxation is never to raise money," since the government "can raise all the money it needs by printing it." The true purpose of taxation is "to leave less in the hands of the taxpayer."2

Economists approach the issue from a different angle. They ask first: what are the effects of confiscatory taxation on capital accumulation? The greater part of that portion of the higher incomes which is taxed away would have been used for the accumulation of additional capital. If the treasury employs the proceeds for current expenditure, the result is a drop in the amount of capital accumulation. The same is valid, even to a greater extent, for death taxes. They force the heirs to sell a considerable part of the testator's estate. This capital is, of course, not destroyed; it merely changes ownership. But the savings of the purchasers, which are spent for the acquisition of the capital sold by the heirs, would have constituted a net increment in capital available. Thus the accumulation of new capital is slowed down. The realization of technological improvement is impaired; the quota of capital invested per worker employed is reduced; a check is placed upon the rise in the marginal productivity of labor and upon the concomitant rise in real wage rates. It is obvious that the popular belief that this mode of confiscatory taxation harms only the immediate victims, the rich, is false.

If capitalists are faced with the likelihood that the income tax or the estate tax will rise to 100 per cent, they will prefer to consume their capital funds rather than to preserve them for the tax collector.

Confiscatory taxation results in checking economic progress and improvement not only by its effect upon capital accumulation. It brings about a general trend toward stagnation and the preservation of business practices which could not last under the competitive conditions of the unhampered market economy.

It is an inherent feature of capitalism that it is no respecter of vested interests and forces every capitalist and entrepreneur to adjust his conduct of business anew each day to the changing structure of the market. Capitalists and entrepreneurs are never free to relax. As long as they remain in business they are never granted the privilege of quietly enjoying the fruits of their ancestors' and their own achievements and of lapsing into a routine. If they forget that their task is to serve the consumers to the best of their abilities, they will very soon forfeit their eminent position and will be thrown back into the ranks of the common man. Their leadership and their funds are continually challenged by newcomers.

Every ingenious man is free to start new business projects. He may be poor, his funds may be modest and most of them may be borrowed. But if he fills the wants of consumers in the best and cheapest way, he will succeed by means of "excessive" profits. He ploughs back the greater part of his profits into his business, thus making it grow rapidly. It is the activity of such enterprising *parvenus* that provides the market economy with its dynamism. These *nouveaux riches* are the harbingers of economic improvement. Their threatening competition forces the old firms and big corporations either to adjust their conduct to the best possible service of the public or to go out of business.

But today taxes often absorb the greater part of the newcomer's "excessive" profits. He cannot accumulate capital; he cannot expand his own business; he will never become big business and a match for the vested interests. The old firms do not need to fear his competition; they are sheltered by the tax collector. They may with impunity indulge in routine, they may defy the wishes of the public and become conservative. It is true, the income tax prevents them, too, from accumulating new capital. But what is more important for them is that it prevents the dangerous newcomer from accumulating any capital. They are virtually privileged by the tax system. In this sense progressive taxation checks economic progress and makes for rigidity. While under unhampered capitalism the ownership of capital is a liability forcing the owner to serve the consumers, modern methods of taxation transform it into a privilege.

The interventionists complain that big business is getting rigid and bureaucratic and that it is no longer possible for competent newcomers to challenge the vested interests of the old rich families. However, as far as their complaints are justified, they complain about things which are merely the result of their own policies.

Profits are the driving force of the market economy. The greater the profits, the better the needs of the consumers are supplied. For profits can only be reaped by removing discrepancies between the demands of the consumers and the previous state of production activities. He who serves the public best, makes the highest profits. In fighting profits governments deliberately sabotage the operation of the market economy.

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Confiscatory Taxation And Risk-Taking

A popular fallacy considers entrepreneurial profit a reward for risktaking. It looks upon the entrepreneur as a gambler who invests in a lottery after having weighed the favorable chances of winning a prize against the unfavorable chances of losing his stake. This opinion manifests itself most clearly in the description of stock-exchange transactions as a sort of gambling. From the point of view of this widespread fable, the evil caused by confiscatory taxation is that it disarranges the ratio between the favorable and the unfavorable chances in the lottery. The prizes are cut down, while the unfavorable hazards remain unchanged. Thus capitalists and entrepreneurs are discouraged from embarking upon risky ventures.

Every word in this reasoning is false. The owner of capital does not choose between more risky, less risky, and safe investments. He is forced, by the very operation of the market economy, to invest his funds in such a way as to supply the most urgent needs of the consumers to the best possible extent. If the methods of taxation resorted to by the government bring about capital consumption or restrict the accumulation of new capital, the capital required for marginal employments is lacking and an expansion of investment which would have been effected in the absence of these taxes is prevented. The wants of the consumers are satisfied to a lesser extent only. But this outcome is not caused by a reluctance of capitalists to take risks; it is caused by a drop in capital supply.

There is no such thing as a safe investment. If capitalists were to behave in the way the risk fable describes and were to strive after what they consider to be the safest investment, their conduct would render this line of investment unsafe and they would certainly lose their input. For the capitalist there is no means of evading the law of the market that makes it imperative for the investor to comply with the wishes of the consumers and to produce all that can be produced under the given state of capital supply, technological knowledge, and the valuations of the consumers. A capitalist never chooses that investment in which, according to his understanding of the future, the danger of losing his input is smallest. He chooses that investment in which he expects to make the highest possible profit.

Those capitalists who are aware of their own lack of ability to judge correctly for themselves the trend of the market do not invest in equity capital, but lend their funds to the owners of such venture capital. They thus enter into a sort of partnership with those on whose better ability to appraise the conditions of the market they rely. It is customary to call venture capital *risk* capital. However, as has been pointed out, the success or failure of the investment in preferred stock, bonds, debentures, mortgages, and other loans depends ultimately also on the same factors that determine success or failure of the venture capital invested.[3] There is no such thing as independence of the vicissitudes of the market.

If taxation were to strengthen the supply of loan capital at the expense of the supply of venture capital, it would make the gross market rate of interest drop and at the same time, by increasing the share of borrowed capital as against the share of equity capital in the capital structure of the firms and corporations, render the investment in loans more uncertain. The process would therefore be self-liquidating.

The fact that a capitalist as a rule does not concentrate his investments, both in common stock and in loans, in one enterprise or one branch of business, but prefers to spread out his funds among various classes of investment, does not suggest that he wants to reduce his “gambling risk.” He wants to improve his chances of earning profits.

Nobody embarks upon any investment if he does not expect to make a good investment. Nobody deliberately chooses a malinvestment. It is only the emergence of conditions not properly anticipated by the investor that turns an investment into a malinvestment.

As has been pointed out, there cannot be such a thing as noninvested capital.4 The capitalist is not free to choose between investment and noninvestment. Neither is he free to deviate in the choice of his investments in capital goods from the lines determined by the most urgent among the stillunsatisfied wants of the consumers. He must try to anticipate these future wants correctly. Taxes may reduce the amount of capital goods available by bringing about consumption of capital. But they do not restrict the employment of all capital goods available.5

With an excessive height of the income and estate tax rates for the very rich, a capitalist may consider it the most advisable thing to keep all his funds in cash or in bank balances not bearing any interest. He consumes part of his capital, pays no income tax and reduces the inheritance tax which his heirs will have to pay. But even if people really behave this way, their conduct does not affect the employment of the capital available. It affects prices. But no capital good remains uninvested on account of it. And the operation of the market pushes investment into those lines in which it is expected to satisfy the most urgent not yet satisfied demand of the buying public.

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CHAPTER 33

Syndicalism And Corporativism

1

The Syndicalist Idea

The term *syndicalism* is used to signify two entirely different things.

Syndicalism, as used by the partisans of Georges Sorel, means special revolutionary tactics to be resorted to for the realization of socialism. Labor unions, it implies, should not waste their strength in the task of improving the conditions of wage earners within the frame of capitalism. They should adopt *action directe,* unflinching violence to destroy all the institutions of capitalism. They should never cease to fight—in the genuine sense of the term—for their ultimate goal, socialism. The proletarians must not let themselves be fooled by the catchwords of the bourgeoisie, such as liberty, democracy, representative government. They must seek their salvation in the class struggle, in bloody revolutionary upheavals and in the pitiless annihilation of the bourgeois.

This doctrine played and still plays an enormous role in modern politics. It has provided essential ideas to Russian Bolshevism, Italian Fascism, and German Nazism. But it is a purely political issue and may be disregarded in a catallactic analysis.

The second meaning of the term syndicalism refers to a program of society's economic organization. While socialism aims at the substitution of government ownership of the means of production for private ownership, syndicalism wants to give the ownership of the plants to the workers employed in them. Such slogans as "The railroads to the railroadmen" or "The mines to the miners" best indicate the ultimate goals of syndicalism.

The ideas of socialism and those of syndicalism in the sense of *action directe* were developed by intellectuals whom consistent adepts of all Marxian sects cannot help describing as bourgeois. But the idea of syndicalism as a system of social organization is a genuine product of the "proletarian mind." It is precisely what the naïve employee considers a fair and expedient means for improving his own material wellbeing. Eliminate the idle parasites, the entrepreneurs and capitalists, and give their "unearned incomes" to the workers! Nothing could be simpler.

If one were to take these plans seriously, one would not have to deal with them in a discussion of the problems of interventionism. One would have to realize that syndicalism is neither socialism, nor capitalism, nor interventionism, but a system of its own different from these three schemes. However, one cannot take the syndicalist program seriously, and nobody ever has. Nobody has been so confused and injudicious as to advocate syndicalism openly as a social system. Syndicalism has played a role in the discussion of economic issues only as far as certain programs unwittingly contained syndicalist features. There are elements of syndicalism in certain objectives of government and labor-union interference with market phenomena. There are, moreover, guild socialism and corporativism, which pretended to avoid the government omnipotence inherent in all socialist and interventionist ventures by adulterating them with a syndicalist admixture.

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2

The Fallacies Of Syndicalism

The root of the syndicalist idea is to be seen in the belief that entrepreneurs and capitalists are irresponsible autocrats who are free to conduct their affairs arbitrarily. Such a dictatorship must not be tolerated. The liberal movement, which has substituted representative government for the despotism of hereditary kings and aristocrats, must crown its achievements by substituting "industrial democracy" for the tyranny of hereditary capitalists and entrepreneurs. The economic revolution must bring to a climax the liberation of the people which the political revolution has inaugurated.

The fundamental error of this argument is obvious. The entrepreneurs and capitalists are not irresponsible autocrats. They are unconditionally subject to the sovereignty of the consumers. The market is a consumers' democracy. The syndicalists want to transform it into a producers' democracy. This idea is fallacious, for the sole end and purpose of production is consumption.

What the syndicalist considers the most serious defect of the capitalist system and disparages as the brutality and callousness of autocratic profit-seekers is precisely the outcome of the supremacy of the consumers. Under the competitive conditions of the unhampered market economy the entrepreneurs are forced to improve technological methods of production without regard to the vested interests of the workers. The employer is forced never to pay workers more than corresponds to the consumers' appraisal of their achievements. If an employee asks for a raise because his wife has borne him a new baby and the employer refuses on the ground that the infant does not contribute to the factory's effort, the employer acts as the mandatary of the consumers. These consumers are not prepared to pay more for any commodity merely because the worker has a large family. The naïveté of the syndicalists manifests itself in the fact that they would never concede to those producing the articles, which they themselves are using, the same privileges which they claim for themselves.

The syndicalist principle requires that the shares of every corporation should be taken away from "absentee ownership" and be equally distributed among the employees; payment of interest and principal of debts is to be discontinued. "Management" will then be placed in the hands of a board elected by the workers who are now also the shareholders. This mode of confiscation and redistribution will not bring about equality within the nation or the world. It would give more to the employees of those enterprises in which the quota of capital invested per worker is greater and less to those in which it is smaller.

It is a characteristic fact that the syndicalists in dealing with these issues always refer to management and never mention entrepreneurial activities. As the average subordinate employee sees things, all that is to be done in the conduct of business is to accomplish those ancillary tasks which are entrusted to the managerial hierarchy within the frame of the entrepreneurial plans. In his eyes the individual plant or workshop as it exists and operates today is a permanent establishment. It will never change. It will always turn out the same products. He ignores completely the fact that conditions are in a ceaseless flux, and that the industrial structure must be daily adjusted to the solution of new problems. His world view is stationary. It does not allow for new branches of business, new products, and new and better methods for manufacturing the old products. Thus the syndicalist ignores the essential problems of entrepreneurship: providing the capital for new industries and the expansion of already existing industries, restricting outfits for the products of which demand drops, technological improvement. It is not unfair to call syndicalism the economic philosophy of short-sighted people, of those adamant conservatives who look askance upon any innovation and are so blinded by envy that they call down curses upon those who provide them with more, better, and cheaper products. They are like patients who grudge the doctor his success in curing them of a malady.

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3

Syndicalist Elements In Popular Policies

The popularity of syndicalism manifests itself in various postulates of contemporary economic policies. The essence of these policies is always to grant privileges to a minority group at the expense of the immense majority. They invariably result in impairing the wealth and income of the majority.

Many labor unions are intent upon restricting the number of workers employed in their field. While the public wants more and cheaper books, periodicals and newspapers, and would get them under the conditions of an unhampered labor market, the typographical unions prevent many newcomers from working in printing offices. The effect is, of course, an increase in the wages earned by the union members. But the corollary is a drop of wage rates for those not admitted and an enhancement in the price of printed matter. The same effect is brought about by union opposition to the utilization of technological improvements and by all sorts of featherbedding practices.

Radical syndicalism aims at entirely eliminating payment of dividends to shareholders and of interest to creditors. The interventionists in their enthusiasm for middle-of-the-road solutions want to appease the syndicalists by giving the employees a part of the profits. Profit-sharing is a very popular slogan. There is no need to enter anew into an examination of the fallacies implied in the underlying philosophy. It suffices to show the absurd consequences to which such a system must lead.

It may sometimes be good policy for a small shop or for an enterprise employing highly skilled workers, to grant an extra bonus to employees if business is prosperous. But it is a non sequitur to assume that what under special conditions may be wise for an individual firm could work satisfactorily as a general system. There is no reason why one welder should make more money because his employer earns high profits and another welder less because his employer earns lower profits or no profits at all. The workers themselves would rebel against such a method of remuneration. It could not be preserved even for a short time.

A caricature of the profit-sharing scheme is the *ability-to-pay* principle as recently introduced into the program of American labor unionism. While the profit-sharing scheme aims at an allocation to the employees of a part of profits already earned, the ability-to-pay scheme aims at a distribution of profits which some external observers believe the employer may earn in the future. The issue has been obfuscated by the fact that the Truman Administration, after having accepted the new union doctrine, announced that it was appointing a “fact-finding” board which would have the authority to examine the books of the employers in order to determine their ability to pay an increase in wages. However, the books can provide information only about past costs and proceeds and past profits and losses. Estimates of future volume of production, future sales, future costs, or future profits or losses are not facts, but speculative anticipations. There are no facts about future profits.1

There cannot be any question of realizing the syndicalist ideal according to which the proceeds of an enterprise should completely go to the employees and nothing should be left for interest on the capital invested and profits. If one wants to abolish what is called "unearned income," one must adopt socialism.

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4

Guild Socialism And Corporativism

The ideas of guild socialism and corporativism originated from two different lines of thought.

The eulogists of medieval institutions long praised the eminence of the guilds. What was needed to wash away the alleged evils of the market economy was simply to return to the well-tried methods of the past. However, all these diatribes remained sterile. The critics never attempted to particularize their suggestions or to elaborate definite plans for an economic reconstruction of the social order. The most they did was to point out the alleged superiority of the old quasi-representative assemblies of the type of the French *États-Généraux* and the German *Ständische Landtage* as against the modern parliamentary bodies. But even with regard to this constitutional issue their ideas were rather vague.

The second source of guild socialism is to be found in specific political conditions of Great Britain. When the conflict with Germany became aggravated and finally in 1914 led to war, the younger British socialists began to feel uneasy about their program. The state idolatry of the Fabians and their glorification of German and Prussian institutions was paradoxical indeed at a time when their own country was involved in a pitiless struggle against Germany. What was the use of fighting the Germans when the most "progressive" intellectuals of the country longed for the adoption of German social policies? Was it possible to praise British liberty as against Prussian bondage and at the same time to recommend the methods of Bismarck and his successors? British socialists yearned for a specifically British brand of socialism as different as possible from the Teutonic brand. The problem was to construct a socialist scheme without totalitarian state supremacy and omnipotence, an individualistic variety of collectivism.

The solution of this problem is no less impossible than that of the construction of a triangular square. Yet the young men of Oxford confidently tried to solve it. They borrowed for their program the name *guild socialism* from the little known group of the eulogists of the Middle Ages. They characterized their scheme as industrial self-government, an economic corollary of the most renowned principle of English political rule, local government. In their plans they assigned the leading role to the most powerful British pressure group, the trade unions. Thus they did everything to make their device palatable to their countrymen.

However, neither these captivating adornments nor the obtrusive and noisy propaganda could mislead intelligent people. The plan was contradictory and blatantly impracticable. After only a few years it fell into complete oblivion in the country of its origin.

But then came a resurrection. The Italian Fascists badly needed an economic program of their own. After having seceded from the international parties of Marxian socialism, they could no longer pose as socialists. Neither were they, the proud scions of the invincible Roman legionaries, prepared to make concessions to Western capitalism or to Prussian interventionism, the counterfeit ideologies of the barbarians who had destroyed their glorious empire. They were in search of a social philosophy, purely and exclusively Italian. Whether or not they knew that their gospel was merely a replica of British guild socialism is immaterial. At any rate, the *stato corporativo* was nothing but a rebaptized edition of guild socialism. The differences concerned only unimportant details.

Corporativism was flamboyantly advertised by the bombastic propaganda of the Fascists, and the success of their campaign was overwhelming. Many foreign authors exuberantly praised the miraculous achievements of the new system. The governments of Austria and Portugal emphasized that they were firmly committed to the noble ideas of corporativism. The Pope's encyclical *Quadragesimo anno* (1931) contained passages which could—but need not—be interpreted as an endorsement of corporativism. In any case it is a fact that Catholic authors supported this interpretation in books which were published with the imprimatur of the Church authorities.

Yet neither the Italian Fascists nor the Austrian and Portuguese governments ever made any serious attempt to realize the corporativist utopia. The Italians attached to various institutions the label *corporativist* and transformed the university chairs of political economy into chairs of *economia politica e corporativa* [political and corporativist economy]. But never was there any question of the much talked about essential feature of corporativism, self-government of the various branches of trade and industry. The Fascist Government clung first to the same principles of economic policies which all not outright socialist governments have adopted in our day, interventionism. Then later it turned step by step toward the German system of socialism, i.e., all-around state control of economic activities.

The fundamental idea both of guild socialism and of corporativism is that every branch of business forms a monopolistic body, the guild or corporazione.2 This entity enjoys full autonomy; it is free to settle all its internal affairs without interference of external factors and of people who are not themselves members of the guild. The mutual relations between the various guilds are settled by direct bargaining from guild to guild or by the decisions of a general assembly of the delegates of all guilds. In the regular course of affairs the government does not interfere at all. Only in exceptional cases, when an agreement between the various guilds cannot be attained, is the state called in.3

In drafting this scheme the guild socialists had in mind the conditions of British local government and the relation between the various local authorities and the central government of the United Kingdom. They aimed at self-government of each branch of industry; they wanted, as the Webbs put it, "the right of self-determination for each vocation."4 In the same way in which each municipality takes care of its local community affairs and the national government handles only those affairs which concern the interests of the whole nation, the guild alone should have jurisdiction over its internal affairs and the government should restrict its interference to those things which the guilds themselves cannot settle.

However, within a system of social cooperation under the division of labor there are no such things as matters of concern only to those engaged in a special plant, enterprise, or branch of industry and of no concern to outsiders. There are no internal affairs of any guild or *corporazione* the arrangement of which does not affect the whole nation. A branch of business does not serve only those who are occupied in it; it serves everybody. If within any branch of business there is inefficiency, a squandering of scarce factors of production, or a reluctance to adopt the most appropriate methods of production, everybody's material interests are hurt. One cannot leave decisions concerning the choice of technological methods, the quantity and quality of products, the hours of work, and a thousand other things to the members of the guild, because they concern outsiders no less than members. In the market economy the entrepreneur in making such decisions is unconditionally subject to the law of the market. He is responsible to the consumers. If he were to defy the orders of the consumers, he would suffer losses and would very soon forfeit his entrepreneurial position. But the monopolistic guild does not need to fear competition. It enjoys the inalienable right of exclusively covering its field of production. It is, if left alone and autonomous, not the servant of the consumers, but their master. It is free to resort to practices which favor its members at the expense of the rest of the people.

It is of no importance whether within the guild the workers alone rule or whether and to what extent the capitalists and the former entrepreneurs cooperate in the management of affairs. It is likewise without importance whether or not some seats in the guild's governing board are assigned to representatives of the consumers. What counts is that the guild, if autonomous, is not subject to pressure that would force it to adjust its operations to the best possible satisfaction of the consumers. It is free to give the interests of its members precedence over the interests of consumers. There is in the scheme of guild socialism and corporativism nothing that would take into account the fact that the only purpose of production is consumption. Things are turned upside down. Production becomes an end in itself.

When the American New Deal embarked upon the National Recovery Administration scheme, the government and its brain trust were fully aware of the fact that what they planned was merely the establishment of an administrative apparatus for full government control of business. The short-sightedness of the guild socialists and corporativists is to be seen in the fact that they believed that the autonomous guild or *corporazione* could be considered a device for a working system of social cooperation.

It is very easy indeed for each guild to arrange its allegedly internal affairs in such a way as to satisfy its members fully. Short hours of work, high wage rates, no further improvements in technological methods or in the quality of the products which could inconvenience the members—very well. But what will the result be if all guilds resort to the same policies?

Under the guild system there is no longer any question of a market. There are no longer any prices in the catallactic sense of the term. There are neither competitive prices nor monopoly prices. Those guilds which monopolize the supply of vital necessities attain a dictatorial position. The producers of indispensable foodstuffs and fuel and the suppliers of electric current and of transportation can with impunity squeeze the whole people. Does anybody expect that the majority will tolerate such a state of affairs? There is no doubt that any attempt to realize the corporativist utopia would in a very short time lead to violent conflicts, if the government did not interfere when the vital industries abused their privileged position. What the doctrinaires envisage only as an exceptional measure—the interference of the government—will become the rule. Guild socialism and corporativism will turn into full government control of all production activities. They will develop into that system of Prussian *Zwangswirtschaft* which they were designed to avoid.

There is no need to deal with the other fundamental shortcomings of the guild scheme. It is as deficient as any other syndicalist project. It does not take into account the necessity of shifting capital and labor from one branch to another and of establishing new branches of production. It entirely neglects the problem of saving and capital accumulation. In short, it is nonsense.

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CHAPTER 34

The Economics Of War

1

Total War

The market economy involves peaceful cooperation. It bursts asunder when the citizens turn into warriors and, instead of exchanging commodities and services, fight one another.

The wars fought by primitive tribes did not affect cooperation under the division of labor. Such cooperation by and large did not exist between the warring parties before the outbreak of hostilities. These wars were unlimited or total wars. They aimed at total victory and total defeat. The defeated were either exterminated or expelled from their dwelling places or enslaved. The idea that a treaty could settle the conflict and make it possible for both parties to live in peaceful neighborly conditions was not present in the minds of the fighters.

The spirit of conquest does not acknowledge restraints other than those imposed by a power which resists successfully. The principle of empire building is to expand the sphere of supremacy as far as possible. The great Asiatic conquerors and the Roman Imperators stopped only when they could not march farther. Then they postponed aggression for later days. They did not abandon their ambitious plans and did not consider independent foreign states as anything else than targets for later onslaughts.

This philosophy of boundless conquest also animated the rulers of medieval Europe. They too aimed first of all at the utmost expansion of the size of their realms. But the institutions of feudalism provided them with only scanty means for warfare. Vassals were not obliged to fight for their lord more than a limited time. The selfishness of the vassals who insisted on their rights checked the king's aggressiveness. Thus the peaceful coexistence of a number of sovereign states originated. In the sixteenth century a Frenchman, Bodin, developed the theory of national sovereignty. In the seventeenth century a Dutchman, Grotius, added to it a theory of international relations in war and peace.

With the disintegration of feudalism, sovereigns could no longer rely upon summoned vassals. They "nationalized" the country's armed forces. Henceforth, the warriors were the king's mercenaries. The organization, equipment, and support of such troops were rather costly and a heavy burden on the ruler's revenues. The ambitions of the princes were unbounded, but financial considerations forced them to moderate their designs. They no longer planned to conquer a whole country. All they aimed at was the conquest of a few cities or of a province. To attain more would also have been unwise politically. For the European powers were anxious not to let any one of them become too powerful and a menace to their own safety. A too impetuous conqueror must always fear a coalition of all those whom his bigness has frightened.

The combined effect of military, financial, and political circumstances produced the limited warfare which prevailed in Europe in the three hundred years preceding the French Revolution. Wars were fought by comparatively small armies of professional soldiers. War was not an affair of the peoples; it concerned the rulers only. The citizens detested war which brought mischief to them and burdened them with taxes and contributions. But they considered themselves victims of events in which they did not participate actively. Even the belligerent armies respected the "neutrality" of the civilians. As they saw it, they were fighting the supreme warlord of the hostile forces, but not the noncombatant subjects of the enemy. In the wars fought on the European continent the property of civilians was considered inviolable. In 1856 the Congress of Paris made an attempt to extend this principle to naval warfare. More and more, eminent minds began to discuss the possibility of abolishing war altogether.

Looking at conditions as they had developed under the system of limited warfare, philosophers found wars useless. Men are killed or maimed, wealth is destroyed, countries are devastated for the sole benefit of kings and ruling oligarchies. The peoples themselves do not derive any gain from victory. The individual citizens are not enriched if their rulers expand the size of their realm by annexing a province. For the people wars do not pay. The only cause of armed conflict is the greed of autocrats. The substitution of representative government for royal despotism will abolish war altogether. Democracies are peaceful. It is no concern of theirs whether their nation's sovereignty stretches over a larger or smaller territory. They will treat territorial problems without bias and passion. They will settle them peacefully. What is needed to make peace durable is to dethrone the despots. This, of course, cannot be achieved peacefully. It is necessary to crush the mercenaries of the kings. But this revolutionary war of the people against the tyrants will be the last war, the war to abolish war forever.

This idea was already dimly present in the minds of the French revolutionary leaders when, after having repelled the invading armies of Prussia and Austria, they embarked upon a campaign of aggression. Of course, under the leadership of Napoleon they themselves very soon adopted the most ruthless methods of boundless expansion and annexation until a coalition of all European powers frustrated their ambitions. But the idea of durable peace was soon resurrected. It was one of the main points in the body of nineteenth-century liberalism as consistently elaborated in the much abused principles of the Manchester School.

These British liberals and their continental friends were keen enough to realize that what can safeguard durable peace is not simply government by the people, but government by the people under unlimited laissez faire. In their eyes free trade, both in domestic affairs and in international relations, was the necessary prerequisite of the preservation of peace. In such a world without trade and migration barriers no incentives for war and conquest are left. Fully convinced of the irrefutable persuasiveness of the liberal ideas, they dropped the notion of the last war to abolish all wars. All peoples will of their own accord recognize the blessings of free trade and peace and will curb their domestic despots without any aid from abroad.

Most historians entirely fail to recognize the factors which replaced the "limited" war of the *ancien régime* by the "unlimited" war of our age. As they see it, the change came with the shift from the dynastic to the national form of state and was a consequence of the French Revolution. They look only upon attending phenomena and confuse causes and effects. They speak of the composition of the armies, of strategical and tactical principles, of weapons and transportation facilities, and of many other matters of military art and administrative technicalities.[1] However, all these things do not explain why modern nations prefer aggression to peace.

There is perfect agreement with regard to the fact that total war is an offshoot of aggressive nationalism. But this is merely circular reasoning. We call aggressive nationalism that ideology which makes for modern total war. Aggressive nationalism is the necessary derivative of the policies of interventionism and national planning. While laissez faire eliminates the causes of international conflict, government interference with business and socialism creates conflicts for which no peaceful solution can be found. While under free trade and freedom of migration no individual is concerned about the territorial size of his country, under the protective measures of economic nationalism nearly every citizen has a substantial interest in these territorial issues. The enlargement of the territory subject to the sovereignty of his own government means material improvement for him or at least relief from restrictions which a foreign government has imposed upon his well-being. What has transformed the limited war between royal armies into total war, the clash between peoples, is not technicalities of military art, but the substitution of the welfare state for the laissezfaire state.

If Napoleon I had reached his goal, the French Empire would have stretched far beyond the limits of 1815. Spain and Naples would have been ruled by kings of the house of Bonaparte-Murat instead of kings of another French family, the Bourbons. The palace of Kassel would have been occupied by a French playboy instead of one of the egregious Electors of the Hesse family. All these things would not have made the citizens of France more prosperous. Neither did the citizens of Prussia win anything from the fact that their king in 1866 evicted his cousins of Hanover, Hesse-Kassel and Nassau from their luxurious residences. But if Hitler had realized his plans, the Germans expected to enjoy a higher standard of living. They were confident that the annihilation of the French, the Poles, and the Czechs would make every member of their own race richer. The struggle for more *Lebensraum* [living space] was their own war.

Under laissez faire peaceful coexistence of a multitude of sovereign nations is possible. Under government control of business it is impossible. The tragic error of President Wilson was that he ignored this essential point. Modern total war has nothing in common with the limited war of the old dynasties. It is a war against trade and migration barriers, a war of the comparatively overpopulated countries against the comparatively underpopulated. It is a war to abolish those institutions which prevent the emergence of a tendency toward an equalization of wage rates all over the world.

It is a war of the farmers tilling poor soil against those governments which bar them from access to much more fertile soil lying fallow. It is, in short, a war of wage earners and farmers who describe themselves as underprivileged “have-nots” against the wage earners and farmers of other nations whom they consider privileged “haves.”

The acknowledgment of this fact does not suggest that victorious wars would really do away with those evils about which the aggressors complain. These conflicts of vital interests can be eliminated only by a general and unconditional substitution of a philosophy of mutual cooperation for the prevailing ideas of allegedly irreconcilable antagonisms between the various social, political, religious, linguistic, and racial subdivisions of mankind.

It is futile to place confidence in treaties, conferences, and such bureaucratic outfits as the League of Nations and the United Nations. Plenipotentiaries, office clerks and experts make a poor show in fighting ideologies. The spirit of conquest cannot be smothered by red tape. What is needed is a radical change in ideologies and economic policies.

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2

War And The Market Economy

The market economy, say the socialists and the interventionists, is at best a system that may be tolerated in peacetime. But when war comes, such indulgence is impermissible. It would jeopardize the vital interests of the nation for the sole benefit of the selfish concerns of capitalists and entrepreneurs. War, and in any case modern total war, peremptorily requires government control of business.

Hardly anybody has been bold enough to challenge this dogma. It served in both World Wars as a convenient pretext for innumerable measures of government interference with business which in many countries step by step led to full "war socialism." When the hostilities ceased, a new slogan was launched. The period of transition from war to peace and of "reconversion," people contended, requires even more government control than the period of war. Besides, why should one ever return to a social system which can work, if at all, only in the interval between two wars? The most appropriate thing would be to cling permanently to government control in order to be duly prepared for any possible emergency.

An examination of the problems which the United States had to face in the second World War will clearly show how fallacious this reasoning is.

What America needed in order to win the war was a radical conversion of all its production activities. All not absolutely indispensable civilian consumption was to be eliminated. The plants and farms were henceforth to turn out only a minimum of goods for nonmilitary use. For the rest, they were to devote themselves completely to the task of supplying the armed forces.

The realization of this program did not require the establishment of controls and priorities. If the government had raised all the funds needed for the conduct of war by taxing the citizens and by borrowing from them, everybody would have been forced to cut down his consumption drastically. The entrepreneurs and farmers would have turned toward production for the government because the sale of goods to private citizens would have dropped. The government, now by virtue of the inflow of taxes and borrowed money the biggest buyer on the market, would have been in a position to obtain all it wanted. Even the fact that the government chose to finance a considerable part of the war expenditure by increasing the quantity of money in circulation and by borrowing from the commercial banks would not have altered this state of affairs. The inflation must, of course, bring about a marked tendency toward a rise in the prices of all goods and services. The government would have had to pay higher nominal prices. But it would still have been the most solvent buyer on the market. It would have been possible for it to outbid the citizens who on the one hand had not the right of manufacturing the money they needed and on the other hand would have been squeezed by enormous taxes.

But the government deliberately adopted a policy which was bound to make it impossible for it to rely upon the operation of the unhampered market. It resorted to price control and made it illegal to raise commodity prices. Furthermore it was very slow in taxing the incomes swollen by the inflation. It surrendered to the claim of the unions that the workers' real take-home wages should be kept at a height which would enable them to preserve in the war their prewar standard of living. In fact, the most numerous class of the nation, the class which in peacetime consumed the greatest part of the total amount of goods consumed, had so much more money in their pockets that their power to buy and to consume was greater than in peacetime. The wage earners—and to some extent also the farmers and the owners of plants producing for the government—would have frustrated the government's endeavors to direct industries toward the production of war materials. They would have induced business to produce more, not less, of those goods which in wartime are considered superfluous luxuries. It was this circumstance that forced the Administration to resort to the systems of priorities and of rationing. The shortcomings of the methods adopted for financing war expenditure made government control of business necessary. If no inflation had been made and if taxation had cut down the income (after taxes) of all citizens, not only of those enjoying higher incomes, to a fraction of their peacetime revenues, these controls would have been supererogatory. The endorsement of the doctrine that the wage earners' real income must in wartime be even higher than in peacetime made them unavoidable.

Not government decrees and the paperwork of hosts of people on the government's payroll, but the efforts of private enterprise produced those goods which enabled the American armed forces to win the war and to provide all the material equipment its allies needed for their cooperation. The economist does not infer anything from these historical facts. But it is expedient to mention them as the interventionists would have us believe that a decree prohibiting the employment of steel for the construction of apartment houses automatically produces airplanes and battleships.

The adjustment of production activities to a change in the demand of consumers is the source of profits. The greater the discrepancy between the previous state of production activities and that agreeing with the new structure of demand, the greater adjustments are required and the greater profits are earned by those who succeed best in accomplishing these adjustments. The sudden transition from peace to war revolutionizes the structure of the market, makes radical readjustments indispensable and thus becomes for many a source of high profits. The planners and interventionists regard such profits as a scandal. As they see it, the first duty of government in time of war is to prevent the emergence of new millionaires. It is, they say, unfair to let some people become richer while other people are killed or maimed.

Nothing is fair in war. It is not just that God is for the big battalions and that those who are better equipped defeat poorly equipped adversaries. It is not just that those in the front line shed their life-blood in obscurity, while the commanders, comfortably located in headquarters hundreds of miles behind the trenches, gain glory and fame. It is not just that John is killed and Mark crippled for the rest of his life, while Paul returns home safe and sound and enjoys all the privileges accorded to veterans.

It may be admitted that it is not "fair" that war enhances the profits of those entrepreneurs who contribute best to the equipment of the fighting forces. But it would be foolish to deny that the profit system produces the best weapons. It was not socialist Russia that aided capitalist America with lend-lease; the Russians were lamentably defeated before American-made bombs fell on Germany and before they got the arms manufactured by American big business. The most important thing in war is not to avoid the emergence of high profits, but to give the best equipment to one's own country's soldiers and sailors. The worst enemies of a nation are those malicious demagogues who would give their envy precedence over the vital interests of their nation's cause.

Of course, in the long run war and the preservation of the market economy are incompatible. Capitalism is essentially a scheme for peaceful nations. But this does not mean that a nation which is forced to repel foreign aggressors must substitute government control for private enterprise. If it were to do this, it would deprive itself of the most efficient means of defense. There is no record of a socialist nation which defeated a capitalist nation. In spite of their much glorified war socialism, the Germans were defeated in both World Wars.

What the incompatibility of war and capitalism really means is that war and high civilization are incompatible. If the efficiency of capitalism is directed by governments toward the output of instruments of destruction, the ingenuity of private business turns out weapons which are powerful enough to destroy everything. What makes war and capitalism incompatible with one another is precisely the unparalleled efficiency of the capitalist mode of production.

The market economy, subject to the sovereignty of the individual consumers, turns out products which make the individual's life more agreeable. It caters to the individual's demand for more comfort. It is this that made capitalism despicable in the eyes of the apostles of violence. They worshiped the "hero," the destroyer and killer, and despised the bourgeois and his "peddler mentality" (Sombart). Now mankind is reaping the fruits which ripened from the seeds sown by these men.

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3

War And Autarky

If an economically self-sufficient man starts a feud against another autarkic man, no specific problems of "war-economy" arise. But if the tailor goes to war against the baker, he must henceforth produce his bread for himself. If he neglects to do this, he will be in distress sooner than his adversary, the baker. For the baker can wait longer for a new suit than the tailor can for fresh bread. The economic problem of making war is therefore different for the baker and for the tailor.

The international division of labor was developed under the assumption that there would no longer be wars. In the philosophy of the Manchester School free trade and peace were seen as mutually conditioning one another. The businessmen who made trade international did not consider the possibility of new wars.

Nor did general staffs and students of the art of warfare pay any attention to the change in conditions which international division of labor brought about. The method of military science consists in examining the experience of wars fought in the past and in abstracting general rules from it. Even the most scrupulous occupation with the campaigns of Turenne and Napoleon I could not suggest the existence of a problem which was not present in ages in which there was practically no international division of labor.

The European military experts slighted the study of the American Civil War. In their eyes this war was not instructive. It was fought by armies of irregulars led by nonprofessional commanders. Civilians like Lincoln interfered with the conduct of the operations. Little, they believed, could be learned from this experience. But it was in the Civil War that, for the first time, problems of the interregional division of labor played the decisive role. The South was predominantly agricultural; its processing industries were negligible. The Confederates depended on the supply of manufactures from Europe. As the naval forces of the Union were strong enough to blockade their coast, they soon began to lack needed equipment.

The Germans in both World Wars had to face the same situation. They depended on the supply of foodstuffs and raw materials from overseas. But they could not run the British blockade. In both wars the outcome was decided by the battles of the Atlantic. The Germans lost because they failed in their efforts to cut off the British Isles from access to the world market and could not themselves safeguard their own maritime supply lines. The strategical problem was determined by the conditions of the international division of labor.

The German warmongers were intent upon adopting policies which, as they hoped, could make it possible for Germany to wage a war in spite of the handicap of the foreign trade situation. Their panacea was Ersatz, the substitute.

A substitute is a good which is either less suitable or more expensive or both less suitable and more expensive than the proper good which it is designed to replace. Whenever technology succeeds in manufacturing or discovering something which is either more suitable or cheaper than the thing previously used, this new thing represents a technological innovation; it is improvement and not *Ersatz*. The essential feature of *Ersatz,* as this term is employed in the economico-military doctrine, is inferior quality or higher costs or both together.2

The *Wehrwirtschaftslehre,* the German doctrine of the economics of war, contends that neither cost of production nor quality are important in matters of warfare. Profit-seeking business is concerned with costs of production and with the quality of the products. But the heroic spirit of a superior race does not care about such specters of the acquisitive mind. What counts alone is war preparedness. A warlike nation must aim at autarky in order to be independent of foreign trade. It must foster the production of substitutes irrespective of mammonist considerations. It cannot do without full government control of production because the selfishness of the individual citizens would thwart the plans of the leader. Even in peacetime the commander-in-chief must be entrusted with economic dictatorship.

Both theorems of the Ersatz doctrine are fallacious.

First, it is not true that the quality and suitability of the substitute are of no importance. If soldiers are sent into battle badly nourished and equipped with weapons made of inferior material, the chances for victory are impaired. Their action will be less successful, and they will suffer heavier casualties. The awareness of their technical inferiority will weigh on their minds. *Ersatz* jeopardizes both the material strength and the morale of an army.

No less incorrect is the theorem that the higher costs of production of the substitutes do not count. Higher costs of production mean that more labor and more material factors of production must be expended in order to achieve the same effect which the adversary, producing the proper product, attains with a lower expenditure. It is tantamount to squandering scarce factors of production, material and manpower. Such waste under conditions of peace results in lowering the standard of living, and under conditions of war in cutting down the supply of goods needed for the conduct of operations. In the present state of technological knowledge it is only a slight exaggeration to say that everything can be produced out of anything. But what matters is to pick out from the great multitude of possible methods those with which output is highest per unit of input. Any deviation from this principle penalizes itself. The consequences in war are as bad as they are in peace.

In a country like the United States, which depends only to a comparatively negligible extent on the importation of raw materials from abroad, it is possible to improve the state of war preparedness by resorting to the production of substitutes such as synthetic rubber. The disadvantageous effects would be small when weighed against the beneficial effects. But a country like Germany was badly mistaken in the assumption that it could conquer with synthetic gasoline, synthetic rubber, *Ersatz* textiles and *Ersatz* fats. In both World Wars Germany was in the position of the tailor fighting against the man who supplies him with bread. With all their brutality the Nazis could not alter this fact.

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4.

The Futility Of War

What distinguishes man from animals is the insight into the advantages that can be derived from cooperation under the division of labor. Man curbs his innate instinct of aggression in order to cooperate with other human beings. The more he wants to improve his material well-being, the more he must expand the system of the division of labor. Concomitantly he must more and more restrict the sphere in which he resorts to military action. The emergence of the international division of labor requires the total abolition of war. Such is the essence of the laissez-faire philosophy of Manchester.

This philosophy is, of course, incompatible with statolatry. In its context the state, the social apparatus of violent oppression, is entrusted with the protection of the smooth operation of the market economy against the onslaughts of antisocial individuals and gangs. Its function is indispensable and beneficial, but it is an ancillary function only. There is no reason to idolize the police power and ascribe to it omnipotence and omniscience. There are things which it can certainly not accomplish. It cannot conjure away the scarcity of the factors of production, it cannot make people more prosperous, it cannot raise the productivity of labor. All it can achieve is to prevent gangsters from frustrating the efforts of those people who are intent upon promoting material well-being.

The liberal philosophy of Bentham and Bastiat had not yet completed its work of removing trade barriers and government meddling with business when the counterfeit theology of the divine state began to take effect. Endeavors to improve the conditions of wage earners and small farmers by government decree made it necessary to loosen more and more the ties which connected each country's domestic economy with those of other countries. Economic nationalism, the necessary complement of domestic interventionism, hurts the interests of foreign peoples and thus creates international conflict. It suggests the idea of amending this unsatisfactory state of affairs by war. Why should a powerful nation tolerate the challenge of a less powerful nation? Is it not insolence on the part of small Laputania to injure the citizens of big Ruritania by customs, migration barriers, foreign exchange control, quantitative trade restrictions, and expropriation of Ruritanian investments in Laputania? Would it not be easy for the army of Ruritania to crush Laputania's contemptible forces?

Such was the ideology of the German, Italian, and Japanese warmongers. It must be admitted that they were consistent from the point of view of the new "unorthodox" teachings. Interventionism generates economic nationalism, and economic nationalism generates bellicosity. If men and commodities are prevented from crossing the borderlines, why should not the armies try to pave the way for them?

From the day when Italy, in 1911, fell upon Turkey, fighting was continual. There was almost always shooting somewhere in the world. The peace treaties concluded were virtually merely armistice agreements. Moreover they had to do only with the armies of the great powers. Some of the smaller nations were always at war. In addition there were no less pernicious civil wars and revolutions.

How far we are today from the rules of international law developed in the age of limited warfare! Modern war is merciless, it does not spare pregnant women or infants; it is indiscriminate killing and destroying. It does not respect the rights of neutrals. Millions are killed, enslaved, or expelled from the dwelling places in which their ancestors lived for centuries. Nobody can foretell what will happen in the next chapter of this endless struggle.

This has little to do with the atomic bomb. The root of the evil is not the construction of new, more dreadful weapons. It is the spirit of conquest. It is probable that scientists will discover some methods of defense against the atomic bomb. But this will not alter things, it will merely prolong for a short time the process of the complete destruction of civilization.

Modern civilization is a product of the philosophy of laissez faire. It cannot be preserved under the ideology of government omnipotence. Statolatry owes much to the doctrines of Hegel. However, one may pass over many of Hegel's inexcusable faults, for Hegel also coined the phrase *die Ohnmacht des Sieges,* the futility of victory.[3] To defeat the aggressors is not enough to make peace durable. The main thing is to discard the ideology that generates war.

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CHAPTER 35

The Welfare Principle Versus The Market Principle

1

The Case Against The Market Economy

The objections which the various schools of *Sozialpolitik* raise against the market economy are based on very bad economics. They repeat again and again all the errors that the economists long ago exploded. They blame the market economy for the consequences of the very anticapitalistic policies which they themselves advocate as necessary and beneficial reforms. They fix on the market economy the responsibility for the inevitable failure and frustration of interventionism.

These propagandists must finally admit that the market economy is after all not so bad as their "unorthodox" doctrines paint it. It delivers the goods. From day to day it increases the quantity and improves the quality of products. It has brought about unprecedented wealth. But, objects the champion of interventionism, it is deficient from what he calls the social point of view. It has not wiped out poverty and destitution. It is a system that grants privileges to a minority, an upper class of rich people, at the expense of the immense majority. It is an unfair system. The principle of *welfare* must be substituted for that of profits.

We may try, for the sake of argument, to interpret the concept of welfare in such a way that its acceptance by the immense majority of nonascetic people would be probable. The better we succeed in these endeavors, the more we deprive the idea of welfare of any concrete meaning and content. It turns into a colorless paraphrase of the fundamental category of human action, viz., the urge to remove uneasiness as far as possible. As it is universally recognized that this goal can be more readily, and even exclusively, attained by social division of labor, men cooperate within the framework of societal bonds. Social man as differentiated from autarkic man must necessarily modify his original biological indifference to the well-being of people beyond his own family. He must adjust his conduct to the requirements of social cooperation and look upon his fellow men's success as an indispensable condition of his own. From this point of view one may describe the objective of social cooperation as the realization of the greatest happiness of the greatest number. Hardly anybody would venture to object to this definition of the most desirable state of affairs and to contend that it is *not* a good thing to see as many people as possible as happy as possible. All the attacks directed against the Bentham formula have centered around ambiguities or misunderstandings concerning the notion of happiness; they have not affected the postulate that the good, whatever it may be, should be imparted to the greatest number.

However, if we interpret *welfare* in this manner, the concept is void of any specific significance. It can be invoked for the justification of every variety of social organization. It is a fact that some of the defenders of Negro slavery contended that slavery is the best means of making the Negroes happy and that today in the South many Whites sincerely believe that rigid segregation is beneficial no less to the colored man than it allegedly is to the white man. The main thesis of racism of the Gobineau and Nazi variety is that the hegemony of the superior races is salutary to the true interests even of the inferior races. A principle that is broad enough to cover all doctrines, however conflicting with one another, is of no use at all.

But in the mouths of the welfare propagandists the notion of welfare has a definite meaning. They intentionally employ a term the generally accepted connotation of which precludes any opposition. No decent man likes to be so rash as to raise objections against the realization of welfare. In arrogating to themselves the exclusive right to call their own program the program of welfare, the welfare propagandists want to triumph by means of a cheap logical trick. They want to render their ideas safe against criticism by attributing to them an appellation which is cherished by everybody. Their terminology already implies that all opponents are ill-intentioned scoundrels eager to foster their selfish interests to the prejudice of the majority of good people.

The plight of Western civilization consists precisely in the fact that serious people can resort to such syllogistic artifices without encountering sharp rebuke. There are only two explanations open. Either these self-styled welfare economists are themselves not aware of the logical inadmissibility of their procedure, in which case they lack the indispensable power of reasoning; or they have chosen this mode of arguing purposely in order to find shelter for their fallacies behind a word which is intended beforehand to disarm all opponents. In each case their own acts condemn them.

There is no need to add anything to the disquisitions of the preceding chapters concerning the effects of all varieties of interventionism. The ponderous volumes of welfare economics have not brought forth any arguments that could invalidate our conclusions. The only task that remains is to examine the critical part of the welfare propagandists' work, their indictment of the market economy.

All this passionate talk of the welfare school ultimately boils down to three points. Capitalism is bad, they say, because there is poverty, inequality of incomes and wealth, and insecurity.

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2

Poverty

We may depict conditions of a society of agriculturists in which every member tills a piece of land large enough to provide himself and his family with the indispensable necessities of life. We may include in such a picture the existence of a few specialists, artisans like smiths and professional men like doctors. We may even go further and assume that some men do not own a farm, but work as laborers on other people's farms. The employer remunerates them for their help and takes care of them when sickness or old age disables them.

This scheme of an ideal society was at the bottom of many utopian plans. It was by and large realized for some time in some communities. The nearest approach to its realization was probably the commonwealth which the Jesuit padres established in the country which is today Paraguay. There is, however, no need to examine the merits of such a system of social organization. Historical evolution burst it asunder. Its frame was too narrow for the number of people who are living today on the earth's surface.

The inherent weakness of such a society is that the increase in population must result in progressive poverty. If the estate of a deceased farmer is divided among his children, the holdings finally become so small that they can no longer provide sufficient sustenance for a family. Everybody is a landowner, but everybody is extremely poor. Conditions as they prevailed in large areas of China provide a sad illustration of the misery of the tillers of small parcels. The alternative to this outcome is the emergence of a huge mass of landless proletarians. Then a wide gap separates the disinherited paupers from the fortunate farmers. They are a class of pariahs whose very existence presents society with an insoluble problem. They search in vain for a livelihood. Society has no use for them. They are destitute.

When in the ages preceding the rise of modern capitalism statesmen, philosophers, and lawyers referred to the poor and to the problems of poverty, they meant these supernumerary wretches. Laissez faire and its offshoot, industrialism, converted the employable poor into wage earners. In the unhampered market society there are people with higher and people with lower incomes. There are no longer men, who, although able and ready to work, cannot find regular jobs because there is no room left for them in the social system of production. But liberalism and capitalism were even in their heyday limited to comparatively small areas of Western and Central Europe, North America, and Australia. In the rest of the world hundreds of millions still vegetate on the verge of starvation. They are poor or paupers in the old sense of the term, supernumerary and superfluous, a burden to themselves and a latent threat to the minority of their more lucky fellow citizens.

The penury of these miserable masses of—in the main colored—people is not caused by capitalism, but by the absence of capitalism. But for the triumph of laissez faire, the lot of the peoples of Western Europe would have been even worse than that of the coolies. What is wrong with Asia is that the per capita quota of capital invested is extremely low when compared with the capital equipment of the West. The prevailing ideology and the social system which is its offshoot check the evolution of profit-seeking entrepreneurship. There is very little domestic capital accumulation, and manifest hostility to foreign investors. In many of these countries the increase in population figures even outruns the increase in capital available.

It is false to blame the European powers for the poverty of the masses in their former colonial empires. In investing capital the foreign rulers did all they could do for an improvement in material well-being. It is not the fault of the Whites that the Oriental peoples are reluctant to abandon their traditional tenets and abhor capitalism as an alien ideology.

As far as there is unhampered capitalism, there is no longer any question of poverty in the sense in which this term is applied to the conditions of a noncapitalistic society. The increase in population figures does not create supernumerary mouths, but additional hands whose employment produces additional wealth. There are no able-bodied paupers. Seen from the point of view of the economically backward nations, the conflicts between “capital” and “labor” in the capitalist countries appear as conflicts within a privileged upper class. In the eyes of the Asiatics, the American automobile worker is an “aristocrat.” He is a man who belongs to the 2 per cent of the earth’s population whose income is highest. Not only the colored races, but also the Slavs, the Arabs, and some other peoples look upon the average income of the citizens of the capitalistic countries—about 12 or 15 per cent of the total of mankind—as a curtailment of their own material well-being. They fail to realize that the prosperity of these allegedly privileged groups is, apart from the effects of migration barriers, not paid for by their own poverty, and that the main obstacle to the improvement of their own conditions is their abhorrence of capitalism.

Within the frame of capitalism the notion of poverty refers only to those people who are unable to take care of themselves. Even if we disregard the case of children, we must realize that there will always be such unemployables. Capitalism, in improving the masses’ standard of living, hygienic conditions, and methods of prophylactics and therapeutics, does not remove bodily incapacity. It is true that today many people who in the past would have been doomed to life-long disability are restored to full vigor. But on the other hand many whom innate defects, sickness, or accidents would have extinguished sooner in earlier days survive as permanently incapacitated people. Moreover, the prolongation of the average length of life tends toward an increase in the number of the aged who are no longer able to earn a living.

The problem of the incapacitated is a specific problem of human civilization and of society. Disabled animals must perish quickly. They either die of starvation or fall prey to the foes of their species. Savage man had no pity on those who were substandard. With regard to them many tribes practiced those barbaric methods of ruthless extirpation to which the Nazis resorted in our time. The very existence of a comparatively great number of invalids is, however paradoxical, a characteristic mark of civilization and material well-being.

Provision for those invalids who lack means of sustenance and are not taken care of by their next of kin has long been considered a work of charity. The funds needed have sometimes been provided by governments, more often by voluntary contributions. The Catholic orders and congregations and some Protestant institutions have accomplished marvels in collecting such contributions and in using them properly. Today there are also many nondenominational establishments vying with them in noble rivalry.

The charity system is criticized for two defects. One is the paucity of the means available. However, the more capitalism progresses and increases wealth, the more sufficient become the charity funds. On the one hand, people are more ready to donate in proportion to the improvement in their own well-being. On the other hand, the number of the needy drops concomitantly. Even for those with moderate incomes the opportunity is offered, by saving and insurance policies, to provide for accidents, sickness, old age, the education of their children, and the support of widows and orphans. It is highly probable that the funds of the charitable institutions would be sufficient in the capitalist countries if interventionism were not to sabotage the essential institutions of the market economy. Credit expansion and inflationary increase of the quantity of money frustrate the "common man's" attempts to save and to accumulate reserves for less propitious days. But the other procedures of interventionism are hardly less injurious to the vital interests of the wage earners and salaried employees, the professions, and the owners of small-size business. The greater part of those assisted by charitable institutions are needy only because interventionism has made them so. At the same time inflation and the endeavors to lower the rate of interest below the potential market rates virtually expropriate the endowments of hospitals, asylums, orphanages, and similar establishments. As far as the welfare propagandists lament the insufficiency of the funds available for assistance, they lament one of the results of the policies that they themselves are advocating.

The second defect charged to the charity system is that it is charity and compassion only. The indigent has no legal claim to the kindness shown to him. He depends on the mercy of benevolent people, on the feelings of tenderness which his distress arouses. What he receives is a voluntary gift for which he must be grateful. To be an almsman is shameful and humiliating. It is an unbearable condition for a self-respecting man.

These complaints are justified. Such shortcomings do indeed inhere in all kinds of charity. It is a system that corrupts both givers and receivers. It makes the former self-righteous and the latter submissive and cringing. However, it is only the mentality of a capitalistic environment that makes people feel the indignity of giving and receiving alms. Outside of the field of the cash nexus and of deals transacted between buyers and sellers in a purely businesslike manner, all interhuman relations are tainted by the same failing. It is precisely the absence of this personal element in market transactions that all those deplore who blame capitalism for hard-heartedness and callousness. In the eyes of such critics cooperation under the *do ut des* principle dehumanizes all societal bonds. It substitutes contracts for brotherly love and readiness to help one another. These critics indict the legal order of capitalism for its neglect of the "human side.” They are inconsistent when they blame the charity system for its reliance upon feelings of mercy.

Feudal society was founded on acts of grace and on the gratitude of those favored. The mighty overlord bestowed a benefit upon the vassal and the latter owed him personal fidelity. Conditions were human in so far as the subordinates had to kiss their superiors’ hands and to show allegiance to them. In a feudal environment the element of grace inherent in charitable acts did not give offense. It agreed with the generally accepted ideology and practice. It is only in the setting of a society based entirely upon contractual bonds that the idea emerged of giving to the indigent a legal claim, an actionable title to sustenance against society.

The metaphysical arguments advanced in favor of such a right to sustenance are based on the doctrine of natural right. Before God or nature all men are equal and endowed with an inalienable right to live. However, the reference to inborn equality is certainly out of place in dealing with the effects of inborn inequality. It is a sad fact that physical disability prevents many people from playing an active role in social cooperation. It is the operation of the laws of nature that makes these people outcasts. They are stepchildren of God or nature. We may fully endorse the religious and ethical precepts that declare it to be man’s duty to assist his unlucky brethren whom nature has doomed. But the recognition of this duty does not answer the question concerning what methods should be resorted to for its performance. It does not enjoin the choice of methods which would endanger society and curtail the productivity of human effort. Neither the able-bodied nor the incapacitated would derive any benefit from a drop in the quantity of goods available.

The problems involved are not of a praxeological character, and economics is not called upon to provide the best possible solution for them. They concern pathology and psychology. They refer to the biological fact that the fear of penury and of the degrading consequences of being supported by charity are important factors in the preservation of man’s physiological equilibrium. They impel a man to keep fit, to avoid sickness and accidents, and to recover as soon as possible from injuries suffered. The experience of the social security system, especially that of the oldest and most complete scheme, the German, has clearly shown the undesirable effects resulting from the elimination of these incentives.[1] No civilized community has callously allowed the incapacitated to perish. But the substitution of a legally enforceable claim to support or sustenance for charitable relief does not seem to agree with human nature as it is. Not metaphysical prepossessions, but considerations of practical expediency make it inadvisable to promulgate an actionable right to sustenance.

It is, moreover, an illusion to believe that the enactment of such laws could free the indigent from the degrading features inherent in receiving alms. The more openhanded these laws are, the more punctilious must their application become. The discretion of bureaucrats is substituted for the discretion of people whom an inner voice drives to acts of charity. Whether this change renders the lot of those incapacitated any easier, is hard to say.

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3

Inequality

The inequality of incomes and wealth is an inherent feature of the market economy. Its elimination would entirely destroy the market economy.[2]

What those people who ask for equality have in mind is always an increase in their own power to consume. In endorsing the principle of equality as a political postulate nobody wants to share his own income with those who have less. When the American wage earner refers to equality, he means that the dividends of the stockholders should be given to him. He does not suggest a curtailment of his own income for the benefit of those 95 per cent of the earth's population whose income is lower than his.

The role that income inequality plays in the market society must not be confused with the role it plays in a feudal society or in other types of noncapitalistic societies.[3] Yet in the course of historical evolution this precapitalistic inequality was of momentous importance.

Let us compare the history of China with that of England. China has developed a very high civilization. Two thousand years ago it was far ahead of England. But at the end of the nineteenth century England was a rich and civilized country while China was poor. Its civilization did not differ much from the stage it had already reached ages before. It was an arrested civilization.

China had tried to realize the principle of income equality to a greater extent than did England. Land holdings were divided and subdivided. There was no numerous class of landless proletarians. But in eighteenth-century England this class was very numerous. For a very long time the restrictive practices of nonagricultural business, sanctified by traditional ideologies, delayed the emergence of modern entrepreneurship. But when the laissez-faire philosophy had opened the way for capitalism by utterly destroying the fallacies of restrictionism, the evolution of industrialism could proceed at an accelerated pace because the labor force needed was already available.

What generated the "machine age" was not, as Sombart imagined, aspecific mentality of acquisitiveness which one day mysteriously got hold of the minds of some people and turned them into "capitalistic men." There have always been people ready to profit from better adjusting production to the satisfaction of the needs of the public. But they were paralyzed by the ideology that branded acquisitiveness as immoral and erected institutional barriers to check it. The substitution of the laissez-faire philosophy for the doctrines that approved of the traditional system of restrictions removed these obstacles to material improvement and thus inaugurated the new age.

The liberal philosophy attacked the traditional caste system because its preservation was incompatible with the operation of the market economy. It advocated the abolition of privileges because it wanted to give a free hand to those men who had the ingenuity to produce in the cheapest way the greatest quantity of products of the best quality. In this negative aspect of their program the utilitarians and economists agreed with the ideas of those who attacked the status privileges from the point of view of an alleged right of nature and the doctrine of the equality of all men. Both these groups were unanimous in the support of the principle of the equality of all men under the law. But this unanimity did not eradicate the fundamental opposition between the two lines of thought.

In the opinion of the natural law school all men are biologically equal and therefore have the inalienable right to an equal share in all things. The first theorem is manifestly contrary to fact. The second theorem leads, when consistently interpreted, to such absurdities that its supporters abandon logical consistency altogether and ultimately come to consider every institution, however discriminating and iniquitous, as compatible with the inalienable equality of all men. The eminent Virginians whose ideas animated the American Revolution acquiesced in the preservation of Negro slavery. The most despotic system of government that history has ever known, Bolshevism, parades as the very incarnation of the principle of equality and liberty of all men.

The liberal champions of equality under the law were fully aware of the fact that men are born unequal and that it is precisely their inequality that generates social cooperation and civilization. Equality under the law was in their opinion not designed to correct the inexorable facts of the universe and to make natural inequality disappear. It was, on the contrary, the device to secure for the whole of mankind the maximum of benefits it can derive from it. Henceforth no man-made institutions should prevent a man from attaining that station in which he can best serve his fellow citizens. The liberals approached the problem not from the point of view of alleged inalienable rights of the individuals, but from the social and utilitarian angle. Equality under the law is in their eyes good because it best serves the interests of all. It leaves it to the voters to decide who should hold public office and to the consumers to decide who should direct production activities. It thus eliminates the causes of violent conflict and secures a steady progress toward a more satisfactory state of human affairs.

The triumph of this liberal philosophy produced all those phenomena which in their totality are called modern Western civilization. However, this new ideology could triumph only within an environment in which the ideal of income equality was very weak. If the Englishmen of the eighteenth century had been preoccupied with the chimera of income equality, laissez-faire philosophy would not have appealed to them, just as it does not appeal today to the Chinese or the Mohammedans. In this sense the historian must acknowledge that the ideological heritage of feudalism and the manorial system contributed to the rise of our modern civilization, however different it is.

Those eighteenth-century philosophers who were foreign to the ideas of the new utilitarian theory could still speak of a superiority of conditions in China and in the Mohammedan countries. They knew, it is true, very little about the social structure of the oriental world. What they found praiseworthy in the dim reports they had obtained was the absence of a hereditary aristocracy and of big land holdings. As they fancied it, these nations had succeeded better in establishing equality than their own nations.

Then later in the nineteenth century these claims were renewed by the nationalists of the nations concerned. The cavalcade was headed by Panslavism, whose champions exalted the eminence of communal cooperation as realized in the Russian *mir* and *artel* and in the *zadruga* of the Yugoslavs. With the progress of the semantic confusion which has converted the meaning of political terms into their very opposite, the epithet “democratic” is now lavishly spent. The Moslem peoples, which never knew any form of government other than unlimited absolutism, are called democratic. Indian nationalists take pleasure in speaking of traditional Hindu democracy!

Economists and historians are indifferent with regard to all such emotional effusions. In describing the civilizations of the Asiatics as inferior civilizations they do not express any value judgments. They merely establish the fact that these peoples did not bring forth those ideological and institutional conditions which in the West produced that capitalist civilization the superiority of which the Asiatics today implicitly accept in clamoring at least for its technological and therapeutical implements and paraphernalia. It is precisely when one recognizes the fact that in the past the culture of many Asiatic peoples was far ahead of that of their Western contemporaries, that the question is raised as to what causes stopped progress in the East. In the case of the Hindu civilization the answer is obvious. Here the iron grip of the inflexible caste system stunted individual initiative and nipped in the bud every attempt to deviate from traditional standards. But China and the Mohammedan countries were, apart from the slavery of a comparatively small number of people, free from caste rigidity. They were ruled by autocrats. But the individual subjects were equal under the autocrat. Even slaves and eunuchs were not barred from access to the highest dignities. It is this equality before the ruler to which people refer today in speaking of the supposed democratic customs of these Orientals.

The notion of the economic equality of the subjects to which these peoples and their rulers were committed was not well defined but vague. But it was very distinct in one respect, namely, in utterly condemning the accumulation of a large fortune by any private individual. The rulers considered wealthy subjects a threat to their political supremacy. All people, the rulers as well as the ruled, were convinced that no man can amass abundant means otherwise than by depriving others of what by rights should belong to them, and that the riches of the wealthy few are the cause of the poverty of the many. The position of wealthy businessmen was in all oriental countries extremely precarious. They were at the mercy of the officeholders. Even lavish bribes failed to protect them against confiscation. The whole people rejoiced whenever a prosperous businessman fell victim to the envy and hatred of the administrators.

This antichrematistic spirit arrested the progress of civilization in the East and kept the masses on the verge of starvation. As capital accumulation was checked, there could be no question of technological improvement. Capitalism came to the East as an imported alien ideology, imposed by foreign armies and navies in the shape either of colonial domination or of extraterritorial jurisdiction. These violent methods were certainly not the appropriate means to change the traditionalist mentality of the Orientals. But acknowledgment of this fact does not invalidate the statement that it was the abhorrence of capital accumulation that doomed many hundreds of millions of Asiatics to poverty and starvation.

The notion of equality which our contemporary welfare propagandists have in mind is the replica of the Asiatic idea of equality. While vague in every other respect, it is very clear in its abomination of large fortunes. It objects to big business and great riches. It advocates various measures to stunt the growth of individual enterprises and to bring about more equality by confiscatory taxation of incomes and estates. And it appeals to the envy of the injudicious masses.

The immediate economic consequences of confiscatory policies have been dealt with already.4 It is obvious that in the long run such policies must result not only in slowing down or totally checking the further accumulation of capital, but also in the consumption of capital accumulated in previous days. They would not only arrest further progress toward more material prosperity, but even reverse the trend and bring about a tendency toward progressing poverty. The ideals of Asia would triumph; and finally East and West would meet on an equal level of distress.

The welfare school pretends not only to stand for the interests of the whole of society as against the selfish interests of profit-seeking business; it contends moreover that it takes into account the lasting secular interests of the nation as against the short-term concerns of speculators, promoters, and capitalists who are exclusively committed to profiteering and do not bother about the future of the whole of society. This second claim is, of course, irreconcilable with the emphasis laid by the school upon short-run policies as against long-run concerns. However, consistency is not one of the virtues of the welfare doctrinaires. Let us for the sake of argument disregard this contradiction in their statements and examine them without reference to their inconsistency.

Saving, capital accumulation, and investment withhold the amount concerned from current consumption and dedicate it to the improvement of future conditions. The saver foregoes the increase in present satisfaction in order to improve his own well-being and that of his family in the more distant future. His intentions are certainly selfish in the popular connotation of the term. But the effects of his selfish conduct are beneficial to the lasting secular interests of the whole of society as well as of all its members. His conduct produces all those phenomena to which even the most bigoted welfare propagandist attributes the epithets *economic improvement* and *progress.*

The policies advocated by the welfare school remove the incentive to saving on the part of private citizens. On one hand, the measures directed toward a curtailment of big incomes and fortunes seriously reduce or destroy entirely the wealthier people’s power to save. On the other hand, the sums which people with moderate incomes previously contributed to capital accumulation are manipulated in such a way as to channel them into the lines of consumption. When in the past a man saved by entrusting money to a savings bank or by taking out an insurance policy, the bank or the insurance company invested the equivalent. Even if the saver at a later date consumed the sums saved, no disinvestment and capital consumption resulted. The total investments of the savings banks and the insurance companies steadily increased in spite of these withdrawals.

Today there prevails a tendency to push banks and insurance companies more and more toward investment in government bonds. The funds of the social security institutions completely consist in titles to the public debt. As far as public indebtedness was incurred by spending for current expenditure, the saving of the individual does not result in capital accumulation. While in the unhampered market economy saving, capital accumulation, and investment coincide in the interventionist economy the individual citizens' savings can be dissipated by the government. The individual citizen restricts his current consumption in order to provide for his own future; in doing this he contributes his share to the further economic advancement of society and to an improvement of his fellow men's standard of living. But the government steps in and removes the socially beneficial effects of the individuals' conduct. Nothing explodes better than this example the welfare cliché that contrasts the selfish and narrow-minded individual, exclusively committed to the enjoyment of the pleasures of the moment and having no regard for the well-being of his fellow men and for the perennial concerns of society, and the far-sighted benevolent government, unflaggingly devoted to the promotion of the lasting welfare of the whole of society.

The welfare propagandist, it is true, raises two objections. First, that the individual's motive is selfishness, while the government is imbued with good intentions. Let us admit for the sake of argument that individuals are devilish and rulers angelic. But what counts in life and reality is—in spite of what Kant said to the contrary—not good intentions, but accomplishments. What makes the existence and the evolution of society possible is precisely the fact that peaceful cooperation under the social division of labor in the long run best serves the selfish concerns of all individuals. The eminence of the market society is that its whole functioning and operation is the consummation of this principle.

The second objection points out that under the welfare system capital accumulation by the government and public investment are to be substituted for private accumulation and investment. It refers to the fact that not all the funds which governments borrowed in the past were spent for current expenditure. A considerable part was invested in the construction of roads, railroads, harbors, airports, power stations, and other public works. Another no less conspicuous part was spent for waging wars of defense which admittedly could not be financed by other methods. The objection, however, misses the point. What matters is that a part of the individual's saving is employed by the government for current consumption, and that nothing hinders the government from so increasing this part that it in fact absorbs the whole.

It is obvious that if governments make it impossible for their subjects to accumulate and to invest additional capital, responsibility for the formation of new capital, if there is to be any, devolves upon government. The welfare propagandist, in whose opinion government control is a synonym for God's providential care that wisely and imperceptibly leads mankind to higher and more perfect stages of an inescapable evolutionary progress, fails to see the intricacy of the problem and its ramifications.

Not only further saving and accumulation of additional capital, but no less the maintenance of capital at its present level, require curtailing today's consumption in order to be more amply supplied later. It is abstinence, a refraining from satisfactions which could be reaped instantly.5 The market economy brings about an environment in which such abstinence is practiced to a certain extent, and in which its product, the accumulated capital, is invested in those lines in which it best satisfies the most urgent needs of the consumers. The questions arise whether government accumulation of capital can be substituted for private accumulation, and in what way a government would invest additional capital accumulated. These problems do not refer only to a socialist commonwealth. They are no less urgent in an interventionist scheme that has either totally or almost totally removed the conditions making for private capital formation. Even the United States is manifestly more and more approaching such a state of affairs.

Let us consider the case of a government that has got control of the employment of a considerable part of the citizens' savings. The investments of the social security system, of the private insurance companies, of savings banks, and of commercial banks are to a great extent determined by the authorities and channeled into the public debt. The private citizens are still savers. But whether or not their savings bring about capital accumulation and thus increase the quantity of capital goods available for an improvement of the apparatus of production depends on the employment of the funds borrowed by the government. If the government squanders these sums either by spending them for current expenditure or by malinvestment, the process of capital accumulation as inaugurated by the saving of individuals and continued by the investment operations of the banks and insurance enterprises is cut off. A contrast between the two ways may clarify the matter:

In the process of the unhampered market economy Bill saves one hundred dollars and deposits it with a savings bank. If he is wise in choosing a bank which is wise in its lending and investing business, an increment in capital results, and brings about a rise in the marginal productivity of labor. Out of the surplus thus produced a part goes to Bill in the shape of interest. If Bill blunders in the choice of his bank and entrusts his hundred dollars to a bank that fails, he goes emptyhanded.

In the process of government interference with saving and investment, Paul in the year 1940 saves by paying one hundred dollars to the national social security institution.6 He receives in exchange a claim which is virtually an unconditional government IOU. If the government spends the hundred dollars for current expenditure, no additional capital comes into existence, and no increase in the productivity of labor results. The government's IOU is a check drawn upon the future taxpayers. In 1970 a certain Peter may have to fulfill the government's promise although he himself does not derive any benefit from the fact that Paul in 1940 saved one hundred dollars.

Thus it becomes obvious that there is no need to look at Soviet Russia in order to comprehend the role that public finance plays in our day. The trumpery argument that the public debt is no burden because "we owe it to ourselves" is delusive. The Pauls of 1940 do not owe it to themselves. It is the Peters of 1970 who owe it to the Pauls of 1940. The whole system is the acme of the short-run principle. The statesmen of 1940 solve their problems by shifting them to the statesmen of 1970. On that date the statesmen of 1940 will be either dead or elder statesmen glorying in their wonderful achievement, social security.

The Santa Claus fables of the welfare school are characterized by their complete failure to grasp the problems of capital. It is precisely this defect that makes it imperative to deny them the appellation *welfare economics* with which they describe their doctrines. He who does not take into consideration the scarcity of capital goods available is not an economist, but a fabulist. He does not deal with reality but with a fabulous world of plenty. All the effusions of the contemporary welfare school are, like those of the socialist authors, based on the implicit assumption that there is an abundant supply of capital goods. Then, of course, it seems easy to find a remedy for all ills, to give to everybody "according to his needs" and to make everyone perfectly happy.

It is true that some of the champions of the welfare school feel troubled by a dim notion of the problems involved. They realize that capital must be maintained intact if the future productivity of labor is not to be impaired.[7] However, these authors too fail to comprehend that even the mere maintenance of capital depends on the skillful handling of the problems of investment, that it is always the fruit of successful speculation, and that endeavors to maintain capital intact presuppose economic calculation and thereby the operation of the market economy. The other welfare propagandists ignore the issue completely. It does not matter whether or not they endorse in this respect the Marxian scheme or resort to the invention of new chimerical notions such as "the self-perpetuating character" of useful things.[8] In any event their teachings are designed to provide a justification for the doctrine which blames oversaving and underconsumption for all that is unsatisfactory and recommends spending as a panacea.

When pushed hard by economists, some welfare propagandists and socialists admit that impairment of the average standard of living can only be avoided by the maintenance of capital already accumulated and that economic improvement depends on accumulation of additional capital. Maintenance of capital and accumulation of new capital, they say, will henceforth be a task of government. They will no longer be left to the selfishness of individuals, exclusively concerned with their own enrichment and that of their families; the authorities will deal with them from the point of view of the commonweal.

The crux of the issue lies precisely in the operation of selfishness. Under the system of inequality this selfishness impels a man to save and always to invest his savings in such a way as to fill best the most urgent needs of the consumers. Under the system of equality this motive fades. The curtailment of consumption in the immediate future is a perceptible privation, a blow to the individuals' selfish aims. The increment in the supply available in more distant periods of the future which is expected from this immediate privation is less recognizable for the average intellect. Moreover, its beneficial effects are, under a system of public accumulation, so thinly spread out that they hardly appear to a man as an appropriate compensation for what he foregoes today. The welfare school blithely assumes that the expectation that the fruits of today's saving will be reaped equally by the whole of the future generation will turn everybody's selfishness toward more saving. Thus they fall prey to a corollary of Plato's illusion that preventing people from knowing which children's parents they are will inspire them with parental feelings toward all younger people. It would have been wise if the welfare school had been mindful of Aristotle's observation that the result will rather be that all parents will be equally indifferent to all children.[9]

The problem of maintaining and increasing capital is insoluble for a socialist system which cannot resort to economic calculation. Such a socialist commonwealth lacks any method of ascertaining whether its capital equipment is decreasing or increasing. But under interventionism and under a socialist system which is still in a position to resort to economic calculation on the basis of prices established abroad, things are not so bad. Here it is at least possible to comprehend what is going on.

If such a country is under a democratic government, the problems of capital preservation and accumulation of additional capital become the main issue of political antagonisms. There will be demagogues to contend that more could be dedicated to current consumption than those who happen to be in power or the other parties are disposed to allow. They will always be ready to declare that "in the present emergency" there cannot be any question of piling up capital for later days and that, on the contrary, consumption of a part of the capital already available is fully justified. The various parties will outbid one another in promising the voters more government spending and at the same time a reduction of all taxes which do not exclusively burden the rich. In the days of laissez faire people looked upon government as an institution whose operation required an expenditure of money which must be defrayed by taxes paid by the citizens. In the individual citizens' budgets the state was an item of expenditure. Today the majority of the citizens look upon government as an agency dispensing benefits. The wage earners and the farmers expect to receive from the treasury more than they contribute to its revenues. The state is in their eyes a spender, not a taker. These popular tenets were rationalized and elevated to the rank of a quasi-economic doctrine by Lord Keynes and his disciples. Spending and unbalanced budgets are merely synonyms for capital consumption. If current expenditure, however beneficial it may be considered, is financed by taking away by inheritance taxes those parts of higher incomes which would have been employed for investment, or by borrowing, the government becomes a factor making for capital consumption. The fact that in present-day America there is probably[10] still a surplus of annual capital accumulation over annual capital consumption does not invalidate the statement that the total complex of the financial policies of the Federal Government, the States, and the municipalities tends toward capital consumption.

Many who are aware of the undesirable consequences of capital consumption are prone to believe that popular government is incompatible with sound financial policies. They fail to realize that not democracy as such is to be indicted, but the doctrines which aim at substituting the Santa Claus conception of government for the night watchman conception derided by Lassalle. What determines the course of a nation's economic policies is always the economic ideas held by public opinion. No government, whether democratic or dictatorial, can free itself from the sway of the generally accepted ideology.

Those advocating a restriction of the parliament's prerogatives in budgeting and taxation issues or even a complete substitution of authoritarian government for representative government are blinded by the chimerical image of a perfect chief of state. This man, no less benevolent than wise, would be sincerely dedicated to the promotion of his subjects' lasting welfare. The real Führer, however, turns out to be a mortal man who first of all aims at the perpetuation of his own supremacy and that of his kin, his friends, and his party. As far as he may resort to unpopular measures, he does so for the sake of these objectives. He does not invest and accumulate capital. He constructs fortresses and equips armies.

The much talked about plans of the Soviet and Nazi dictators involved restriction of current consumption for the sake of "investment." The Nazis never tried to suppress the truth that all these investments were designed as a preparation for the wars of aggression that they planned. The Soviets were less outspoken at the beginning. But later they proudly declared that all their planning was directed by considerations of war preparedness. History does not provide any example of capital accumulation brought about by a government. As far as governments invested in the construction of roads, railroads, and other useful public works, the capital needed was provided by the savings of individual citizens and borrowed by the government. But the greater part of the funds collected by the public debts was spent for current expenditure. What individuals had saved was dissipated by the government.

Even those who look upon the inequality of wealth and incomes as a deplorable thing, cannot deny that it makes for progressing capital accumulation. And it is additional capital accumulation alone that brings about technological improvement, rising wage rates, and a higher standard of living.

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4

Insecurity

The vague notion of security which the welfare doctrinaires have in mind when complaining about insecurity refers to something like a warrant by means of which society guarantees to everybody, irrespective of his achievements, a standard of living which he considers satisfactory.

Security in this sense, contend the eulogists of times gone by, was provided under the social regime of the Middle Ages. There is, however, no need to enter into an examination of these claims. Real conditions even in the much-glorified thirteenth century were different from the ideal picture painted by scholastic philosophy; these schemes were meant as a description of conditions not as they were but as they ought to be. But even these utopias of the philosophers and theologians allow for the existence of a numerous class of destitute beggars, entirely dependent on alms given by the wealthy. This is not precisely the idea of security which the modern usage of the term suggests.

The concept of security is the wage earners' and small farmers' pendant to the concept of stability held by the capitalists.[11] In the same way in which capitalists want to enjoy permanently an income which is not subject to the vicissitudes of changing human conditions, wage earners and small farmers want to make their revenues independent of the market. Both groups are eager to withdraw from the flux of historical events. No further occurrence should impair their own position; on the other hand, of course, they do not expressly object to an improvement of their material well-being. That structure of the market to which they have in the past adjusted their activities should never be altered in such a way as to force them to a new adjustment. The farmer in a European mountain valley waxes indignant upon encountering the competition of Canadian farmers producing at lower cost. The house painter boils over with rage when the introduction of a new appliance affects conditions in his sector of the labor market. It is obvious that the wishes of these people could be fulfilled only in a perfectly stagnant world.

A characteristic feature of the unhampered market society is that it is no respecter of vested interests. Past achievements do not count if they are obstacles to further improvement. The advocates of security are therefore quite correct in blaming capitalism for insecurity. But they distort the facts in implying that the selfish interests of capitalists and entrepreneurs are responsible. What harms the vested interests is the urge of the consumers for the best possible satisfaction of their needs. Not the greed of the wealthy few, but the propensity of everyone to take advantage of any opportunity offered for an improvement of his own well-being makes for producer insecurity. What makes the housepainter indignant is the fact that his fellow citizens prefer cheaper houses to more expensive ones. And the housepainter himself, in preferring cheaper commodities to dearer ones, contributes his share to the emergence of insecurity in other sectors of the labor market.

It is certainly true that the necessity of adjusting oneself again and again to changing conditions is onerous. But change is the essence of life. In an unhampered market economy the absence of security, i.e., the absence of protection for vested interests, is the principle that makes for a steady improvement in material well-being. There is no need to argue with the bucolic dreams of Virgil and of eighteenth-century poets and painters. There is no need to examine the kind of security which the real shepherds enjoyed. No one really wishes to change places with them.

The longing for security became especially intense in the great depression that started in 1929. It met with an enthusiastic response from the millions of unemployed. That is capitalism for you, shouted the leaders of the pressure groups of the farmers and the wage earners. Yet the evils were not created by capitalism, but, on the contrary, by the endeavors to “reform” and to “improve” the operation of the market economy by interventionism. The crash was the necessary outcome of the attempts to lower the rate of interest by credit expansion. Institutional unemployment was the inevitable result of the policy of fixing wage rates above the potential market height.

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5

Social Justice

In one respect at least present-day welfare propagandists are superior to most of the older schools of socialists and reformers. They no longer stress a concept of social justice with whose arbitrary precepts men should comply however disastrous the consequences may be. They endorse the utilitarian point of view. They do not oppose the principle that the only standard for appreciating social systems is judging them with regard to their ability to realize the ends sought by acting men.

However, as soon as they embark upon an examination of the operation of the market economy, they forget their sound intentions. They invoke a set of metaphysical principles and condemn the market economy beforehand because it does not conform to them. They smuggle in through a back door the idea of an absolute standard of morality which they had barred from the main entrance. In searching for remedies against poverty, inequality, and insecurity, they come step by step to endorse all the fallacies of the older schools of socialism and interventionism. They become more and more entangled in contradictions and absurdities. Finally they cannot help catching at the straw at which all earlier “unorthodox” reformers tried to grasp—the superior wisdom of perfect rulers. Their last word is always state, government, society, or other cleverly designed synonyms for the superhuman dictator.

The welfare school, foremost among them the German *Kathedersozialisten* and their adepts, the American Institutionalists, have published many thousands of volumes stuffed with punctiliously documented information about unsatisfactory conditions. In their opinion the collected materials clearly illustrate the shortcomings of capitalism. In truth they merely illustrate the fact that human wants are practically unlimited and that there is an immense field open for further improvements. They certainly do not prove any of the statements of the welfare doctrine.

There is no need to tell us that an ampler supply of various commodities would be welcome to all people. The question is whether there is any means of achieving a greater supply other than by increasing the productivity of human effort by the investment of additional capital. All the babble of the welfare propagandists aims only at one end, namely, obscuring this point, the point that alone matters. While the accumulation of additional capital is the indispensable means for any further economic progress, these people speak of “oversaving” and “overinvestment,” of the necessity of spending more and of restricting output. Thus they are the harbingers of economic retrogression, preaching a philosophy of decay and social disintegration. A society arranged according to their precepts may appear to some people as fair from the point of view of an arbitrary standard of social justice. But it will certainly be a society of progressing poverty for all its members.

For more than a century public opinion in Western countries has been deluded by the idea that there is such a thing as “the social question” or “the labor problem.” The meaning implied was that the very existence of capitalism hurts the vital interests of the masses, especially those of the wage earners and the small farmers. The preservation of this manifestly unfair system cannot be tolerated; radical reforms are indispensable.

The truth is that capitalism has not only multiplied population figures but at the same time improved the people’s standard of living in an unprecedented way. Neither economic thinking nor historical experience suggest that any other social system could be as beneficial to the masses as capitalism. The results speak for themselves. The market economy needs no apologists and propagandists. It can apply to itself the words of Sir Christopher Wren’s epitaph in St. Paul’s: *Si monumentum requiris, circumspice.*12

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CHAPTER 36

The Crisis Of Interventionism

1

The Harvest Of Interventionism

The interventionist policies as practiced for many decades by all governments of the capitalistic West have brought about all those effects which the economists predicted. There are wars and civil wars, ruthless oppression of the masses by clusters of self-appointed dictators, economic depressions, mass unemployment, capital consumption, famines.

However, it is not these catastrophic events which have led to the crisis of interventionism. The interventionist doctrinaires and their followers explain all these undesired consequences as the unavoidable features of capitalism. As they see it, it is precisely these disasters that clearly demonstrate the necessity of intensifying interventionism. The failures of the interventionist policies do not in the least impair the popularity of the implied doctrine. They are so interpreted as to strengthen, not to lessen, the prestige of these teachings. As a vicious economic theory cannot be simply refuted by historical experience, the interventionist propagandists have been able to go on in spite of all the havoc they have spread.

Yet the age of interventionism is reaching its end. Interventionism has exhausted all its potentialities and must disappear.

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2

The Exhaustion Of The Reserve Fund

The idea underlying all interventionist policies is that the higher income and wealth of the more affluent part of the population is a fund which can be freely used for the improvement of the conditions of the less prosperous. The essence of the interventionist policy is to take from one group to give to another. It is confiscation and distribution. Every measure is ultimately justified by declaring that it is fair to curb the rich for the benefit of the poor.

In the field of public finance progressive taxation of incomes and estates is the most characteristic manifestation of this doctrine. Tax the rich and spend the revenue for the improvement of the condition of the poor, is the principle of contemporary budgets. In the field of industrial relations shortening the hours of work, raising wages, and a thousand other measures are recommended under the assumption that they favor the employee and burden the employer. Every issue of government and community affairs is dealt with exclusively from the point of view of this principle.

An illustrative example is provided by the methods applied in the operation of nationalized and municipalized enterprises. These enterprises very often result in financial failure; their accounts regularly show losses burdening the state or the city treasury. It is of no use to investigate whether the deficits are due to the notorious inefficiency of the public conduct of business enterprises or, at least partly, to the inadequacy of the prices at which the commodities or services are sold to the customers. What matters is the fact that the taxpayers must cover these deficits. The interventionists fully approve of this arrangement. They passionately reject the two other possible solutions: selling the enterprises to private entrepreneurs or raising the prices charged to the customers to such a height that no further deficit remains. The first of these proposals is in their eyes manifestly reactionary because they believe that the inevitable trend of history is toward more and more socialization. The second is deemed “antisocial” because it places a heavier load upon the consuming masses. It is fairer to make the taxpayers, i.e., the wealthy citizens, bear the burden. Their ability to pay is greater than that of the average people riding the nationalized railroads and the municipalized subways, trolleys, and buses. To ask that such public utilities should be self-supporting, is, say the interventionists, a relic of the old-fashioned ideas of orthodox finance. One might as well aim at making the roads and the public schools self-supporting.

It is not necessary to argue with the advocates of this deficit policy. It is obvious that recourse to this ability-to-pay principle depends on the existence of such incomes and fortunes as can still be taxed away. It can no longer be resorted to once these extra funds have been exhausted by taxes and other interventionist measures.

This is precisely the present state of affairs in most of the European countries. The United States has not yet gone so far; but if the actual trend of its economic policies is not radically altered very soon, it will be in the same condition in a few years.

For the sake of argument we may disregard all the other consequences which the full triumph of the ability-to-pay principle must bring about and concentrate upon its financial aspects.

The interventionist in advocating additional public expenditure is not aware of the fact that the funds available are limited. He does not realize that increasing expenditure in one department enjoins restricting it in other departments. In his opinion there is plenty of money available. The income and wealth of the rich can be freely tapped. In recommending a greater allowance for the schools he simply stresses the point that it would be a good thing to spend more for education. He does not venture to prove that to raise the budgetary allowance for schools is more expedient than to raise that of another department, e.g., that of health. It never occurs to him that grave arguments could be advanced in favor of restricting public spending and lowering the burden of taxation. The champions of cuts in the budget are in his eyes merely the defenders of the manifestly unfair class interests of the rich.

With the present height of income and inheritance tax rates, this reserve fund out of which the interventionists seek to cover all public expenditure is rapidly shrinking. It has practically disappeared altogether in most European countries. In the United States the recent advances in tax rates produced only negligible revenue results beyond what would be produced by a progression which stopped at much lower rates. High surtax rates for the rich are very popular with interventionist dilettantes and demagogues, but they secure only modest additions to the revenue.[1] From day to day it becomes more obvious that large-scale additions to the amount of public expenditure cannot be financed by "soaking the rich," but that the burden must be carried by the masses. The traditional tax policy of the age of interventionism, its glorified devices of progressive taxation and lavish spending have been carried to a point at which their absurdity can no longer be concealed. The notorious principle that, whereas private expenditures depend on the size of income available, public revenues must be regulated according to expenditures, refutes itself. Henceforth, governments will have to realize that one dollar cannot be spent twice, and that the various items of government expenditure are in conflict with one another. Every penny of additional government spending will have to be collected from precisely those people who hitherto have been intent upon shifting the main burden to other groups. Those anxious to get subsidies will themselves have to foot the bill. The deficits of publicly owned and operated enterprises will be charged to the bulk of the population.

The situation in the employer-employee nexus will be analogous. The popular doctrine contends that wage earners are reaping "social gains" at the expense of the unearned income of the exploiting classes. The strikers, it is said, do not strike against the consumers but against "management." There is no reason to raise the prices of products when labor costs are increased; the difference must be borne by employers. But when more and more of the share of the entrepreneurs and capitalists is absorbed by taxes, higher wage rates, and other “social gains” of employees, and by price ceilings, nothing remains for such a buffer function. Then it becomes evident that every wage raise, with its whole momentum, must affect the prices of the products and that the social gains of each group fully correspond to the social losses of the other groups. Every strike becomes, even in the short run and not only in the long run, a strike against the rest of the people.

An essential point in the social philosophy of interventionism is the existence of an inexhaustible fund which can be squeezed forever. The whole system of interventionism collapses when this fountain is drained off: The Santa Claus principle liquidates itself.

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3

The End Of Interventionism

The interventionist interlude must come to an end because interventionism cannot lead to a permanent system of social organization. The reasons are threefold.

First: Restrictive measures always restrict output and the amount of goods available for consumption. Whatever arguments may be advanced in favor of definite restrictions and prohibitions, such measures in themselves can never constitute a system of social production.

Second: All varieties of interference with the market phenomena not only fail to achieve the ends aimed at by their authors and supporters, but bring about a state of affairs which—from the point of view of their authors' and advocates' valuations—is less desirable than the previous state of affairs which they were designed to alter. If one wants to correct their manifest unsuitableness and preposterousness by supplementing the first acts of intervention with more and more of such acts, one must go farther and farther until the market economy has been entirely destroyed and socialism has been substituted for it.

Third: Interventionism aims at confiscating the "surplus" of one part of the population and at giving it to the other part. Once this surplus is exhausted by total confiscation, a further continuation of this policy is impossible.

Marching ever further along the path of interventionism, all those countries that have not adopted full socialism of the Russian pattern are more and more approaching what is called a planned economy, i.e., socialism of the German or Hindenburg pattern. In regard to economic policies, there is nowadays little difference among the various nations and, within each nation, among the various political parties and pressure groups. The historical party names have lost their significance. There are, as far as economic policy is concerned, practically only two factions left: the advocates of the Lenin method of all-around nationalization and the interventionists. The advocates of the free market economy have little influence upon the course of events. What economic freedom still exists is the out-come of the failure of the measures resorted to by the governments, rather than of an intentional policy.

It is difficult to find out how many of the supporters of interventionism are conscious of the fact that the policies they recommend directly lead toward socialism, and how many hold fast to the illusion that what they are aiming at is a middle-of-the-road system that can last as a permanent system—a "third solution" of the problem of society's economic organization. At any rate, it is certain that all interventionists believe that the government, and the government alone, is called upon to decide in every single case whether one has to let things go as the market determines them or whether an act of intervention is needed. This means that they are prepared to tolerate the supremacy of the consumers only as far as it brings about a result of which they themselves approve. As soon as something happens in the economy that any of the various bureaucratic institutions does not like or that arouses the anger of a pressure group, people clamor for new interventions, controls, and restrictions. But for the inefficiency of the law-givers and the laxity, carelessness, and corruption of many of the functionaries, the last vestiges of the market economy would have long since disappeared.

The unsurpassed efficiency of capitalism never before manifested itself in a more beneficial way than in this age of heinous anticapitalism. While governments, political parties, and labor unions are sabotaging all business operations, the spirit of enterprise still succeeds in increasing the quantity and improving the quality of products and in rendering them more easily accessible to the consumers. In the countries that have not yet entirely abandoned the capitalistic system the common man enjoys today a standard of living for which the princes and nabobs of ages gone by would have envied him. A short time ago the demagogues blamed capitalism for the poverty of the masses. Today they rather blame capitalism for the "affluence" that it bestows upon the common man.

It has been shown that the managerial system, i.e., the assignment of ancillary tasks in the conduct of business to responsible helpers to whom a certain amount of discretion can be granted, is possible only within the frame of the profit system.[2] What characterizes the manager as such and imparts to him a condition different from that of the mere technician is that, within the sphere of his assignment, he himself determines the methods by which his actions should conform to the profit principle. In a socialist system in which there is neither economic calculation nor capital accounting nor profit computation, there is no room left for managerial activities either. But as long as a socialist commonwealth is still in a position to calculate on the ground of prices determined on foreign markets, it can also utilize a quasi-managerial hierarchy to some extent.

It is a poor makeshift to call any age an age of transition. In the living world there is always change. Every age is an age of transition. We may distinguish between social systems that can last and such as are inevitably transitory because they are self-destructive. It has already been pointed out in what sense interventionism liquidates itself and must lead to socialism of the German pattern. Some European countries have already reached this phase, and nobody knows whether or not the United States will follow suit. But as long as the United States clings to the market economy and does not adopt the system of full government control of business, the socialist economies of Western Europe will still be in a position to calculate. Their conduct of business still lacks the most characteristic feature of socialist conduct; it is still based on economic calculation. It is therefore in every respect very different from what it would become if all the world were to turn toward socialism.

It is often said that one half of the world cannot remain committed to the market economy when the other half is socialist, and vice versa. However, there is no reason to assume that such a partition of the earth and the coexistence of the two systems is impossible. If this is really the case, then the present economic system of the countries that have discarded capitalism may go on for an indefinite period of time. Its operation may result in social disintegration, chaos, and misery for the peoples. But neither a low standard of living nor progressive impoverishment automatically liquidates an economic system. It gives way to a more efficient system only if people themselves are intelligent enough to comprehend the advantages such a change might bring them. Or it may be destroyed by foreign invaders provided with better military equipment by the greater efficiency of their own economic system.

Optimists hope that at least those nations which have in the past developed the capitalist market economy and its civilization will cling to this system in the future too. There are certainly as many signs to confirm as to disprove such an expectation. It is vain to speculate about the outcome of the great ideological conflict between the principles of private ownership and public ownership, of individualism and totalitarianism, of freedom and authoritarian regimentation. All that we can know beforehand about the result of this struggle can be condensed in the following three statements:

> 1. We have no knowledge whatever about the existence and operation of agencies which would bestow final victory in this clash on those ideologies whose application will secure the preservation and further intensification of societal bonds and the improvement of mankind's material well-being. Nothing suggests the belief that progress toward more satisfactory conditions is inevitable or a relapse into very unsatisfactory conditions impossible.
> 2. Men must choose between the market economy and socialism. They cannot evade deciding between these alternatives by adopting a "middle-of-the-road" position, whatever name they may give to it.
> 3. In abolishing economic calculation the general adoption of socialism would result in complete chaos and the disintegration of social cooperation under the division of labor.

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PART 7

The Place Of Economics In Society

CHAPTER 37

The Nondescript Character Of Economics

1

The Singularity Of Economics

What assigns economics its peculiar and unique position in the orbit both of pure knowledge and of the practical utilization of knowledge is the fact that its particular theorems are not open to any verification or falsification on the ground of experience. Of course, a measure suggested by sound economic reasoning results in producing the effects aimed at, and a measure suggested by faulty economic reasoning fails to produce the ends sought. But such experience is always still historical experience, i.e., the experience of complex phenomena. It can never, as has been pointed out, prove or disprove any particular theorem.[1] The application of spurious economic theorems results in undesired consequences. But these effects never have that undisputable power of conviction which the *experimental facts* in the field of the natural sciences provide. The ultimate yardstick of an economic theorem's correctness or incorrectness is solely reason unaided by experience.

The ominous import of this state of affairs is that it prevents the naïve mind from recognizing the reality of the things economics deals with. "Real" is, in the eyes of man, all that he cannot alter and to whose existence he must adjust his actions if he wants to attain his ends. The cognizance of reality is a sad experience. It teaches the limits on the satisfaction of one's wishes. Only reluctantly does man resign himself to the insight that there are things, viz., the whole complex of all causal relations between events, which wishful thinking cannot alter. Yet sense experience speaks an easily perceptible language. There is no use arguing about experiments. The reality of experimentally established facts cannot be contested.

But in the field of praxeological knowledge neither success nor failure speaks a distinct language audible to everybody. The experience derived exclusively from complex phenomena does not bar escape into interpretations based on wishful thinking. The naïve man's propensity to ascribe omnipotence to his thoughts, however confused and contradictory, is never manifestly and unambiguously falsified by experience. The economist can never refute the economic cranks and quacks in the way in which the doctor refutes the medicine man and the charlatan. History speaks only to those people who know how to interpret it on the ground of correct theories.

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2

Economics And Public Opinion

The significance of this fundamental epistemological difference becomes clear if we realize that the practical utilization of the teachings of economics presupposes their endorsement by public opinion. In the market economy the realization of technological innovations does not require anything more than the cognizance of their reasonableness by one or a few enlightened spirits. No dullness and clumsiness on the part of the masses can stop the pioneers of improvement. There is no need for them to win the approval of inert people beforehand. They are free to embark upon their projects even if everyone else laughs at them. Later, when the new, better and cheaper products appear on the market, these scoffers will scramble for them. However dull a man may be, he knows how to tell the difference between a cheaper shoe and a more expensive one, and to appreciate the usefulness of new products.

But it is different in the field of social organization and economic policies. Here the best theories are useless if not supported by public opinion. They cannot work if not accepted by a majority of the people. Whatever the system of government may be, there cannot be any question of ruling a nation lastingly on the ground of doctrines at variance with public opinion. In the end the philosophy of the majority prevails. In the long run there cannot be any such thing as an unpopular system of government. The difference between democracy and despotism does not affect the final outcome. It refers only to the method by which the adjustment of the system of government to the ideology held by public opinion is brought about. Unpopular autocrats can only be dethroned by revolutionary upheavals, while unpopular democratic rulers are peacefully ousted in the next election.

The supremacy of public opinion determines not only the singular role that economics occupies in the complex of thought and knowledge. It determines the whole process of human history.

The customary discussions concerning the role the individual plays in history miss the point. Everything that is thought, done and accomplished is a performance of individuals. New ideas and innovations are always an achievement of uncommon men. But these great men cannot succeed in adjusting social conditions to their plans if they do not convince public opinion.

The flowering of human society depends on two factors: the intellectual power of outstanding men to conceive sound social and economic theories, and the ability of these or other men to make these ideologies palatable to the majority.

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3

The Illusion Of The Old Liberals

The masses, the hosts of common men, do not conceive any ideas, sound or unsound. They only choose between the ideologies developed by the intellectual leaders of mankind. But their choice is final and determines the course of events. If they prefer bad doctrines, nothing can prevent disaster.

The social philosophy of the Enlightenment failed to see the dangers that the prevalence of unsound ideas could engender. The objections customarily raised against the rationalism of the classical economists and the utilitarian thinkers are vain. But there was one deficiency in their doctrines. They blithely assumed that what is reasonable will carry on merely on account of its reasonableness. They never gave a thought to the possibility that public opinion could favor spurious ideologies whose realization would harm welfare and well-being and disintegrate social cooperation.

It is fashionable today to disparage those thinkers who criticized the liberal philosophers' faith in the common man. Yet, Burke and Haller, Bonald and de Maistre paid attention to an essential problem which the liberals had neglected. They were more realistic in the appraisal of the masses than their adversaries.

Of course, the conservative thinkers labored under the illusion that the traditional system of paternal government and the rigidity of economic institutions could be preserved. They were full of praise for the *ancien régime* which had made people prosperous and had even humanized war. But they did not see that it was precisely these achievements that had increased population figures and thus created an excess population for which there was no room left in the old system of economic restrictionism. They shut their eyes to the growth of a class of people which stood outside the pale of the social order they wanted to perpetuate. They failed to suggest any solution to the most burning problem with which mankind had to cope on the eve of the "Industrial Revolution."

Capitalism gave the world what it needed, a higher standard of living for a steadily increasing number of people. But the liberals, the pioneers and supporters of capitalism, overlooked one essential point. A social system, however beneficial, cannot work if it is not supported by public opinion. They did not anticipate the success of the anticapitalistic propaganda. After having nullified the fable of the divine mission of anointed kings, the liberals fell prey to no less illusory doctrines, to the irresistible power of reason, to the infallibility of the *volonté générale* [general will] and to the divine inspiration of majorities. In the long run, they thought, nothing can stop the progressive improvement of social conditions. In unmasking age-old superstitions the philosophy of the Enlightenment has once and for all established the supremacy of reason. The accomplishments of the policies of freedom will provide such an overwhelming demonstration of the blessings of the new ideology that no intelligent man will venture to question it. And, implied the philosophers, the immense majority of people are intelligent and able to think correctly.

It never occurred to the old liberals that the majority could interpret historical experience on the ground of other philosophies. They did not anticipate the popularity which ideas that they would have called reactionary, superstitious, and unreasonable acquired in the nineteenth and twentieth centuries. They were so fully imbued with the assumption that all men are endowed with the faculty of correct reasoning that they entirely misconstrued the meaning of the portents. As they saw it, all these unpleasant events were temporary relapses, accidental episodes to which no importance could be attached by the philosopher looking upon mankind's history *sub specie aeternitatis* [from the point of view of eternity]. Whatever the reactionaries might say, there was one fact which they would not be able to deny; namely, that capitalism provided for a rapidly increasing population a steadily improving standard of living.

It was precisely this fact that the immense majority did contest. The essential point in the teachings of all socialist authors, and especially in the teachings of Marx, is the doctrine that capitalism results in a progressive pauperization of the working masses. With regard to the capitalistic countries the fallacy of this theorem can hardly be ignored. With regard to the backward countries, which were only superficially affected by capitalism, the unprecedented increase in population figures does not suggest the interpretation that the masses sink deeper and deeper. These countries are poor when compared with the more advanced countries. Their poverty is the outcome of the rapid growth of population. These peoples have preferred to rear more progeny instead of raising the standard of living to a higher level. That is their own affair. But the fact remains that they had the wealth to prolong the average length of life. It would have been impossible for them to bring up more children if the means of sustenance had not been increased.

Nonetheless not only the Marxians but many allegedly "bourgeois" authors assert that Marx's anticipation of capitalist evolution has been by and large verified by the history of the last hundred years.

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CHAPTER 38

The Place Of Economics In Learning

1

The Study Of Economics

The natural sciences are ultimately based on the facts as established by laboratory experiment. Physical and biological theories are confronted with these facts, and are rejected when in conflict with them. The perfection of these theories no less than the improvement of technological and therapeutical procedures requires more and better laboratory research. These experimental ventures absorb time, painstaking effort of specialists, and costly expenditure of material. Research can no longer be conducted by isolated and penniless scientists, however ingenious. The seat of experimentation today is in the huge laboratories supported by governments, universities, endowments, and big business. Work in these institutions has developed into professional routine. The majority of those employed in it are technicians recording those facts which the pioneers, of whom some are themselves experimenters, will one day use as building stones for their theories. As far as the progress of scientific theories is concerned, the achievements of the rank-and-file researcher are only ancillary. But very often his discoveries have immediate practical results in improving the methods of therapeutics and of business.

Ignoring the radical epistemological difference between the natural sciences and the sciences of human action, people believe that what is needed to further economic knowledge is to organize economic research according to the well-tried methods of the institutes for medical, physical, and chemical research. Considerable sums of money have been spent for what is labeled economic research. In fact the subject matter of the work of all these institutes is recent economic history.

It is certainly a laudable thing to encourage the study of economic history. However instructive the result of such studies may be, one must not confuse them with the study of economics. They do not produce facts in the sense in which this term is applied with regard to the events tested in laboratory experiments. They do not deliver bricks for the construction of a posteriori hypotheses and theorems. On the contrary, they are without meaning if not interpreted in the light of theories developed without reference to them. There is no need to add anything to what has been said in this respect in the preceding chapters. No controversy concerning the causes of a historical event can be solved on the ground of an examination of the facts which is not guided by definite praxeological theories.[1]

The foundation of institutes for cancer research can possibly contribute to the discovery of methods for fighting and preventing this pernicious disease. But a business cycle research institute is of no help in endeavors to avoid the recurrence of depressions. The most exact and reliable assemblage of all the data concerning economic depressions of the past is of little use for our knowledge in this field. Scholars do not disagree with regard to these data; they disagree with regard to the theorems to be resorted to in their interpretation.

Still more important is the fact that it is impossible to collect the data concerning a concrete event without reference to the theories held by the historian at the very outset of his work. The historian does not report all facts, but only those which he considers as relevant on the ground of his theories; he omits data considered irrelevant for the interpretation of the events. If he is misled by faulty theories, his report becomes clumsy and may be almost worthless.

Even the most faithful examination of a chapter of economic history, though it be the history of the most recent period of the past, is no substitute for economic thinking. Economics, like logic and mathematics, is a display of abstract reasoning. Economics can never be experimental and empirical. The economist does not need an expensive apparatus for the conduct of his studies. What he needs is the power to think clearly and to discern in the wilderness of events what is essential from what is merely accidental.

There is no conflict between economic history and economics. Every branch of knowledge has its own merits and its own rights. Economists have never tried to belittle or deny the significance of economic history. Neither do real historians object to the study of economics. The antagonism was intentionally called into being by the socialists and interventionists who could not refute the objections raised against their doctrines by the economists. The Historical School and the Institutionalists tried to displace economics and to substitute "empirical" studies for it precisely because they wanted to silence the economists. Economic history, as they planned it, was a means of destroying the prestige of economics and of propagandizing for interventionism.

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2

Economics As A Profession

The early economists devoted themselves to the study of the problems of economics. In lecturing and writing books they were eager to communicate to their fellow citizens the results of their thinking. They tried to influence public opinion in order to make sound policies prevail in the conduct of civic affairs. They never conceived of economics as a profession.

The development of a profession of economists is an offshoot of interventionism. The professional economist is the specialist who is instrumental in designing various measures of government interference with business. He is an expert in the field of economic legislation, which today invariably aims at hindering the operation of the market economy.

There are thousands and thousands of such professional experts busy in the bureaus of the governments and of the various political parties and pressure groups and in the editorial offices of party newspapers and pressure-group periodicals. Others are employed as advisers by business or run independent agencies. Some of them have nationwide or even worldwide reputations; many are among the most influential men of their country. It often happens that such experts are called to direct the affairs of big banks and corporations, are elected into the legislature, and are appointed as cabinet ministers. They rival the legal profession in the supreme conduct of political affairs. The eminent role they play is one of the most characteristic features of our age of interventionism.

There can be no doubt that a class of men who are so preponderant includes extremely talented individuals, even the most eminent men of our age. But the philosophy that guides their activities narrows their horizon. By virtue of their connection with definite parties and pressure groups, eager to acquire special privileges, they become one-sided. They shut their eyes to the remoter consequences of the policies they are advocating. With them nothing counts but the short-run concerns of the group they are serving. The ultimate aim of their efforts is to make their clients prosper at the expense of other people. They are intent upon convincing themselves that the fate of mankind coincides with the short-run interests of their group. They try to sell this idea to the public. In fighting for a higher price of silver, of wheat, or of sugar, for higher wages for the members of their union, or for a tariff on cheaper foreign products, they claim to be fighting for the supreme good, for liberty and justice, for their nation's flowering, and for civilization.

The public looks askance upon the lobbyists and blames them for the dismal features of interventionist legislation. However, the seat of the evil is much deeper. The philosophy of the various pressure groups has penetrated the legislative bodies. There are in the present-day parliaments representatives of wheat growers, of cattle breeders, of farmers' cooperatives, of silver, of the various labor unions, of industries which cannot stand foreign competition without tariffs, and of many other pressure groups. There are few for whom the nation counts more than their pressure group. The same holds true for the departments of the administration. The cabinet minister of agriculture considers himself the champion of the interests of farming; his main objective is to make food prices soar. The minister of labor considers himself the advocate of labor unions; his foremost aim is to make the unions as formidable as possible. Each department follows its own course and works against the endeavors of the other departments.

Many people complain today about the lack of creative statesmanship. However, under the predominance of interventionist ideas, a political career is open only to men who identify themselves with the interests of a pressure group. The mentality of a union leader or of a secretary of farmers' associations is not what is required for a far-sighted statesman. Service to the shortrun interests of a pressure group is not conducive to the development of those qualities which make a great statesman. Statesmanship is invariably long-run policy; but pressure groups do not bother about the long run. The lamentable failure of the German Weimar system and of the Third Republic in France was primarily due to the fact that their politicians were merely experts in pressure group interests.

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3

Forecasting As A Profession

When the businessmen finally learned that the boom created by credit expansion cannot last and must necesarily lead to a slump, they realized that it was important for them to know in time the date of the break. They turned to the economists for advice.

The economist knows that such a boom must result in a depression. But he does not and cannot know when the crisis will appear. This depends on the special conditions of each case. Many political events can influence the outcome. There are no rules according to which the duration of the boom or of the following depression can be computed. And even if such rules were available, they would be of no use to businessmen. What the individual businessman needs in order to avoid losses is knowledge about the date of the turning point at a time when other businessmen still believe that the crash is farther away than is really the case. Then his superior knowledge will give him the opportunity to arrange his own operations in such a way as to come out unharmed. But if the end of the boom could be calculated according to a formula, all businessmen would learn the date at the same time. Their endeavors to adjust their conduct of affairs to this information would immediately result in the appearance of all the phenomena of the depression. It would be too late for any of them to avoid being victimized.

If it were possible to calculate the future state of the market, the future would not be uncertain. There would be neither entrepreneurial loss nor profit. What people expect from the economists is beyond the power of any mortal man.

The very idea that the future is predictable, that some formulas could be substituted for the specific understanding which is the essence of entrepreneurial activity, and that familiarity with these formulas could make it possible for anybody to take over the conduct of business is, of course, an outgrowth of the whole complex of fallacies and misconceptions which are at the bottom of present-day anticapitalistic policies. There is in the whole body of what is called the Marxian philosophy not the slightest reference to the fact that the main task of action is to provide for the events of an *uncertain* future. The fact that the term speculator is today used only with an opprobrious connotation clearly shows that our contemporaries do not even suspect in what the fundamental problem of action consists.

Entrepreneurial judgment cannot be bought on the market. The entrepreneurial idea that carries on and brings profit is precisely that idea which did not occur to the majority. It is not correct foresight as such that yields profits, but foresight better than that of the rest. The prize goes only to the dissenters, who do not let themselves be misled by the errors accepted by the multitude. What makes profits emerge is the provision for future needs for which others have neglected to make adequate provision.

Entrepreneurs and capitalists expose their own material well-being if they are fully convinced of the soundness of their plans. They would never venture to take their economic life into their hands because an expert advised them to do so. Those ignorant people who operate on the stock and commodity exchanges according to tips are destined to lose their money, from whatever source they may have got their inspiration and "inside" information.

In fact reasonable businessmen are fully aware of the uncertainty of the future. They realize that the economists do not dispense any reliable information about things to come and that all that they provide is interpretation of statistical data referring to the past. For the capitalists and entrepreneurs the economists' opinions about the future count only as questionable conjectures. They are skeptical and not easily fooled. But as they quite correctly believe that it is useful to know all the data which could possibly have any relevance for their affairs, they subscribe to the newspapers and periodicals publishing the forecasts. Anxious not to neglect any source of information available, big business employs staffs of economists and statisticians.

Business forecasting fails in the vain attempts to make the uncertainty of the future disappear and to deprive entrepreneurship of its inherent speculative character. But it renders some services in assembling and interpreting the available data about economic trends and developments of the recent past.

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4

Economics And The Universities

Tax-supported universities are under the sway of the party in power. The authorities try to appoint only professors who are ready to advance ideas of which they themselves approve. As all nonsocialist governments are today firmly committed to interventionism, they appoint only interventionists. In their opinion, the first duty of the university is to sell the official social philosophy to the rising generation.2 They have no use for economists.

However, interventionism prevails also at many of the independent universities.

According to an age-old tradition the objective of the universities is not only teaching, but also the promotion of knowledge and science. The duty of the university teacher is not merely to hand down to the students the complex of knowledge developed by other men. He is supposed to contribute to the enlargement of this treasure by his own work. It is assumed that he is a full-fledged member of the world-embracing republic of scholarship, an innovator and a pioneer on the road toward more and better knowledge. No university would admit that the members of its faculty are inferior to anybody in their respective fields. Every university professor considers himself equal to all other masters of his science. Like the greatest of them, he too contributes his share to the advancement of learning.

This idea of the equality of all professors is, of course, fictitious. There is an enormous difference between the creative work of the genius and the monograph of a specialist. Yet in the field of empirical research it is possible to cling to this fiction. The great innovator and the simple routinist resort in their investigations to the same technical methods of research. They arrange laboratory experiments or collect historical documents. The outward appearance of their work is the same. Their publications refer to the same subjects and problems. They are commensurable.

It is quite otherwise in theoretical sciences like philosophy and economics. Here there is nothing that the routinist can achieve according to a more or less stereotyped pattern. There are no tasks which require the conscientious and painstaking effort of sedulous monographers. There is no empirical research; all must be achieved by the power to reflect, to meditate, and to reason. There is no specialization, as all problems are linked with one another. In dealing with any part of the body of knowledge one deals actually with the whole. An eminent historian once described the psychological and educational significance of the doctoral thesis by declaring that it gives the author the proud assurance that there is a little corner, although small, in the field of learning in the knowledge of which he is second to none. It is obvious that this effect cannot be realized by a thesis on a subject of economic analysis. There are no such isolated corners in the complex of economic thought.

There never lived at the same time more than a score of men whose work contributed anything essential to economics. The number of creative men is as small in economics as it is in other fields of learning. Besides, many of the creative economists do not belong to the teaching profession. But there is a demand for thousands of university and college teachers of economics. Scholastic tradition requires that each of them should attest his worth by the publication of original contributions, not merely by compiling textbooks and manuals. An academic teacher's reputation and salary depend more on his literary work than on his didactic abilities. A professor cannot help publishing books. If he does not feel the vocation to write on economics, he turns to economic history or descriptive economics. But then, in order not to lose face, he must insist on the claim that the problems he treats are economics proper, not economic history.

He must even pretend that his writings cover the only legitimate field of economic studies, that they alone are empirical, inductive, and scientific, while the merely deductive outpourings of the "armchair" theorists are idle speculations. If he were to neglect this, he would admit that there are among the teachers of economics two classes—those who themselves have contributed to the advancement of economic thought and those who have not, although they may have done a fine job in other disciplines such as recent economic history. Thus the academic atmosphere becomes unpropitious for the teaching of economics. Many professors—happily not all of them—are intent upon disparaging "mere theory." They try to substitute an unsystematically assembled collection of historical and statistical information for economic analysis. They dissolve economics into a number of integrated branches. They specialize in agriculture, in labor, in Latin American conditions, and in many other similar subdivisions.

It is certainly one of the tasks of university training to make students familiar with economic history in general and no less with recent economic developments. But all such endeavors are doomed to failure if not firmly grounded upon a thorough acquaintance with economics. Economics does not allow of any breaking up into special branches. It invariably deals with the interconnectedness of all the phenomena of action. The catallactic problems cannot become visible if one deals with each branch of production separately. It is impossible to study labor and wages without studying implicitly commodity prices, interest rates, profit and loss, money and credit, and all the other major problems. The real problems of the determination of wage rates cannot even be touched in a course on labor. There are no such things as "economics of labor" or "economics of agriculture." There is only one coherent body of economics.

What these specialists deal with in their lectures and publications is not economics, but the doctrines of the various pressure groups. Ignoring economics, they cannot help falling prey to the ideologies of those aiming at special privileges for their group. Even those specialists who do not openly side with a definite pressure group and who claim to maintain a lofty neutrality unwittingly endorse the essential creeds of the interventionist doctrine. Dealing exclusively with the innumerable varieties of government interference with business, they do not want to cling to what they call mere negativism. If they criticize the measures resorted to, they do it only in order to recommend their own brand of interventionism as a substitute for other people's interventionism. Without a qualm they endorse the fundamental thesis of both interventionism and socialism that the unhampered market economy unfairly harms the vital interests of the immense majority for the sole benefit of callous exploiters. As they see it, an economist who demonstrates the futility of interventionism is a bribed champion of the unjust claims of big business. It is imperative to bar such scoundrels from access to the universities and their articles from being printed in the periodicals of the associations of university teachers.

The students are bewildered. In the courses of the mathematical economists they are fed formulas describing hypothetical states of equilibrium in which there is no longer any action. They easily conclude that these equations are of no use whatever for the comprehension of economic activities. In the lectures of the specialists they hear a mass of detail concerning interventionist measures. They must infer that conditions are paradoxical indeed, because there is never equilibrium, and wage rates and the prices of farm products are not so high as the unions or the farmers want them to be. It is obvious, they conclude, that a radical reform is indispensable. But what kind of reform?

The majority of the students espouse without any inhibitions the interventionist panaceas recommended by their professors. Social conditions will be perfectly satisfactory when the government enforces minimum wage rates and provides everybody with adequate food and housing, or when the sale of margarine and the importation of foreign sugar are prohibited. They do not see the contradictions in the words of their teachers, who one day lament the madness of competition and the next day the evils of monopoly, who one day complain about falling prices and the next day about rising living costs. They take their degrees and try as soon as possible to get a job with the government or a powerful pressure group.

But there are many young men who are keen enough to see through the fallacies of interventionism. They accept their teachers' rejection of the unhampered market economy. But they do not believe that the isolated measures of interventionism could succeed in attaining the ends sought. They consistently carry their preceptors' thoughts to their ultimate logical consequences. They turn toward socialism. They hail the Soviet system as the dawn of a new and better civilization.

However, what has made many of the present-day universities by and large nurseries of socialism is not so much the conditions prevailing in the departments of economics as the teachings handed down in other departments. In the departments of economics there can still be found some economists, and even the other teachers may be familiar with some of the objections raised against the practicability of socialism. The case is different with many of the teachers of philosophy, history, literature, sociology, and political science. They interpret history on the ground of a garbled vulgarization of dialectical materialism. Even many of those who passionately attack Marxism on account of its materialism and atheism are under the sway of the ideas developed in the *Communist Manifesto* and in the program of the Communist International. They explain depressions, mass unemployment, inflation, war and poverty as evils necessarily inherent in capitalism and intimate that these phenomena can disappear only with the passing of capitalism.

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5

General Education And Economics

In countries which are not harassed by struggles between various linguistic groups public education can work if it is limited to reading, writing, and arithmetic. With bright children it is even possible to add elementary notions of geometry, the natural sciences, and the valid laws of the country. But as soon as one wants to go farther, serious difficulties appear. Teaching at the elementary level necessarily turns into indoctrination. It is not feasible to represent to adolescents all the aspects of a problem and to let them choose between dissenting views. It is no less impossible to find teachers who could hand down opinions of which they themselves disapprove in such a way as to satisfy those who hold these opinions. The party that operates the schools is in a position to propagandize its tenets and to disparage those of other parties.

In the field of religious education the nineteenth-century liberals solved this problem by the separation of state and church. In liberal countries religion is no longer taught in public schools. But the parents are free to send their children into denominational schools supported by religious communities.

However, the problem does not refer only to the teaching of religion and of certain theories of the natural sciences at variance with the Bible. It concerns even more the teaching of history and economics.

The public is aware of the matter only with regard to the international aspects of the teaching of history. There is some talk today about the necessity of freeing the teaching of history from the impact of nationalism and chauvinism. But few people realize that the problem of impartiality and objectivity is no less present in dealing with the domestic aspects of history. The teacher’s or the textbook author’s own social philosophy colors the narrative. The more the treatment must be simplified and condensed in order to be comprehensible to the immature minds of children and adolescents, the worse are the effects.

As the Marxians and the interventionists see it, the teaching of history in the schools is tainted by the endorsement of the ideas of classical liberalism. They want to substitute their own interpretation of history for the “bourgeois” interpretation. In Marxian opinion the English Revolution of 1688, the American Revolution, the great French Revolution, and the nineteenth-century revolutionary movements in continental Europe were bourgeois movements. They resulted in the defeat of feudalism and in the establishment of bourgeois supremacy. The proletarian masses were not emancipated; they merely passed from the class rule of the aristocracy to the class rule of the capitalist exploiters. To free the working man, the abolition of the capitalist mode of production is required. This, contend the interventionists, should be brought about by *Sozialpolitik* or the New Deal. The orthodox Marxians, on the other hand, assert that only the violent overthrow of the bourgeois system of government could effectively emancipate the proletarians.

It is impossible to deal with any chapter of history without taking a definite stand on these controversial issues and the implied economic doctrines. The textbooks and the teachers cannot adopt a lofty neutrality with regard to the postulate that the "unfinished revolution" needs to be completed by the communist revolution. Every statement concerning events of the last three hundred years involves a definite judgment on these controversies. One cannot avoid choosing between the philosophy of the Declaration of Independence and the Gettysburg Address and that of the *Communist Manifesto.* The challenge is there, and it is useless to bury one's head in the sand.

On the high school level and even on the college level the handing down of historical and economic knowledge is virtually indoctrination. The greater part of the students are certainly not mature enough to form their own opinion on the ground of a critical examination of their teachers' representation of the subject.

If public education were more efficient than it really is, the political parties would urgently aim at the domination of the school system in order to determine the mode in which these subjects are to be taught. However, general education plays only a minor role in the formation of the political, social, and economic ideas of the rising generation. The impact of the press, the radio, and environmental conditions is much more powerful than that of teachers and textbooks. The propaganda of the churches, the political parties, and the pressure groups outstrips the influence of the schools, whatever they may teach. What is learned in school is often very soon forgotten and cannot carry on against the continuous hammering of the social milieu in which a man moves.

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6

Economics And The Citizen

Economics must not be relegated to classrooms and statistical offices and must not be left to esoteric circles. It is the philosophy of human life and action and concerns everybody and everything. It is the pith of civilization and of man's human existence.

To mention this fact is not to indulge in the often derided weakness of specialists who overrate the importance of their own branch of knowledge. Not the economists, but all the people today assign this eminent place to economics.

All present-day political issues concern problems commonly called economic. All arguments advanced in contemporary discussion of social and public affairs deal with fundamental matters of praxeology and economics. Everybody's mind is preoccupied with economic doctrines. Philosophers and theologians seem to be more interested in economic problems than in those problems which earlier generations considered the subject matter of philosophy and theology. Novels and plays today treat all things human—including sex relations—from the angle of economic doctrines. Everybody thinks of economics whether he is aware of it or not. In joining a political party and in casting his ballot, the citizen implicitly takes a stand upon essential economic theories.

In the sixteenth and seventeenth centuries religion was the main issue in European political controversies. In the eighteenth and nineteenth centuries in Europe as well as in America the paramount question was representative government versus royal absolutism. Today it is the market economy versus socialism. This is, of course, a problem the solution of which depends entirely on economic analysis. Recourse to empty slogans or to the mysticism of dialectical materialism is of no avail.

There is no means by which anyone can evade his personal responsibility. Whoever neglects to examine to the best of his abilities all the problems involved voluntarily surrenders his birthright to a self-appointed elite of supermen. In such vital matters blind reliance upon "experts" and uncritical acceptance of popular catchwords and prejudices is tantamount to the abandonment of self-determination and to yielding to other people's domination. As conditions are today, nothing can be more important to every intelligent man than economics. His own fate and that of his progeny is at stake.

Very few are capable of contributing any consequential idea to the body of economic thought. But all reasonable men are called upon to familiarize themselves with the teachings of economics. This is, in our age, the primary civic duty.

Whether we like it or not, it is a fact that economics cannot remain an esoteric branch of knowledge accessible only to small groups of scholars and specialists. Economics deals with society's fundamental problems; it concerns everyone and belongs to all. It is the main and proper study of every citizen.

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7

Economics And Freedom

The paramount role that economic ideas play in the determination of civic affairs explains why governments, political parties, and pressure groups are intent upon restricting the freedom of economic thought. They are anxious to propagandize the "good" doctrine and to silence the voice of the "bad" doctrines. As they see it, truth has no inherent power which could make it ultimately prevail solely by virtue of its being true. In order to carry on, truth needs to be backed by violent action on the part of the police or other armed troops. In this view, the criterion of a doctrine's truth is the fact that its supporters succeeded in defeating by force of arms the champions of dissenting views. It is implied that God or some mythical agency directing the course of human affairs always bestows victory upon those fighting for the good cause. Government is from God and has the sacred duty of exterminating the heretic.

It is useless to dwell upon the contradictions and inconsistencies of this doctrine of intolerance and persecution of dissenters. Never before has the world known such a cleverly contrived system of propaganda and oppression as that instituted by contemporary governments, parties, and pressure groups. However, all these edifices will crumble like houses of cards as soon as a great ideology attacks them.

Not only in the countries ruled by barbarian and neobarbarian despots, but no less in the so-called Western democracies, the study of economics is practically outlawed today. The public discussion of economic problems ignores almost entirely all that has been said by economists in the last two hundred years. Prices, wage rates, interest rates, and profits are dealt with as if their determination were not subject to any law. Governments try to decree and to enforce maximum commodity prices and minimum wage rates. Statesmen exhort businessmen to cut down profits, to lower prices, and to raise wage rates as if these matters were dependent on the laudible intentions of individuals. In the treatment of international economic relations people blithely resort to the most naïve fallacies of Mercantilism. Few are aware of the shortcomings of all these popular doctrines, or realize why the policies based upon them invariably spread disaster.

These are sad facts. However, there is only one way in which a man can respond to them: by never relaxing in the search for truth.

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CHAPTER 39

Economics And The Essential Problems Of Human Existence

1

Science And Life

It is customary to find fault with modern science because it is *wertfrei,* it abstains from expressing judgments of value. Living and acting man, we are told, has no use for *Wertfreiheit;* he needs to know what he should aim at. If science does not answer this question, it is sterile. However, the objection is unfounded. Science does not value, but it provides acting man with all the information he may need with regard to his valuations. It keeps silence only when the question is raised whether life itself is worth living.

This question, of course, has been raised too and will always be raised. What is the meaning of all these human endeavors and activities if in the end nobody can escape death and decomposition? Man lives in the shadow of death. Whatever he may have achieved in the course of his pilgrimage, he must one day pass away and abandon all that he has built. Each instant can become his last. There is only one thing that is certain about the individual's future—death. Seen from the point of view of this ultimate and inescapable outcome, all human striving appears vain and futile.

Moreover, human action must be called inane even when judged merely with regard to its immediate goals. It can never bring full satisfaction; it merely gives for an evanescent instant a partial removal of uneasiness. As soon as one want is satisfied, new wants spring up and ask for satisfaction. Civilization, it is said, makes people poorer, because it multiplies their wishes and does not soothe, but kindles, desires. All the busy doings and dealings of hard-working men, their hurrying, pushing, and bustling are nonsensical, for they provide neither happiness nor quiet. Peace of mind and serenity cannot be won by action and secular ambition, but only by renunciation and resignation. The only kind of conduct proper to the sage is escape into the inactivity of a purely contemplative existence.

Yet all such qualms, doubts, and scruples are subdued by the irresistible force of man's vital energy. True, man cannot escape death. But for the present he is alive; and life, not death, takes hold of him. Whatever the future may have in store for him, he cannot withdraw from the necessities of the actual hour. As long as a man lives, he cannot help obeying the cardinal impulse, the *élan vital.* It is man's innate nature that he seeks to preserve and to strengthen his life, that he is discontented and aims at removing uneasiness, that he is in search of what may be called happiness. In every living being there works an inexplicable and nonanalyzable *Id.* This *Id* is the impulsion of all impulses, the force that drives man into life and action, the original and ineradicable craving for a fuller and happier existence. It works as long as man lives and stops only with the extinction of life.

Human reason serves this vital impulse. Reason's biological function is to preserve and to promote life and to postpone its extinction as long as possible. Thinking and acting are not contrary to nature; they are, rather, the foremost features of man's nature. The most appropriate description of man as differentiated from nonhuman beings is: a being *purposively* struggling against the forces adverse to his life.

Hence all talk about the primacy of irrational elements is vain. Within the universe the existence of which our reason cannot explain, analyze, or conceive, there is a narrow field left within which man is capable of removing uneasiness to some extent. This is the realm of reason and rationality, of science and purposive action. Neither its narrowness nor the scantiness of the results man can obtain within it suggest the idea of radical resignation and lethargy. No philosophical subtleties can ever restrain a healthy individual from resorting to actions which—as he thinks—can satisfy his needs. It may be true that in the deepest recesses of man's soul there is a longing for the undisturbed peace and inactivity of a merely vegetative existence. But in living man these desires, whatever they may be, are outweighed by the urge to act and to improve his own condition. Once the forces of resignation get the upper hand, man dies; he does not turn into a plant.

It is true, praxeology and economics do not tell a man whether he should preserve or abandon life. Life itself and all the unknown forces that originate it and keep it burning are an ultimate given, and as such beyond the pale of human science. The subject matter of praxeology is merely the essential manifestation of *human* life, viz., action.

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2

Economics And Judgments Of Value

While many people blame economics for its neutrality with regard to value judgments, other people blame it for its alleged indulgence in them. Some contend that economics must necessarily express judgments of value and is therefore not really scientific, as the criterion of science is its valuational indifference. Others maintain that good economics should be and could be impartial, and that only bad economists sin against this postulate.

The semantic confusion in the discussion of the problems concerned is due to an inaccurate use of terms on the part of many economists. An economist investigates whether a measure *a* can bring about the result *p* for the attainment of which it is recommended, and finds that *a* does not result in *p* but in *g*, an effect which even the supporters of the measure *a* consider undesirable. If this economist states the outcome of his investigation by saying that *a* is a bad measure, he does not pronounce a judgment of value. He merely says that from the point of view of those aiming at the goal *p*, the measure *a* is inappropriate. In this sense the free-trade economists attacked protection. They demonstrated that protection does not, as its champions believe, increase but, on the contrary, decreases the total amount of products, and is therefore bad from the point of view of those who prefer an ampler supply of products to a smaller. It is in this sense that economists criticize policies from the point of view of the ends aimed at. If an economist calls minimum wage rates a bad policy, what he means is that its effects are contrary to the purpose of those who recommend their application.

From the same point of view praxeology and economics look upon the fundamental principle of human existence and social evolution, viz., that cooperation under the social division of labor is a more efficient way of acting than is the autarkic isolation of individuals. Praxeology and economics do not say that men should peacefully cooperate within the frame of societal bonds; they merely say that men must act this way *if* they want to make their actions more successful than otherwise. Compliance with the moral rules which the establishment, preservation, and intensification of social cooperation require is not seen as a sacrifice to a mythical entity, but as the recourse to the most efficient methods of action, as a price expended for the attainment of more highly valued returns.

It is against this substitution of an autonomous, rationalistic and voluntaristic ethics for the heteronomous doctrines both of intuitionism and of revealed commandments that the united forces of all antiliberal schools and dogmatisms direct the most furious attacks. They all blame the utilitarian philosophy for the pitiless austerity of its description and analysis of human nature and of the ultimate springs of human action. It is not necessary to add anything more to the refutation of these criticisms which every page of this book provides. Only one point should be mentioned again, because on the one hand it is the acme of the doctrine of all contemporary pied pipers and on the other hand it offers to the average intellectual a welcome excuse to shun the painstaking discipline of economic studies.

Economics, it is said, in its rationalistic prepossessions assumes that men aim only or first of all at material well-being. But in reality men prefer irrational objectives to rational ones. They are guided more by the urge to realize myths and ideals than by the urge to enjoy a higher standard of living.

What economics has to answer is this:

> 1. Economics does not assume or postulate that men aim only or first of all at what is called material well-being. Economics, as a branch of the more general theory of human action, deals with all human action, i.e., with man's purposive aiming at the attainment of ends chosen, whatever these ends may be. To apply the concept *rational or irrational* to the ultimate ends chosen is nonsensical. We may call irrational the ultimate given, viz., those things that our thinking can neither analyze nor reduce to other ultimately given things. Then every ultimate end chosen by any man is irrational. It is neither more nor less rational to aim at riches like Croesus than to aim at poverty like a Buddhist monk.
> 2. What these critics have in mind when employing the term *rational ends* is the desire for material well-being and a higher standard of living. It is a question of fact whether or not their statement is true that men in general and our contemporaries especially are driven more by the wish to realize myths and dreams than by the wish to improve their material well-being. Although no intelligent being could fail to give the correct answer, we may disregard the issue. For economics does not say anything either in favor of or against myths. It is perfectly neutral with regard to the labor-union doctrine, the credit-expansion doctrine and all such doctrines as far as these may present themselves as myths and are supported as myths by their partisans. It deals with these doctrines only as far as they are considered doctrines about the means fit for the attainment of definite ends. Economics does not say labor unionism is a bad myth. It merely says it is an inappropriate means of raising wage rates for all those eager to earn wages. It leaves it to every man to decide whether the realization of the labor-union myth is more important than the avoidance of the inevitable consequences of laborunion policies.

In this sense we may say that economics is apolitical or nonpolitical, although it is the foundation of politics and of every kind of political action. We may furthermore say that it is perfectly neutral with regard to all judgments of value, as it refers always to means and never to the choice of ultimate ends.

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3

Economic Cognition And Human Action

Man's freedom to choose and to act is restricted in a threefold way. There are first the physical laws to whose unfeeling absoluteness man must adjust his conduct if he wants to live. There are second the individual's innate constitutional characteristics and dispositions and the operation of environmental factors; we know that they influence both the choice of the ends and that of the means, although our cognizance of the mode of their operation is rather vague. There is finally the regularity of phenomena with regard to the interconnectedness of means and ends, viz., the praxeological law as distinct from the physical and from the physiological law.

The elucidation and the categorial and formal examination of this third class of the laws of the universe is the subject matter of praxeology and its hitherto best-developed branch, economics. The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological, and therapeutical achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race.

[1.]Cf. below, pp. 717–18.

[2.]There are, however, even today in the United States people who want to knock to pieces largescale production and to do away with corporate business.

[3.][Karl Marx, *Das Kapital, 7th ed.* (Hamburg, 1914). Vol. I, p. 428. English translation, *Capital* I. (New York: Random House, Modern Library), p. 836.]

[4.]*Ibid.*

[1.]Cf. above, pp. 246–50.

[2.]It would hardly be worthwhile even to mention this suggestion if it were not the solution that emanated from the very busy and obtrusive circle of the "logical positivists" who flagrantly advertise their program of the "unified science." Cf. the writings of the late chief organizer of this group, Otto Neurath, who in 1919 acted as the head of the socialization bureau of the short-lived Soviet republic of Munich, especially his *Durch die Kriegswirtschaft zur Naturalwirtschaft* (Munich, 1919), pp. 216 ff. Cf. also C. Landauer, *Planwirtschaft und Verkehrswirtschaft* (Munich and Leipzig, 1931), p. 122.

[3.]“Better” means, of course, more satisfactory from the point of view of the consumers buying on the market.

[4.]This refers, of course, only to those socialists or communists who, like professors H. D. Dickinson and Oskar Lange, are conversant with economic thought. The dull hosts of the “intellectuals” will not abandon their superstitious belief in the superiority of socialism. Superstitions die hard.

[5.]Cf. above, pp. 305–8.

[6.]Cf. Mises, *Socialism* (Macmillan, 1937; Yale, 1952), pp. 137–42; (Liberty Fund, 1981), pp. 119–32. Hayek, *Individualism and Economic Order* (Chicago, 1948), pp. 119–208; T. J. B. Hoff, *Economic Calculation in the Socialist Society* (London, 1949), pp. 129 ff.

[7.]Cf. H. D. Dickinson, *Economics of Socialism* (Oxford, 1939), p. 191.

[8.]For an analysis of the scheme of a corporative state see below, pp. 816–20.

[9.]Supply means a total inventory in which the whole supply available is specified in classes and quantities. Each class comprehends only such items as have in any regard (for instance, also in regard to their location) precisely the same importance for want-satisfaction.

[10.]Of course, we may assume that $T1$ is equal to Tn if we are prepared to imply that technological knowledge has reached its final stage.

[11.]With regard to this algebraic problem, cf. Pareto, *Manuel d’économie politique* (2d ed. Paris, 1927), pp. 233 f.; and Hayek, *Collectivist Economic Planning* (London, 1935), pp. 207–14. Therefore the construction of electronic computers does not affect our problem.

[1.]See above, pp. 258–59.

[2.]See below, pp. 758–67.

[3.]Cf. A. H. Hansen, “Social Planning for Tomorrow,” in *The United States after the War* (Cornell University Lectures, Ithaca, 1945), pp. 32–33.

[4.]See above, pp. 315–16.

[5.](3d ed. Oxford, 1934), p. 74.

[6.](5th ed. Springfield, 1946), p. 73.

[7.]Cf. Laski’s broadcast, “Revolution by Consent,” reprinted in *Talks,* X, no. 10 (October, 1945), 7.

[8.]It is usual today to plead the cause of communist revolutions by denouncing the attacked noncommunist government as corrupt. Thus one tried to justify the support that a part of the American press and some of the representatives of the American Administration gave first to the Chinese communists and then to those of Cuba by calling the regime of Chiang Kai-shek and later that of Batista corrupt. But from this point of view, every communist revolution against a government that is not fully committed to laissez faire appears as justified.

[1.]Cf. Harley Lutz, *Guideposts to a Free Economy* (New York, 1945), p. 76.

[2.]This is the customary method of dealing with problems of public finance. Cf., e.g., Ely, Adams, Lorenz, and Young, *Outlines of Economics* (3d ed. New York, 1920), p. 702.

[3.]*Ibid.*

[1.]Entrepreneurial profits and losses are not affected by prolabor legislation as they entirely depend on the more or less successful adjustment of production to the changing conditions of the market. With regard to these, labor legislation counts only as a factor producing change.

[2.]Cf. above, pp. 614–17.

[3.]This consistency was displayed by some Nazi philosophers. Cf. Sombart, *A New Social Philosophy,* pp. 242–45.

[4.]See above, pp. 479–88.

[5.]For a detailed analysis, cf. above, p. 627.

[6.]See above, pp. 448–52.

[7.]See also what has been said about the function of cartels on pp. 365–69.

[8.]As for the objections raised against this thesis from the point of view of the Ricardo effect, see below, pp. 773–76.

[1.]For the sake of simplicity we deal in the further disquisitions of this section only with maximum prices for commodities and in the next section only with minimum wage rates. However, our statements are, *mutatis mutandis,* equally valid for minimum prices for commodities and maximum wage rates.

[2.]Cf. above, pp. 395–97.

[3.]Cf. Rostovtzeff, *The Social and Economic History of the Roman Empire* (Oxford, 1926), p. 187.

[4.]*Corpus Juris Civilis,* 1. un. C. X. 37.

[5.]Cf. W. H. Beveridge, *Full Employment in a Free Society* (London, 1944), pp. 92 f.

[6.]Cf. Hutt, *The Theory of Collective Bargaining,* pp. 10–21.

[7.]Cf. Marx, *Value, Price and Profit,* ed. E. Marx Aveling (Chicago, Charles H. Kerr & Company), p. 125.

[8.]Cf. A. Lozovsky, *Marx and the Trade Unions* (New York, 1935), p. 17.

[9.]Cf. Marx, *op. cit.,* pp. 126–27.

[10.]Cf. below, pp. 804–20.

[11.]Cf. above, pp. 301–3.

[12.]Cf. Ricardo, *Principles of Political Economy and Taxation,* chap. i, sec. v. The term, *Ricardo effect* is used by Hayek, *Profits, Interest and Investment* (London, 1939), p. 8.

[13.]As we are dealing here with the conditions of the unhampered market economy, we may disregard the capital-consuming effects of government borrowing.

[14.]See above, pp. 522–23.

[15.]The example is merely hypothetical. Such a powerful union would probably prohibit the employment of mechanical devices in the loading and unloading of ships in order to "create more jobs."

[16.]Cf. Keynes, *The General Theory of Employment, Interest and Money* (London, 1936), p. 264. For a critical examination of this idea see Albert Hahn, *Deficit Spending and Private Enterprise,* Postwar Readjustments Bulletin No. 8, U.S. Chamber of Commerce, pp. 28–29; Henry Hazlitt, *The Failure of the "New Economics"* (Princeton, 1959), pp. 263–95. About the success of the Keynesian stratagem in the 'thirties, cf. below, pp. 792–93.

[17.]Cf. Sylvester Petro, *The Labor Policy of the Free Society* (New York, 1957); Roscoe Pound, *Legal Immunities of Labor Unions* (Washington, D.C., American Enterprise Association, 1957).

[1.]See above, pp. 411–13.

[2.]See above, p. 461.

[3.]See below, section 6 of this chapter.

[4.]Cf. P. A. Samuelson, "Lord Keynes and the *General Theory,*" *Econometrica,* 14 (1946), 187; reprinted in *The New Economics,* ed. S. E. Harris (New York, 1947), p. 145.

[5.]If a bank does not expand circulation credit by issuing additional fiduciary media (either in the form of banknotes or in the form of deposit currency), it cannot generate a boom even if it lowers the amount of interest charged below the rate of the unhampered market. It merely makes a gift to the debtors. The inference to be drawn from the monetary cycle theory by those who want to prevent the recurrence of booms and of the subsequent depressions is not that the banks should not lower the rate of interest, but that they should abstain from credit expansion. Of course, credit expansion necessarily entails a temporary downward movement of market interest rates. Professor Haberler (*Prosperity and Depression,* pp. 65–66) has completely failed to grasp this primary point, and thus his critical remarks are vain.

[6.]Cf. Machlup, *The Stock Market, Credit and Capital Formation,* pp. 256–61.

[7.]Cf. League of Nations, *Economic Stability in the Post-War World,* Report of the Delegation on Economic Depressions, Pt. II (Geneva, 1945), p. 173.

[8.]In dealing with the contracyclical policies the interventionists always refer to the alleged success of these policies in Sweden. It is true that public capital expenditure in Sweden was actually doubled between 1932 and 1939. But this was not the cause, but an effect, of Sweden's prosperity in the 'thirties. This prosperity was entirely due to the rearmament of Germany. This Nazi policy increased the German demand for Swedish products on the one hand and restricted, on the other hand, German competition on the world market for those products which Sweden could supply. Thus Swedish exports increased from 1932 to 1938 (in thousands of tons): iron ore from 2,219 to 12,485; pig iron from 31,047 to 92,980; ferro-alloys from 15,453 to 28,605; other kinds of iron and steel from 134,237 to 256,146; machinery from 46,230 to 70,605. The number of unemployed applying for relief was 114,000 in 1932 and 165,000 in 1933. It dropped, as soon as German rearmament came into full swing, to 115,000 in 1934, to 62,000 in 1935, and was 16,000 in 1938. The author of this "miracle" was not Keynes, but Hitler.

[1.]There is no need to emphasize again that the use of the terminology of political rule is entirely inadequate in the treatment of economic problems. See above, pp. 272–73.

[2.]Cf. A. B. Lerner, *The Economics of Control, Principles of Welfare Economics* (New York, 1944), pp. 307–8.

[3.]Cf. above, pp. 539–40.

[4.]Cf. above, pp. 521–23.

[5.]In using the term "capital goods available," due consideration should be given to the problem of convertibility.

[1.]Cf. F. R. Fairchild, *Profits and the Ability to Pay Wages* (Irvington-on-Hudson, 1946), p. 47.

[2.]The most elaborate description of guild socialism is provided by Sidney and Beatrice Webb, *A Constitution for the Socialist Commonwealth of Great Britain* (London, 1920); the best book on corporativism is Ugo Papi, *Lezioni di Economia Generale e Corporativa,* Vol. III (Padova, 1934).

[3.]Mussolini declared on January 13, 1934, in the Senate: "Solo in un secondo tempo, quando le categorie non abbiano trovato la via dell' accordo e dell' equilibrio, lo Stato potrà intervenire." (Quoted by Papi, *op. cit.,* p. 225.) [Only at a later stage, if the guilds (*corporazione*) have not succeeded in reaching an acceptable agreement, will the State be able to intervene.]

[4.]Sidney and Beatrice Webb, *op. cit.,* pp. 227 ff.

[1.]The best presentation of the traditional interpretation is provided by the book, *Makers of Modern Strategy, Military Thought from Machiavelli to Hitler,* ed. E. M. Earle (Princeton University Press, 1944); cf. especially the contribution of R. R. Palmer, pp. 49–53.

[2.]In this sense wheat produced, under the protection of an import duty, within the Reich's territory is *Ersatz* too: it is produced at higher costs than foreign wheat. The notion of *Ersatz* is a catallactic notion, and must not be defined with regard to technological and physical properties of the articles.

[3.]Cf. Hegel *Vorlesungen über die Philosophie der Weltgeschichte,* ed. Lasson (Leipzig, 1920), IV, 930–31.

[1.]Cf. Sulzbach, *German Experience with Social Insurance* (New York, 1947), pp. 22–32.

[2.]Cf. above, pp. 288–89 and pp. 806–8.

[3.]Cf. above, p. 312.

[4.]Cf. above, pp. 804–9.

[5.]To establish this fact is, to be sure, not an endorsement of the theories which tried to describe interest as the "reward" of abstinence. There is in the world of reality no mythical agency that rewards or punishes. What originary interest really is has been shown above in Chapter 19. But as against the would-be ironies of Lassalle (*Herr Bastiat-Schulze von Delitzsch* in *Gesammelte Reden und Schriften,* ed. Bernstein, V, 167), reiterated by innumerable textbooks, it is good to emphasize that saving is privation (*Entbehrung*) in so far as it deprives the saver of an instantaneous enjoyment.

[6.]It makes no difference whether Paul himself pays these hundred dollars or whether the law obliges his employer to pay it. Cf. above, p. 602.

[7.]This refers especially to the writings of Professor A. C. Pigou, the various editions of his book *The Economics of Welfare* and miscellaneous articles. For a critique of Professor Pigou's ideas, cf. Hayek, *Profits, Interest and Investment* (London, 1939), pp. 83–134.

[8.]Cf. F. H. Knight, "Professor Mises and the Theory of Capital," *Economica,* VIII (1941), 409–27.

[9.]Cf. Aristotle, *Politics,* Bk. II, chap. iii in *The Basic Works of Aristotle,* ed. R. McKeon (New York, 1945), pp. 1148 f.

[10.]The attempts to answer this question by statistics are futile in this age of inflation and credit expansion.

[11.]Cf. above, pp. 225–27.

[12.]If you seek [his] monument, look around.

[1.]In the United States the surtax rate under the 1942 Act was 52 per cent on the taxable income bracket $22,000–26,000. If the surtax had stopped at this level, the loss of revenue on 1942 income would have been about $249 million or 2.8 per cent of the total individual income tax for that year. In the same year the total net incomes in the income classes of $10,000 and above was $8,912 million. Complete confiscation of these incomes would not have produced as much revenue as was obtained in this year from all taxable incomes, namely, $9,046 million. Cf. *A Tax Program for a Solvent America,* Committee on Postwar Tax Policy (New York, 1945), pp. 116–17, 120.

[2.]Cf. above, pp. 305–8.

[1.]Cf. above, pp. 31–32.

[1.]Cf., about the essential epistemological problems involved, pp. 31–41, about the problem of "quantitative" economics, pp. 55–57 and 350–52, and about the antagonistic interpretation of labor conditions under capitalism, pp. 617–23.

[2.]G. Santayana, in speaking of a professor of philosophy of the—then Royal Prussian—University of Berlin, observed that it seemed to this man "that a professor's business was to trudge along the governmental towpath with a legal cargo." (*Persons and Places* [New York, 1945], II, 7.)