

both short run and long run.

Some people criticize economics for alleged neglect of the short-run affects and for alleged preference given to the study of the long-run effects. The reproach is nonsensical. Economics has no means of scrutinizing the results of a change in the data other than to start with its immediate consequences and to analyze, step by step, proceeding from the first reaction to the remoter reactions, all the subsequent consequences, until it finally arrives at its ultimate consequences. The long-run analysis necessarily always fully includes the short-run analysis.

It is easy to understand why certain individuals, parties and pressure groups are eager to propagate the exclusive sway of the short-run principle. Politics, they say, should never be concerned about the long-run effects of a device and should never abstain from resorting to a measure form which benefits are expected in the short run merely because its long-run effects are detrimental. What counts is only the short-run effects; "in the long run we shall all be dead." All that economics has to answer to these passionate critics is that every decision should be based on a careful weighing of all its consequences, both those in the short run and those in the long run. there are certainly, both in the actions of individuals and in the conduct of public affairs, situations in which the actors may have good reasons to put up even with very undesirable long-run effects in order to avoid what they consider still more undesirable short-run conditions. It may sometimes be expedient for a man to heat the stove with his furniture. But if he does, he should know what the remoter effects will be. He should not delude himself by believing that he has discovered a wonderful new method of heating his premises.

That is all that economics opposes to the frenzy of the short-run principle==this revival of Madame de Pompadour's notorious phrase *apres nous le deluge*—played in the most serious crisis of Western civilization. It will have to show how welcome this slogan was to governments and parties whose policies aimed at the consumption of the spiritual and material capital inherited from earlier generations.

6. The Limits of Property Rights and the Problems of External Costs and External Economies

Property rights as they are circumscribed by laws and protected by courts and the police, are the outgrowth of an age-long evolution. The history of these ages is the record of struggles aiming at the abolition of private

property. Again and again despots and popular movements have tried to restrict the rights of private property or to abolish it altogether. These endeavors, it is true, failed. But they have left traces in the ideas determining the legal form and definition of property. The legal concepts of property do not fully take account of the social function of private property. There are certain inadequacies and incongruities which are reflected in the determination of the market phenomena.

Carried through consistently, the right of property would entitle the proprietor to claim all the advantages which the good's employment may generate on the one hand and would burden him with all the disadvantages resulting from its employment on the other hand. Then the proprietor alone would be fully responsible for the outcome. In dealing with his property he would take into account all the expected results of his action, those considered favorable as well as those considered unfavorable. But if some of the consequences of his action are outside of the sphere of the benefits he is entitled to reap and of the drawbacks that are put to his debit, he will not bother in his planning about *all* the effects of his action. He will disregard those benefits which do not increase his own satisfaction and those costs which do not burden him. His conduct will deviate from the line which it would have followed if the laws were better adjusted to the economic objectives of private ownership. He will embark upon certain projects only because the laws release him from responsibility for some of the costs incurred. He will abstain from other projects merely because the laws prevent him from harvesting all the advantages derivable.

The laws concerning liability and indemnification for damages caused were and still are in some respects deficient. By and large the principle is accepted that everybody is liable to damages which his actions have inflicted upon other people. But there were loopholes left which the legislators were slow to fill. In some cases this tardiness was intentional because the imperfections agreed with the plans of the authorities. When in the past in many countries the owners of factories and railroads were not held liable for the damages which the conduct of their enterprises inflicted on the property and health of neighbors, patrons, employees, and other people through smoke, soot, noise, water pollution, and accidents caused by defective or inappropriate equipment, the idea was that one should not undermine the progress of industrialization and the development of transportation facilities. The same doctrines which prompted and still are prompting many governments to encourage investment in factories and railroads through subsidies, tax exemption, tariffs, and cheap credit were

at work in the emergence of a legal state of affairs in which the liability of such enterprises was either formally or practically abated. Later again the opposite tendency began to prevail in many countries and the liability of manufacturers and railroads was increased as against that of other citizens and firms. Here again definite political objectives were operative. Legislators wished to protect the poor, the wage earners, and the peasants against the wealthy entrepreneurs and capitalists.

Whether the proprietor's relief from responsibility for some of the disadvantages resulting from his conduct of affairs is the outcome of a deliberate policy on the part of governments and legislators or whether it is an unintentional effect of the traditional working of laws, it is at any rate a datum which the actors must take into account. They are faced with the problem of *external costs*. Then some people choose certain modes of want-satisfaction merely on account of the fact that a part of the costs incurred are debited not to them but to other people.

The extreme instance is provided by the case of no-man's property referred to above.⁹ If land is not owned by anybody, although legal formalism may call it public property, it is utilized without any regard to the disadvantages resulting. Those who are in a position to appropriate to themselves the returns—lumber and game of the forests, fish of the water areas, and mineral deposits of the subsoil—do not bother about the later effects of their mode of exploitation. For them the erosion of the soil, the depletion of the exhaustible resources and other impairments of the future utilization are external costs not entering into their calculation of input and output. They cut down the trees without any regard for fresh shoots or reforestation. In hunting and fishing they do not shrink from methods preventing the repopulation of the hunting and fishing grounds. In the early days of human civilization, when soil of a quality not inferior to that of the utilized pieces was still abundant, people did not find any fault with such predatory methods. When their effects appeared in a decrease in the net returns, the ploughman abandoned his farm and moved to another place. It was only when a country was more densely settled and unoccupied first class land was no longer available for appropriation, that people began to consider such predatory methods wasteful. At that time they consolidated the institution of private property in land. They started with arable land and then, step by step, included pastures, forests, and fisheries. The newly settled colonial countries

9. See above, p. 639.

overseas, especially the vast spaces of the United States, whose marvelous agricultural potentialities were almost untouched when the first colonists from Europe arrived, passed through the same stages. Until the last decades of the nineteenth century there was always a geographic zone open to newcomers—the frontier. Neither the existence of the frontier nor its passing was peculiar to America. What characterizes American conditions is the fact that at the time the frontier disappeared ideological and institutional factors impeded the adjustment of the methods of land utilization to the change in the data.

In the central and western areas of continental Europe, where the institution of private property had been rigidly established for many centuries, things were different. There was no question of soil erosion of formerly cultivated land. There was no problem of forest devastation in spite of the fact that the domestic forests had been for ages the only source of lumber for construction and mining and of fuel for heating and for the foundries and furnaces, the potteries and the glass factories. The owners of the forests were impelled to conservation by their own selfish interests. In the most densely inhabited and industrialized areas up to a few years ago between a fifth and a third of the surface was still covered by first-class forests managed according to the methods of scientific forestry.¹⁰

It is not the task of catallactic theory to elaborate an account of the complex factors that produced modern American land-ownership conditions. Whatever these factors were, they brought about a state of affairs under which a great many farmers and lumber enterprises had reason to consider the disadvantages resulting from the neglect of soil and forest conservation as external costs.¹¹

It is true that where a considerable part of the costs incurred are external costs from the point of view of the acting individuals or firms, the economic calculation established by them is manifestly defective and their results

10. Late in the eighteenth century European governments began to enact laws aiming at forest conservation. However, it would be a serious blunder to ascribe to these laws any role in the conservation of the forests. Before the middle of the nineteenth century there was no administrative apparatus available for their enforcement. Besides the governments of Austria and Prussia, to say nothing of those of the smaller German states, virtually lacked the power to enforce to such laws against the aristocratic lords. No civil servant before 1914 would have been bold enough to rouse the anger of a Bohemian or Silesian magnate or a German mediatized *standesheer*. These princes and counts were spontaneously committed to forest conservation because they felt perfectly safe in the possession of their property and were eager to preserve unabated the source of their revenues and the market price of their estates.

11. One could as well say that they considered the advantage to be derived from giving care to soil and forest conservation external economies.

deceptive. But this is not the outcome of alleged deficiencies inherent in the system of private ownership of the means of production. It is on the contrary a consequence of loopholes left in this system. It could be removed by a reform of the laws concerning liability for damages inflicted and by rescinding the institutional barriers preventing the full operation of private ownership.

The case of external economies is not simply the inversion of the case of external costs. It has its own domain and character. If the results of an actor's action benefit not only himself, but also other people, two alternatives are possible:

1. The planning actor considers the advantages which he expects for himself so important that he is prepared to defray all the costs required. The fact that his project also benefits other people will not prevent him from accomplishing what promotes his own well-being. When a railroad company erects dikes to protect its tracks against snowslides and avalanches, it also protects the houses on adjacent grounds. But the benefits which its neighbors will derive will not hinder the company from embarking upon an expenditure that it deems expedient.

2. The costs incurred by a project are so great that none of those whom it will benefit is ready to expend them in full. The project can be realized only if a sufficient number of those interested in it share in the costs.

It would hardly be necessary to say more about external economies if it were not for the fact that this phenomenon is entirely misinterpreted in current pseudo-economic literature.

A project *P* is unprofitable when and because consumers prefer the satisfaction expected from the realization of some other projects to the satisfaction expected from the realization of *P*. The realization of *P* would withdraw capital and labor from the realization of some other projects for which the demand of the consumers is more urgent. The layman and the pseudo-economist fail to recognize this fact. They stubbornly refuse to notice the scarcity of the factors of production. As they see it, *P* could be realized without any cost at all, i.e., without foregoing any other satisfaction. It is merely the wantonness of the profit system that prevents the nation from enjoying gratuitously the pleasures expected from *P*.

Now, these short-sighted critics go on to say, the absurdity of the profit system becomes especially outrageous if the unprofitability of *P* is merely due to the fact that the entrepreneur's calculations neglect those advantages of *P* which for them are external economies. From the point of view of the whole of society such advantages are not external. They benefit at least some

members of society and would increase "total welfare." The nonrealization of *P* is therefore a loss for society. As profit-seeking business, entirely committed to selfishness, declines to embark upon such unprofitable projects, it is the duty of government to fill the gap. Government should either run them as public enterprises or it should subsidize them in order to make them attractive for the private entrepreneur and investor. The subsidies may be granted either directly by money grants from public funds or indirectly by means of tariffs the incidence of which falls upon the buyers of the products.

However, the means which a government needs in order to run a plant at a loss or to subsidize an unprofitable project must be withdrawn either from the taxpayers' spending and investing power or from the loan market. The government has no more ability than individuals to create something out of nothing. What the government spends more, the public spends less. Public works are not accomplished by the miraculous power of a magic wand. They are paid for by funds taken away from the citizens. If the government had not interfered, the citizens would have employed them for the realization of profit-promising projects the realization of which they must omit because their means have been curtailed by the government. For every unprofitable project that is realized by the aid of the government there is a corresponding project the realization of which is neglected merely on account of the government's intervention. Yet this nonrealized project would have been profitable, i.e., it would have employed the scarce means of production in accordance with the most urgent needs of the consumers. From the point of view of the consumers the employment of these means of production for the realization of an unprofitable project is wasteful. It deprives them of satisfactions which they prefer to those which the government-sponsored project can furnish them.

The gullible masses who cannot see beyond the immediate range of their physical eyes are enraptured by the marvelous accomplishments of their rulers. They fail to see that they themselves foot the bill and must consequently renounce many satisfactions which they would have enjoyed if the government had spent less for unprofitable projects. They have not the imagination to think of the possibilities that the government has not allowed to come into existence.¹²

These enthusiasts are still more bewildered if the government's interference enables submarginal producers to continue producing and to stand the

12.Cf. the brilliant analysis of public spending in Henry Hazlitt's book *Economics in One Lesson* (new ed. New York, 1962), pp. 21 ff.

competition of more efficient plants, shops, or farms. Here, they say, it is obvious that total production is increased and something is added to the wealth that would not have been produced without the assistance of the authorities. What happens in fact is just the opposite; the magnitude of total production and of total wealth is curtailed. Outfits producing at higher costs are brought into existence or preserved while other outfits producing at lower costs are forced to curtail or to discontinue their production. The consumers are not getting more, but less.

There is, for instance, the very popular idea that it is a good thing for the government to promote the agricultural development of those parts of the country which nature has poorly endowed. Costs of production are higher in these districts than in other areas; it is precisely this fact that qualifies a large part of their soil as submarginal. When unaided by public funds, the farmers tilling these submarginal lands could not stand the competition of the more fertile farms. Agriculture would shrink or fail to develop and the whole area would become a backward part of the country. In full cognizance of this state of affairs profit-seeking business avoids investing in the construction of railroads connecting such inauspicious areas with the centers of consumption. The plight of the farmers is not caused by the fact that they lack transportation facilities. The causation is the other way round; because business realizes that the prospects for these farmers are not propitious, it abstains from investing in railroads which are likely to become unprofitable for lack of a sufficient amount of goods to be shipped. If the government, yielding to the demands of the interested pressure groups, builds the railroad and runs it at a deficit, it certainly benefits the owners of farm land in those poor districts of the country. As a part of the costs that the shipping of their products requires is borne by the treasury, they find it easier to compete with those tilling more fertile land to whom such aid is denied. But the boon of these privileged farmers is paid for by the taxpayers who must provide the funds required to defray the deficit. It affects neither the market price nor the total available supply of agricultural products. It merely makes profitable the operation of farms which hitherto were submarginal and makes other farms, the operation of which was hitherto profitable, submarginal. It shifts production from land requiring lower costs to land requiring higher costs. It does not increase total supply and wealth, it curtails them, as the additional amounts of capital and labor required for the cultivation of high-cost fields instead of low-cost fields are withheld from employments in which they would have made possible the production of some other consumers' goods. The government

attains its end of benefiting some parts of the country with what they would have missed, but it produces somewhere else costs which exceed these gains of a privileged group.

The External Economies of Intellectual Creation

The extreme case of external economies is shown in the “production” of the intellectual groundwork of every kind of processing and constructing. The characteristic mark of formulas, i.e., the mental devices directing the technological procedures, is the inexhaustibility of the services they render. These services are consequently not scarce, and there is no need to economize their employment. Those considerations that resulted in the establishment of the institution of private ownership of economic goods did not refer to them. They remained outside the sphere of private property not because they are immaterial, intangible, and impalpable, but because their serviceableness cannot be exhausted.

People began to realize only later that this state of affairs has its drawbacks too. It places the producers of such formulas—especially the inventors of technological procedures and authors and composers—in a peculiar position. They are burdened with the cost of production, while the services of the product they have created can be gratuitously enjoyed by everybody. What they produce is for them entirely or almost entirely external economies.

If there are neither copyrights nor patents, the inventors and authors are in the position of an entrepreneur. They have a temporary advantage as against other people. As they start sooner in utilizing their invention or their manuscript themselves or in making it available for use to other people (manufacturers or publishers), they have the chance to earn profits in the time interval until everybody can likewise utilize it. As soon as the invention or the content of the book are publicly known, they become “free goods” and the inventor or author has only his glory.

The problem involved has nothing to do with the activities of the creative genius. These pioneers and originators of things unheard of do not produce and work in the sense in which these terms are employed in dealing with the affairs of other people. They do not let themselves be influenced by the response their work meets on the part of their contemporaries. They do not wait for encouragement.¹³

It is different with the broad class of professional intellectuals whose services society cannot do without. We may disregard the problem of second-rate authors of poems, fiction, and plays and second-rate composers and need not inquire whether it would be a serious disadvantage for mankind to lack the products of their efforts. But it is obvious that handing down

13. See above, pp. 139-140.

knowledge to the rising generation and familiarizing the acting individuals with the amount of knowledge they need for the realization of their plans require textbooks, manuals, handbooks, and other nonfiction works. It is unlikely that people would undertake the laborious task of writing such publications if everyone were free to reproduce them. This is still more manifest in the field of technological invention and discovery. The extensive experimentation necessary for such achievements is often very expensive. It is very probable that technological progress would be seriously retarded if, for the inventor and for those who defray the expenses incurred by his experimentation, the results obtained were nothing but external economies.

Patents and copyrights are results of the legal evolution of the last centuries. Their place in the traditional body of property rights is still controversial. People look askance at them and deem them irregular. They are considered privileges, a vestige of the rudimentary period of their evolution when legal protection was accorded to authors and investors only by virtue of an exceptional privilege granted by the authorities. They are suspect, as they are lucrative only if they make it possible to sell at monopoly prices.¹⁴ Moreover, the fairness of patent laws is contested on the ground that they reward only those who put the finishing touch leading to practical utilization of achievements of many predecessors. These precursors go empty-handed although their main contribution to the final result was often much more weighty than that of the patentee.

It is beyond the scope of catallactics to enter into an examination of the arguments brought forward for and against the institution of copyrights and patents. It has merely to stress the point that this is a problem of delimitation of property rights and that with the abolition of patents and copyrights authors and inventors would for the most part be producers of external economies.

Privileges and Quasi-privileges

The restrictions which laws and institutions impose upon the discretion to choose and to act are not always so insurmountable that they could not be overcome under certain conditions. To some favorites exemption from the obligation binding the rest of the people may be granted as an explicit privilege either by the laws themselves or by an administrative act of the authorities entrusted with the law's enforcement. Some may be ruthless enough to defy the laws in spite of the vigilance of the authorities; their daring insolence secures them a quasi-privilege.

A law that nobody observes is ineffectual. A law that is not valid for all or which not all obey, may grant to those who are exempt—whether by virtue of the law itself or by virtue of their own audacity—the opportunity to reap either differential rent or monopoly gains.

14. See above, pp. 364-365.

With regard to the determination of the market phenomena it does not matter whether the exemption is legally valid as a privilege or illegal as a quasi-privilege. Neither does it matter whether the costs, if any, incurred by the favored individual or firm for the acquisition of the privilege or quasi-privilege are legal (e.g., a tax levied on licensees) or illegal (e.g., bribes paid to corrupt officers). If an importation embargo is mitigated by the importation of a certain quantity, the prices are affected by the quantity imported and the specific costs incurred by the acquisition and the utilization of the privilege or quasi-privilege. But whether the importation was legal (e.g., a license granted under the system of quantitative trade control to some privileged people), or illegal contraband does not affect the price structure.

XXIV. HARMONY AND CONFLICT OF INTERESTS

1. The Ultimate Source of Profit and Loss on the Market

THE changes in the data whose reiterated emergence prevents the economic system from turning into an evenly rotating economy and produces again and again entrepreneurial profit and loss are favorable to some members of society and unfavorable to others. Hence, people concluded, *the gain of one man is the damage of another; no man profits but by the loss of others*. This dogma was already advanced by some ancient authors. Among modern writers Montaigne was the first to restate it; we may fairly call it the *Montaigne dogma*. It was the quintessence of the doctrines of Mercantilism, old and new. It is at the bottom of all modern doctrines teaching that there prevails, within the frame of the market economy, an irreconcilable conflict among the interests of various social classes within a nation and furthermore between the interests of any nation and those of all other nations.¹

Now the Montaigne dogma is true with regard to the effects of cash-induced changes in the purchasing power of money on deferred payments. But it is entirely wrong with regard to any kind of entrepreneurial profit or loss, whether they emerge in a stationary economy in which the total amount of profits equals the total amount of losses or in a progressing or a retrogressing economy in which these two magnitudes are different.

What produces a man's profit in the course of affairs within an unhampered market society is not his fellow citizen's plight and distress, but the fact that he alleviates or entirely removes what causes his fellow citizen's feeling of uneasiness. What hurts the sick is the plague, not the physician who treats the disease. The doctor's gain is not an outcome of the epidemics, but of the aid he hives to those affected. The ultimate source of profits is always the foresight of future conditions. Those who succeeded better than others in anticipating

1. Cf. Montaigne, *Essais*, Ed. F. Strowski, Bk. I, chap. 22 (Bourdeaux, 1906), I, 135-136; A. Oncken, *Geschichte der Nationalökonomie* (Leipzig, 1902), pp. 152-153; E. F. Heckscher, *Mercantilism*, transl. by M. Shapiro (London, 1935), II, 26-27.

future events and in adjusting their activities to the future state of the market, reap profits because they are in a position to satisfy the most urgent needs of the public. The profits of those who have produced goods and services for which the buyers scramble are not the source of the losses of those who have brought to the market commodities in the purchase of which the public is not prepared to pay the full amount of production costs expended. These losses are caused by the lack of insight displayed in anticipating the future state of the market and the demand of the consumers.

External events affecting demand and supply may sometimes come so suddenly and unexpectedly that people say that no reasonable man could have foreseen them. Then the envious may consider the profits of those who gain from the change as unjustified. Yet such arbitrary value judgments do not alter the real state of interests. It is certainly better for a sick man to be cured by a doctor for a high fee than to lack medical assistance. If it were otherwise, he would not consult the physician.

There are in the market economy no conflicts between the interests of the buyers and sellers. There are disadvantages caused by inadequate foresight. It would be a universal boon if every man and all the members of the market society would always foresee future conditions correctly and in time and act accordingly. If this were the case, retrospection would establish that no particle of capital and labor was wasted for the satisfaction of wants which now are considered as less urgent than some other unsatisfied wants. However, man is not omniscient.

It is wrong to look at these problems from the point of view of resentment and envy. It is no less faulty to restrict one's observation to the momentary position of various individuals. These are social problems and must be judged with regard to the operation of the whole market system. What secures the best possible satisfaction of the demands of each member of society is precisely the fact that those who succeeded better than other people in anticipating future conditions are earning profits. If profits were to be curtailed for the benefit of those whom a change in the data has injured, the adjustment of supply to demand would not be improved but impaired. If one were to prevent doctors from occasionally earning high fees, one would not increase but rather decrease the number of those choosing the medical profession.

The deal is always advantageous both for the buyer and the seller. Even a man who sells at a loss is still better off than he would be if he could not sell at all, or only at a still lower price. He loses on account of his lack of

foresight; the sale limits his loss even if the price received is low. If both the buyer and the seller were not to consider the transaction as the most advantageous action they could choose under the prevailing conditions, they would not enter into the deal.

The statement that one man's boon is the other man's damage is valid with regard to robbery, war, and booty. The robber's plunder is the damage of the despoiled victim. But war and commerce are two different things. Voltaire erred when—in 1764—he wrote in the article “Patrie” of his *Dictionnaire philosophique*: “To be a good patriot is to wish that one's own community should enrich itself by trade and acquire power by arms; it is obvious that a country cannot profit but at the expense of another and that it cannot conquer without inflicting harm on other people.” Voltaire, like so many other authors who preceded and followed him, deemed it superfluous to familiarize himself with economic thought. If he had read the essays of his contemporary David Hume, he would have learned how false it is to identify war and foreign trade. Voltaire, the great debunker of age-old superstitions and popular fallacies, fell prey unawares to the most disastrous fallacy.

When the baker provides the dentist with bread and the dentist relieves the baker's toothache, neither the baker nor the dentist is harmed. It is wrong to consider such an exchange of services and the pillage of the baker's shop by armed gangsters as two manifestations of the same thing. Foreign trade differs from domestic trade only in so far as goods and services are exchanged beyond the borderlines separating the territories of two sovereign nations. It is monstrous that Prince Louis Napoleon Bonaparte, the later Emperor Napoleon III, should have written many decades after Hume, Adam Smith, and Ricardo: “The quantity of merchandise which a country exports is always in direct proportion to the number of shells it can discharge upon its enemies whenever its honor and its dignity may require it.”² All the teachings of economics concerning the effects of the international division of labor and of international trade have up to now failed to destroy the popularity of the Mercantilist fallacy, “that the object of foreign trade is to pauperize foreigners.”³ It is a task of historical investigation to disclose the sources of the popularity of this and other similar delusions and errors. For economics the matter is long since settled.

2. Cf. Louis Napoleon Bonaparte, *Extinction du pauparisme* (éd. populaire, Paris, 1848), p. 6.

3. With these words, H. G. Wells (*The World of William Clissold*, Bk. IV, sec. 10) characterizes the opinion of a typical representative of the British peerage.

2. The Limitation of Offspring

The natural scarcity of the means of sustenance forces every living being to look upon all other living beings as deadly foes in the struggle for survival, and generates pitiless biological competition. But with man these irreconcilable conflicts of interests disappear when, and as far as, the division of labor is substituted for economic autarky of individuals, families, tribes, and nations. Within the system of society there is no conflict of interests as long as the optimum size of population has not been reached. As long as the employment of additional hands results in a more than proportionate increase in the returns, harmony of interests is substituted for conflict. People are no longer rivals in the struggle for the allocation of portions out of a strictly limited supply. They become cooperators in striving after ends common to all of them. An increase in population figures does not curtail, but rather augments, the average shares of the individuals.

If men were to strive only after nourishment and sexual satisfaction, population would tend to increase beyond the optimum size to the limits drawn by the sustenance available. However, men want more than merely to live and to copulate; they want to live *humanly*. An improvement in conditions usually results, it is true, in an increase in population figures; but this increase lags behind the increase in bare sustenance. If it were otherwise, men would have never succeeded in the establishment of social bonds and in the development of civilization. As with rats, mice, and microbes, every increase in sustenance would have made population figures rise to the limits of bare sustenance; nothing would have been left for the seeking of other ends. The fundamental error implied in the iron law of wages was precisely the fact that it looked upon men—or at least upon the wage earners—as beings exclusively driven by animal impulses. Its champions failed to realize that man differs from the beasts as far as he aims also at specifically human ends, which one may call higher or more sublime ends.

The Malthusian law of population is one of the great achievements of thought. Together with the principle of the division of labor it provided the foundations for modern biology and for the theory of evolution; the importance of these two fundamental theorems for the sciences of human action is second only to the discovery of the regularity in the intertwinement and sequence of market phenomena and their inevitable determination by the market data. The objections raised against the Malthusian law as well as against the law of returns are vain and trivial. Both laws are indisputable. But the role to be assigned to

them within the body of the sciences of human action is different from that which Malthus attributed to them.

Nonhuman beings are entirely subject to the operation of the biological saw described by Malthus.⁴ For them the statement that their numbers tend to encroach upon the means of subsistence and that the supernumerary specimens are weeded out by want of sustenance is valid without any exception. With reverence to the nonhuman animals the notion of minimum sustenance has an unequivocal, uniquely determined sense. But the case is different with man. Man integrates the satisfaction of the purely zoological impulses, common to all animals, into a scale of values, in which a place is also assigned to specifically human ends. Acting man also rationalizes the satisfaction of his sexual appetites. Their satisfaction is the outcome of a weighing of pros and cons. Man does not blindly submit to a sexual stimulation like a bull; he refrains from copulation if he deems the costs—the anticipated disadvantages—too high. In this sense we may, without any valuation or ethical connotation, apply the term *moral restraint* employed by Malthus.⁵

Rationalization of sexual intercourse already involves the rationalization of proliferation. Then later further methods of rationalizing the increase of progeny were adopted which were independent of abstention from copulation. People resorted to the egregious and repulsive practices of exposing or killing infants and of abortion. Finally they learned to perform the sexual act in such a way that no pregnancy results. In the last hundred years the technique of contraceptive devices has been perfected and the frequency of their employment increased considerably. Yet the procedures had long been known and practiced.

The affluence that modern capitalism bestows upon the broad masses of the capitalist countries and the improvement in hygienic conditions and therapeutical and prophylactic methods brought about by capitalism have considerably reduced mortality, especially infant mortality, and prolonged the average duration of life. Today in these countries the restriction in generating offspring can succeed only if it is more drastic than in earlier ages. The transition to capitalism—i.e., the removal of the obstacles which

4. The Malthusian law is, of course, a biological and not a praxeological law. However, its cognizance is indispensable for praxeology in order to conceive by contrast the essential characteristic of human action. As the natural sciences failed to discover it, the economists had to fill the gap. The history of the law of population too explodes the popular myth about the backwardness of the sciences of human action and their need to borrow from the natural sciences.

5. Malthus too employed this term without any valuation or ethical implication. Cf. Bonar, *Malthus and His Work* (London, 1885), p. 53. One could as well substitute the term *praxeological restraint* for *moral restraint*.

in former days had fettered the functioning of private initiative and enterprise—has consequently deeply influenced sexual customs. It is not the practice of birth control that is new, but merely the fact that it is more frequently resorted to. Especially new is the fact that the practice is no longer limited to the upper strata of the population, but is common to the whole population. For it is one of the most important social effects of capitalism that it deproletarianizes all strata of society. It raises the standard of living of the masses of the manual workers to such a height that they too turn into “bourgeois” and think and act like well-to-do burghers. Eager to preserve their standard of living for themselves and for their children, they embark upon birth control. With the spread and progress of capitalism, birth control becomes a universal practice. The transition to capitalism is thus accompanied by two phenomena: a decline both in fertility rates and in mortality rates. The average duration of life is prolonged.

In the days of Malthus it was not yet possible to observe these demographical characteristics of capitalism. Today it is no longer permissible to question them. But, blinded by romantic prepossessions, many describe them as phenomena of decline and degeneration peculiar only to the white-skinned peoples of Western civilization, grown old and decrepit. These romantics are seriously alarmed by the fact that the Asiatics do not practice birth control to the same extent to which it is practiced in Western Europe, North America, and Australia. As modern methods of fighting and preventing disease have brought about a drop in mortality rates with these oriental peoples too, their population figures grow more rapidly than those of the Western nations. Will not the indigenes of India, Malaya, China, and Japan, who themselves did not contribute to the technological and therapeutical achievements of the West, but received them as an unexpected present, in the end by the sheer superiority of their numbers squeeze out the peoples of European descent?

These fears are groundless. Historical experience shows that all Caucasian peoples reacted to the drop in mortality figures brought about by capitalism with a drop in the birth rate. Of course, from such historical experience no general law may be deduced. But praxeological reflection demonstrates that there exists between these two phenomena a necessary concatenation. An improvement in the external conditions of well-being makes possible a corresponding increase in population figures. However, if the additional quantity of the means of sustenance is completely absorbed by rearing an additional number of people, nothing is left for a further

improvement in the standard of living. The march of civilization is arrested; mankind reaches a state of stagnation.

The case becomes still more obvious if we assume that a prophylactic invention is made by a lucky chance and that its practical application requires neither a considerable investment of capital nor considerable current expenditure. Of course, modern medical research and still more its utilization absorb huge amounts of capital and labor. They are products of capitalism. They would never have come into existence in a noncapitalist environment. But there were, in earlier days, instances of a different character. The practice of smallpox inoculation did not originate from expensive laboratory research and, in its original crude form, could be applied at trifling costs. Now, what would the results of smallpox inoculation have been if its practice had become general in a precapitalist country not committed to birth control? It would have increased population figures without increasing sustenance, it would have impaired the average standard of living. It would not have been a blessing, but a curse.

Conditions in Asia and Africa are, by and large, the same. These backward peoples receive the devices for fighting and preventing disease ready-made from the West. It is true that in some of these countries imported foreign capital and the adoption of foreign technological methods by the comparatively small domestic capital synchronously tend to increase the per capita output of labor and thus to bring about a tendency toward an improvement in the average standard of living. However, this does not sufficiently counterbalance the opposite tendency resulting from the drop in mortality rates not accompanied by an adequate fall in fertility rates. The contact with the West has not yet benefitted these peoples because it has not yet affected their minds; it has not freed them from age-old superstitions, prejudices, and misapprehensions; it has merely altered their technological and therapeutical knowledge.

The reformers of the oriental peoples want to secure for their fellow citizens the material well-being that the Western nations enjoy. Deluded by Marxian, nationalist, and militarist ideas they think that all that is needed for the attainment of this end is the introduction of European and American technology. Neither the Slavonic Bolsheviki and nationalists nor their sympathizers in the Indies, in China, and in Japan realize that what their peoples need most is not Western technology, but the social order which in addition to other achievements has generated this technological knowledge. They lack first of all economic freedom and private initiative, entrepreneurs

and capitalism. But they look only for engineers and machines. What separates East and West is the social and economic system. The East is foreign to the Western spirit that has created capitalism. It is of no use to import the paraphernalia of capitalism without admitting capitalism as such. No achievement of capitalist civilization would have been accomplished in a noncapitalistic environment or can be preserved in a world without a market economy.

If the Asiatics and Africans really enter into the orbit of Western civilization, they will have to adopt the market economy without reservations. Then their masses will rise above their present proletarian wretchedness and practice birth control as it is practiced in every capitalistic country. No excessive growth of population will longer hinder the improvement in the standards of living. But if the oriental peoples in the future confine themselves to mechanical reception of the tangible achievements of the West without embracing its basic philosophy and social ideologies, they will forever remain in their present state of inferiority and destitution. Their populations may increase considerably, but they will not raise themselves above distress. These miserable masses of paupers will certainly not be a serious menace to the independence of the Western nations. As long as there is a need for weapons, the entrepreneurs of the market society will never stop producing more efficient weapons and thus securing to their countrymen a superiority of equipment over the merely imitative noncapitalistic Orientals. The military events of both World Wars have proved anew that the capitalistic countries are paramount also in armaments production. No foreign aggressor can destroy capitalist civilization if it does not destroy itself. Where capitalistic entrepreneurship is allowed to function freely, the fighting forces will always be so well equipped that the biggest armies of the backward peoples will be no match for them. There has even been great exaggeration of the danger of making the formulas for manufacturing "secret" weapons universally known. If war comes again, the searching mind of the capitalistic world will always have a head start on the peoples who merely copy and imitate clumsily.

The peoples who have developed the system of the market economy and cling to it are in every respect superior to all other peoples. The fact that they are eager to preserve peace is not a mark of their weakness and inability to wage war. They love peace because they know that armed conflicts are pernicious and disintegrate the social division of labor. But if war becomes unavoidable, they show their superior efficiency in military affairs too. They repel the barbarian aggressors whatever their numbers may be.

The purposive adjustment of the birth rate to the supply of the material potentialities of well-being is an indispensable condition of human life and action, of civilization, and of any improvement in wealth and welfare. Whether the only beneficial method of birth control is abstention from coitus is a question which must be decided from the point of view of bodily and mental hygiene. It is absurd to confuse the issue by referring to ethical precepts developed in ages which were faced with different conditions. However, praxeology is not interested in the theological aspects of the problem. It has merely to establish the fact that where there is no limitation of offspring there cannot be any question of civilization and improvement in the standard of living.

A socialist commonwealth would be under the necessity of regulating the fertility rate by authoritarian control. It would have to regiment the sexual life of its wards no less than all other spheres of their conduct. In the market economy every individual is spontaneously intent upon not begetting children whom he could not rear without considerably lowering his family's standard of life. Thus the growth of population beyond the optimum size as determined by the supply of capital available and the state of technological knowledge is checked. The interests of each individual coincide with those of all other individuals.

Those fighting birth control want to eliminate a device indispensable for the preservation of peaceful human cooperation and the social division of labor. Where the average standard of living is impaired by the excessive increase in population figures, irreconcilable conflicts of interests arise. Each individual is again a rival of all other individuals in the struggle for survival. The annihilation of rivals is the only means of increasing one's own well-being. The philosophers and theologians who assert that birth control is contrary to the laws of God and Nature refuse to see things as they really are. Nature straitens the material means required for the improvement of human well-being and survival. As natural conditions are, man has only the choice between the pitiless war of each against each or social cooperation. But social cooperation is impossible if people give rein to the natural impulse of proliferation. In restricting procreation man adjusts himself to the natural conditions of his existence. The rationalization of the sexual passions is an indispensable condition of civilization and societal bonds. Its abandonment would in the long run not increase but decrease the numbers of those surviving, and would render life for everyone as poor and miserable as it was many thousands of years ago for our ancestors.

3. The Harmony of the “Rightly Understood” Interests

From time immemorial men have prattled about the blissful conditions their ancestors enjoyed in the original “state of nature.” From old myths, fables, and poems the image of this primitive happiness passed into many popular philosophies of the seventeenth and eighteenth centuries. In their language the term *natural* denoted what was good and beneficial in human affairs, while the term *civilization* had the connotation of opprobrium. The fall of man was seen in the deviation from the primitive conditions of ages in which there was but little deference between man and other animals. At that time, these romantic eulogists of the past asserted, there were no conflicts between men. Peace was undisturbed in the Garden of Eden.

Yet nature does not generate peace and good will. The characteristic mark of the “state of nature” is irreconcilable conflict. Each specimen is the rival of all other specimens. The means of subsistence are scarce and do not grant survival to all. The conflicts can never disappear. If a band of men, united with the object of defeating rival bands, succeeds in annihilating its foes, new antagonisms arise among the victors over the distribution of the booty. The source of the conflicts is always the fact that each man’s portion curtails the portions of all other men.

What makes friendly relations between human beings possible is the higher productivity of the division of labor. It removes the natural conflict of interests. For where there is division of labor, there is no longer question of the distribution of a supply not capable of enlargement. Thanks to the higher productivity of labor performed under the division of tasks, the supply of goods multiplies. A pre-eminent common interest, the preservation and further intensification of social cooperation, becomes paramount and obliterates all essential collisions. Catallactic competition is substituted for biological competition. It makes for harmony of the interests of all members of society. The very condition from which the irreconcilable conflicts of biological competition arise—viz., the fact that all people by and large strive after the same things—is transformed into a factor making for harmony of interests. Because many people or even all people want bread, clothes, shoes, and cars, large-scale production of these goods becomes feasible and reduces the costs of production to such an extent that they are accessible at low prices. The fact that my fellow man wants to acquire shoes as I do, does not make it harder for me to get shoes, but easier. What enhances the price of shoes is the fact that nature does not provide a more ample supply of leather and other

raw material required, and that one must submit to the disutility of labor in order to transform these raw materials into shoes. The catallactic competition of those who, like me, are eager to have shoes makes shoes cheaper, not more expensive.

This is the meaning of the theorem of the harmony of the rightly understood interests of all members of the market society.⁶ When the classical economists made this statement, they were trying to stress two points: First, that everybody is interested in the preservation of the social division of labor, the system that multiplies the productivity of human efforts. Second, that in the market society consumers' demand ultimately directs all production activities. The fact that not all human wants can be satisfied is not due to inappropriate social institutions or to deficiencies of the system of the market economy. It is a natural condition of human life. The belief that nature bestows upon man inexhaustible riches and that misery is an outgrowth of man's failure to organize the good society is entirely fallacious. The "state of nature" which the reformers and utopians depicted as paradisiac was in fact a state of extreme poverty and distress. "Poverty," says Bentham, "is not the work of the laws, it is the primitive condition of the human race."⁷ Even those at the base of the social pyramid are much better off than they would have been in the absence of social cooperation. They too are benefitted by the operation of the market economy and participate in the advantages of civilized society.

The nineteenth-century reformers did not drop the cherished fable of the original earthly paradise. Frederick Engels incorporated it in the Marxian account of mankind's social evolution. However, they no longer set up the bliss of the *aurea aetas* as a pattern for social and economic reconstruction. They contrast the alleged depravity of capitalism with the ideal happiness man will enjoy in the socialist Elysium of the future. The socialist mode of production will abolish the fetters by means of which capitalism checks the development of the productive forces, and will increase the productivity of labor and wealth beyond all measure. The preservation of free enterprise and the private ownership of the means of production benefits exclusively the small minority of parasitic exploiters and harms the immense majority of working men. Hence there prevails within the frame of the market society an irreconcilable conflict between the interests of "capital" and those of "labor." This class struggle can disappear only when a fair system of social organization—either socialism or interventionism—is substituted for the

6. For "rightly understood" interests we may as well say interests "in the long run."

7. Cf. Bentham, *Pininriples of the Civil Code*, in "Works," I, 309.

manifestly unfair capitalist mode of production.

Such is the almost universally accepted social philosophy of our age. It was not created by Marx, although it owes its popularity mainly to the writings of Marx and the Marxians. It is today endorsed not only by the Marxians, but no less by most of those parties who emphatically declare their anti-Marxism and pay lip service to free enterprise. It is the official social philosophy of Roman Catholicism as well as of Anglo-Catholicism; it is supported by many eminent champions of the various Protestant denominations and of the Orthodox Oriental Church. It is an essential part of the teachings of Italian Fascism and of German nazism and of all varieties of interventionist doctrines. It was the ideology of the Sozialpolitik of the Hohenzollerns in Germany and of the French royalists aiming at the restoration of the house of Bourbon-Orleans, of the New Deal of President Roosevelt, and of the nationalists of Asia and Latin America. The antagonisms between these parties and factions refer to accidental issues—such as religious dogma, constitutional institutions, foreign policy—and, first of all, to the characteristic features of the social system that is to be substituted for capitalism. But they all agree in the fundamental thesis that the very existence of the capitalist system harms the vital interests of the immense majority of workers, artisans, and small farmers, and they all ask in the name of social justice for the abolition of capitalism.⁸

All socialist and interventionist authors and politicians base their analysis and critique of the market economy on two fundamental errors. First,

8. The official doctrine of the Roman Church is outlined in the encyclical *Quadragesimo anno* of Pope Pius XI (1931). The Anglo-Catholic doctrine is presented by the late William Temple, Archbishop of Canterbury, in the book *Christianity and the Social Order* (Penguin Special, 1942). Representative of the ideas of European continental Protestantism is the book of Emil Brunner, *Justice and the Social Order*, trans. by M. Hottinger (New York, 1945). A highly significant document is the section on "The Church and Disorder of Society" of the draft report which the World Council of Churches in September, 1948, recommended for appropriate action to the one hundred and fifty odd denominations whose delegates are member of the Council. For the ideas of Nicolas Berdyayev, the most eminent apologist of Russian Orthodoxy, cf. his book *The Origin of Russian Communism* (London, 1937), especially pp. 217-218 and 225. It is often asserted that an essential difference between the Marxians and the other socialist and interventionist parties is to be found in the fact that the Marxians stand for class struggle, while the latter parties look at the class struggle as upon a deplorable outgrowth of the irreconcilable conflict of class interest inherent in capitalism and want to overcome it by the realization of the reforms they recommend. However, the Marxians do not praise and kindle the class struggle for its own sake. In their eyes the class struggle is good only because it is the device by means of which the "productive forces," those mysterious forces directing the course of human evolution, are bound to bring about the "classless" society in which there will be neither classes nor class conflicts.

they fail to recognize the speculative character inherent in all endeavors to provide for future want-satisfaction, i.e., in all human action. They naively assume that there cannot exist any doubt about the measures to be applied for the best possible provisioning of the consumers. In a socialist commonwealth there will be no need for the production tsar (or the central board of production management) to speculate. He will “simply” have to resort to those measures which are beneficial to his wards. The advocates of a planned economy have never conceived that the problem is to allocate scarce factors of production in the various branches of production in such a way that no wants considered more urgent should remain unsatisfied because the factors of production required for their satisfaction were employed, i.e., wasted, for the satisfaction of wants considered less urgent. This economic problem must not be confused with the technological problem. Technological knowledge can merely tell us what could be achieved under the present state of our scientific insight. It does not answer the questions as to what should be produced and in what quantities, and which of the multitude of technological processes available should be chosen. Deluded by their failure to grasp this essential matter, the advocates of a planned society believe that the production tsar will never err in his decisions. In the market economy the entrepreneurs and capitalists cannot avoid committing serious blunders because they know neither what the consumers want nor what their competitors are doing. The general manager of a socialist state will be infallible because he alone will have the power to determine what should be produced and how, and because no action of other people will cross his plans.⁹

The second fundamental error involved in the socialists’ critique of the market economy stems from their faulty theory of wages. They have failed to realize that wages are the price paid for the earner’s achievement, i.e., for the contribution of his efforts to the processing of the good concerned or, as people say, for the value which his services add to the value of the materials. No matter whether there are time wages or piecework wages, the employer always buys the worker’s performance and services, not his time. It is therefore not true that in the unhampered

9. The thorough exposure of this delusion is provided by the proof of the impossibility of economic calculation under socialism. See below the fifth part of this book.

market economy the worker has no personal interest in the execution of his task. The socialists are badly mistaken in asserting that those paid a certain rate per hour, per day, per week, per month, or per year are not impelled by their own selfish interests when they work efficiently. It is not lofty ideals and the sense of duty that deter a worker paid according to the length of time worked from carelessness and loafing around the shop, but very substantial arguments. He who works more and better gets higher pay, and he who wants to earn more must increase the quantity and improve the quality of his performance. The hard-boiled employers are not so gullible as to let themselves be cheated by slothful employees; they are not so negligent as those governments who pay salaries to hosts of loafing bureaucrats. Neither are the wage earners so stupid as not to know that laziness and inefficiency are heavily penalized on the labor market.¹⁰

On the shaky ground of their misconception of the catallactic nature of wages, the socialist authors have advanced fantastic fables about the increase in the productivity of labor to be expected from the realization of their plans. Under capitalism, they say, the worker's zeal is seriously impaired because he is aware of the fact that he himself does not reap the fruits of his labor and that his toil and trouble enrich merely his employer, this parasitic and idle exploiter. But under socialism every worker will know that he works for the benefit of society, of which he himself is a part. This knowledge will provide him with the most powerful incentive to do his best. An enormous increase in the productivity of labor and thereby in wealth will result.

However, the identification of the interests of each worker and those of the socialist commonwealth is a purely legalistic and formalistic fiction which has nothing to do with the real state of affairs. While the sacrifices an individual worker makes in intensifying his own exertion burden him alone, only an infinitesimal fraction of the produce of his additional exertion benefits himself and improves his own well-being. While the individual worker enjoys completely the pleasures he may reap by yielding to the temptation to carelessness and laziness, the resulting impairment of the social dividend curtails his own share only infinitesimally. Under such a socialist mode of production all personal incentives which selfishness provides under capitalism are removed, and a premium is put upon laziness and negligence. Whereas in a capitalist society selfishness incites everyone to the utmost diligence, in a socialist society it makes for inertia and laxity. The socialists may still babble about the miraculous change in human nature

10.Cf. above, pp. 600-602.

that the advent of socialism will effect, and about the substitution of lofty altruism for mean egotism. But they must no longer indulge in fables about the marvelous effects the selfishness of each individual will bring about under socialism.¹¹

No judicious man can fail to conclude from the evidence of these considerations that in the market economy the productivity of labor is incomparably higher than it would be under socialism. However, this cognition does not settle the question between the advocates of capitalism and those of socialism from a praxeological, i.e., scientific, point of view.

A bona fide advocate of socialism who is free from bigotry, prepossession, and malice could still contend: "It may be true that P , the total net income turned out in a market society, is larger than p , the total net income turned out in a socialist society. But if the socialist system assigns to each of its members an equal share of p (viz., $\frac{P}{z} = d$), all those whose income in the market society is smaller than d are favored by the substitution of socialism for capitalism. It may happen that this group of people includes the majority of men. At any rate it becomes evident that the doctrine of the harmony between the rightly understood interests of all members of the market society is untenable. There is a class of men whose interests are hurt by the very existence of the market economy and who would be better off under socialism." The advocates of the market economy contest the conclusiveness of this reasoning. They believe that p will lag so much behind P that d will be smaller than the income which even those earning the lowest wages get in the market society. There can be no doubt that this objection is well founded. However, it is not based on praxeological considerations and therefore lacks the apodictic and incontestable argumentative power inherent in a praxeological demonstration. It is based on a judgment of relevance, the quantitative appraisal of the difference between the two magnitudes P and p . In the field of human action such quantitative cognition is obtained by understanding, with regard to which full agreement between men cannot be reached. Praxeology, economics, and catallactics are of no use for the settlement of such dissensions concerning quantitative issues.

11. The doctrine refuted in the text found its most brilliant expositor in John Stuard Mill (*Principles of Political Economy* [People's ed. London, 1867], pp. 126 ff.). However, Mill resorted to this doctrine merely in order to refute an objection raised against socialism, viz., that, by eliminating the incentive provided by selfishness, it would impair the productivity of labor. He was not so blind as to assert that the productivity of labor would multiply under socialism. For an analysis and refutation of Mill's reasoning, cf. Mises, *Socialism*, pp. 173-181.

The advocates of socialism could even go farther and say: "Granted that each individual will be worse off under socialism than even the poorest under capitalism. Yet we spurn the market economy in spite of the fact that it supplies everybody with more goods than socialism. We disapprove of capitalism on ethical grounds as an unfair and amoral system. We prefer socialism on grounds commonly called non-economic and put up with the fact that it impairs everybody's well-being."¹² It cannot be denied that this haughty indifference with regard to material well-being is a privilege reserved to ivory-tower intellectuals, secluded from reality, and to ascetic anchorites. What made socialism popular with the immense majority of its supporters was, on the contrary, the illusion that it would supply them with more amenities than capitalism. But however this may be, it is obvious that this type of prosocialist argumentation cannot be touched by the liberal reasoning concerning the productivity of labor.

If no other objections could be raised to the socialist plans than that socialism will lower the standard of living of all or at least of the immense majority, it would be impossible for praxeology to pronounce a final judgment. Men would have to decide the issue between capitalism and socialism on the ground of judgments of value and of judgments of relevance. They would have to choose between the two systems as they choose between many other things. No objective standard could be discovered which would make it possible to settle the dispute in a manner which allows no contradiction and must be accepted by every sane individual. The freedom of each man's choice and discretion would not be annihilated by inexorable necessity. However, the true state of affairs is entirely different. Man is not in a position to choose between these two systems. Human cooperation under the system of the social division of labor is possible only in the market economy. Socialism is not a realizable system of society's economic organization because it lacks any method of economic calculation. To deal with this fundamental problem is the task of the fifth part of this book.

The establishment of this truth does not amount to a depreciation of the conclusiveness and the convincing power of the antisocialist argument derived from the impairment of productivity to be expected from socialism.

12. This mode of reasoning was mainly resorted to by some eminent champions of Christian socialism. The Marxians used to recommend socialism on the ground that it would multiply productivity and bring unprecedented material wealth to everybody. Only lately have they changed their tactics. They declare that the Russian worker is happier than the American worker in spite of the fact that his standard of living is much lower; the knowledge that he lives under a fair system compensates by far for all his material hardships.

The weight of this objection raised to the socialist plans is so overwhelming that no judicious man could hesitate to choose capitalism. Yet this would still be a choice between alternative systems of society's economic organization, preference given to one system as against another. However, such is not the alternative. Socialism cannot be realized because it is beyond human power to establish it as a social system. The choice is between capitalism and chaos. A man who chooses between drinking a glass of milk and a glass of a solution of potassium cyanide does not choose between two beverages; he chooses between life and death. A society that chooses between capitalism and socialism does not choose between two social systems; it chooses between social cooperation and the disintegration of society. Socialism is not an alternative to capitalism; it is an alternative to any system under which men can live as *human* beings. To stress this point is the task of economics as it is the task of biology and chemistry to teach that potassium cyanide is not a nutriment but deadly poison.

The convincing power of the productivity argument is in fact so irresistible that the advocates of socialism were forced to abandon their old tactics and to resort to new methods. They are eager to divert attention from the productivity issue by throwing into relief the monopoly problem. All contemporary socialist manifestoes expatiate on monopoly power. Statesmen and professors try to outdo one another in depicting the evils of monopoly. Our age is called the age of monopoly capitalism. The foremost argument advanced today in favor of socialism is the reference to monopoly.

Now, it is true that the emergence of monopoly prices (not of monopoly as such without monopoly prices) creates a discrepancy between the interests of the monopolist and those of the consumers. The monopolist does not employ the monopolized good according to the wishes of the consumers. As far as there are monopoly prices, the interests of the monopolists take precedence over those of the public and the democracy of the market is restricted. with regard to monopoly prices there is not harmony, but conflict of interests.

It is possible to contest these statements with regard to the monopoly prices received in the sale of articles under patents and copyrights. One may argue that in the absence of patent and copyright legislation these books, compositions, and technological innovations would never have come into existence. The public pays monopoly prices for things it would not have enjoyed at all under competitive prices. However, we may fairly disregard this issue. It has little to do with the great monopoly controversy of our day. When people deal with the evils of monopoly, they imply that there prevails within the unhampered

market economy a general and inevitable tendency toward the substitution of monopoly prices for competitive prices. This is, they say, a characteristic mark of "mature" or "late" capitalism. Whatever conditions may have been in the earlier stages of capitalist evolution and whatever one may think about the validity of the classical economists' statements concerning the harmony of the rightly understood interests, today there is no longer any question of such a harmony.

As has been pointed out already,¹³ there is no such tendency toward monopolization. It is a fact that with many commodities in many countries monopoly prices prevail, and moreover, some articles are sold at monopoly prices on the world market. However, almost all of these instances of monopoly prices are the outgrowth of government interference with business. They were not created by the interplay of the factors operating on a free market. They are not products of capitalism, but precisely of the endeavors to counteract the forces determining the height of the market prices. It is a distortion of fact to speak of monopoly capitalism. It would be more appropriate to speak of monopoly interventionism or of monopoly statism.

Those instances of monopoly prices which would appear also on a market not hampered and sabotaged by the interference of the various national governments and by conspiracies between groups of governments are of minor importance. They concern some raw materials the deposits of which are few and geographically concentrated, and local limited-space monopolies. However, it is a fact that in these cases monopoly prices can be realized even in the absence of government policies aiming directly or indirectly at their establishment. It is necessary to realize that consumers' sovereignty is not perfect and that there are limits to the operation of the democratic process of the market. There is in some exceptional and rare cases of minor importance even on a market not hampered and sabotaged by government interference an antagonism between the interests of the owners of factors of production and those of the rest of the people. However, the existence of such antagonisms by no means impairs the concord of the interests of all people with regard to the preservation of the market economy. The market economy is the only system of society's economic organization that can function and really has been functioning. Socialism is unrealizable because of its inability to develop a method for economic calculation. Interventionism must result in a state of affairs which, from the point of view of its advocates, is less desirable than the

13.Cf. above, p. 366.

conditions of the unhampered market economy which it aims to alter. In addition, it liquidates itself as soon as it is pushed beyond a narrow field of application.¹⁴ Such being the case, the only social order that can preserve and further intensify the social division of labor is the market economy. All those who do not wish to disintegrate social cooperation and to return to the conditions of primitive barbarism are interested in the perpetuation of the market economy.

The classical economists' teachings concerning the harmony of the rightly understood interests were defective in so far as they failed to recognize the fact that the democratic process of the market is not perfect, because in some instances of minor importance, even in the unhampered market economy, monopoly prices may appear. But much more conspicuous was their failure to recognize that and why no socialist system can be considered as a system of society's economic organization. They based the doctrine of the harmony of interests upon the erroneous assumption that there are no exceptions to the rule that the owners of the means of production are forced by the market process to employ their property according to the wishes of the consumers. Today this theorem must be based on the knowledge that no economic calculation is feasible under socialism.

4. Private Property

Private ownership of the means of production is the fundamental institution of the market economy. It is the institution the presence of which characterizes the market economy as such. Where it is absent, there is no question of a market economy.

Ownership means full control of the services that can be derived from a good. This catallactic notion of ownership and property rights is not to be confused with the legal definition of ownership and property rights as stated in the laws of various countries. It was the idea of legislators and courts to define the legal concept of property in such a way as to give to the proprietor full protection by the governmental apparatus of coercion and compulsion and to prevent anybody from encroaching upon his rights. As far as this purpose was adequately realized, the legal concept of property rights corresponded to the catallactic concept. However, nowadays there are tendencies to abolish the institution of private property by a change in the laws determining the scope of the actions which the proprietor is entitled to undertake with regard to the things which are his property. While retaining

14.Cf. the sixth part of this book.

the term private property, these reforms aim at the substitution of public ownership for private ownership. This tendency is the characteristic mark of the plans of various schools of Christian socialism and of nationalist socialism. But few of the champions of these schools have been so keen as the Nazi philosopher Othmar Spann, who explicitly declared that the realization of his plans would bring about a state of affairs in which the institution of private property will be preserved only in a "formal sense, while in fact there will be only public ownership."¹⁵ There is need to mention these things in order to avoid popular fallacies and confusion. In dealing with private property, catallactics deals with control, not with legal terms, concepts and definitions. Private ownership means that the proprietors determine the employment of the factors of production, while public ownership means that the government controls their employment.

Private property is a human device. It is not sacred. It came into existence in early ages of history, when people with their own power and by their own authority appropriated to themselves what had previously not been anybody's property. Again and again proprietors were robbed of their property by expropriation. The history of private property can be traced back to a point at which it originated out of acts which were certainly not legal. Virtually every owner is the direct or indirect legal successor of people who acquired ownership either by arbitrary appropriation of ownerless things or by violent spoliation of their predecessor.

However, the fact that legal formalism can trace back every title either to arbitrary appropriation or to violent expropriation has no significance whatever for the conditions of a market society. Ownership in the market economy is no longer linked up with the remote origin of private property. Those events in a far-distant past, hidden in the darkness of primitive mankind's history, are no longer of any concern for our day. For in an unhampered market society the consumers daily decide anew who should own and how much he should own. The consumers allot control of the means of production to those who know how to use them best for the satisfaction of the most urgent wants of the consumers. Only in a legal and formalistic sense can the owners be considered the successors of appropriators and expropriators. In fact, they are mandataries of the consumers, bound by the operation of the market to serve the consumers best. Under capitalism, private property is the consummation of the self-determination of the consumers.

The meaning of private property in the market society is radically different from what it is under a system of each household's autarky. Where

15.Cf. Spann, *der wahre Staat* (Leipzig, 1921), p. 249.

each household is economically self-sufficient, the privately owned means of production exclusively serve the proprietor. He alone reaps all the benefits derived from their employment. In the market society the proprietors of capital and land can enjoy their property only by employing it for the satisfaction of other people's wants. They must serve the consumers in order to have any advantage from what is their own. The very fact that they own means of production forces them to submit to the wishes of the public. Ownership is an asset only for those who know how to employ it in the best possible way for the benefit of the consumers. It is a social function.

5. The Conflicts of Our Age

Popular opinion sees the source of the conflicts which bring about the civil wars and international wars of our age in the collision of "economic" interests inherent in the market economy. Civil war is the rebellion of the "exploited" masses against the "exploiting" classes. Foreign war is the revolt of the "have-not" nations against those nations who have appropriated to themselves an unfair share of the earth's natural resources and, with insatiable greed, want to snatch even more of this wealth destined for the use of all. He who in face of these facts speaks of the harmony of the rightly understood interests, is either a moron or an infamous apologist of a manifestly unjust social order. No intelligent and honest man could fail to realize that there prevail today irreconcilable conflicts of material interests which can be settled only by recourse to arms.

It is certainly true that our age is full of conflicts which generate war. However, these conflicts do not spring from the operation of the unhampered market society. It may be permissible to call them economic conflicts because they concern that sphere of human life which is, in common speech, known as the sphere of economic activities. But it is a serious blunder to infer from this appellation that the source of these conflicts are conditions which develop within the frame of a market society. It is not capitalism that produces them, but precisely the anticapitalistic policies designed to check the functioning of capitalism. They are an outgrowth of the various governments' interference with business, of trade and migration barriers and discrimination against foreign labor, foreign products, and foreign capital.

None of these conflicts could have emerged in an unhampered market economy. Imagine a world in which everybody were free to live and work as entrepreneur or as employee where he wanted and how he chose, and ask which of these conflicts could still exist. Imagine a world in which the

principle of private ownership of the means of production is fully realized, in which there are no institutions hindering the mobility of capital, labor, and commodities, in which the laws, the courts, and the administrative officers do not discriminate against any individual or groups of individuals, whether native or alien. Imagine a state of affairs in which governments are devoted exclusively to the task of protecting the individual's life, health, and property against violent and fraudulent aggression. In such a world the frontiers are drawn on the maps, but they do not hinder anybody from the pursuit of what he thinks will make him more prosperous. No individual is interested in the expansion of the size of his nation's territory, as he cannot derive any gain from such an aggrandizement. Conquest does not pay and war becomes obsolete.

In the ages preceding the rise of liberalism and the evolution of modern capitalism, people for the most part consumed only what could be produced out of raw materials available in their own neighborhood. The development of the international division of labor has radically altered this state of affairs. Food and raw materials imported from distant countries are articles of mass consumption. the most advanced European nations could do without these imports only at the price of a very considerable lowering of their standard of living. They must pay for the badly needed purchase of minerals, lumber, oil, cereals, fat, coffee, tea, cocoa, fruit, wool, and cotton by exporting manufactures, most of them processed out of imported raw materials. Their vital interests are hurt by the protectionist trade policies of the countries producing these primary products.

Two hundred years ago it was of little concern to the Swedes or the Swiss whether or not a non-European country was efficient in utilizing its natural resources. But today economic backwardness in a foreign country, endowed by rich natural resources, hurts the interests of all those whose standard of living could be raised if a more appropriate mode of utilizing this natural wealth were adopted. The principle of each nation's unrestricted sovereignty is *in a world of government interference with business* a challenge to all other nations. The conflict between the have-nots and the haves is a real conflict. But it is present only in a world in which any sovereign government is free to hurt the interests of all peoples—its own included—by depriving the consumers of the advantages a better exploitation of this country's resources would give them. It is not sovereignty as such that makes for war, but sovereignty of governments not entirely committed to the principles of the market economy.

Liberalism did not and does not build its hopes upon abolition of the

sovereignty of the various national governments, a venture which would result in endless wars. It aims at a general recognition of the idea of economic freedom. If all peoples become liberal and conceive that economic freedom best serves their own interests, national sovereignty will no longer engender conflict and war. What is needed to make peace durable is neither international treaties and covenants nor international tribunals and organizations like the defunct League of Nations or its successor, the United Nations. If the principle of the market economy is universally accepted, such makeshifts are unnecessary; if it is not accepted, they are futile. Durable peace can only be the outgrowth of a change in ideologies. As long as the peoples cling to the Montaigne dogma and think that they cannot prosper economically except at the expense of other nations, peace will never be anything other than a period of preparation for the next war.

Economic nationalism is incompatible with durable peace. Yet economic nationalism is unavoidable where there is government interference with business. Protectionism is indispensable where there is no domestic free trade. Where there is government interference with business, free trade even in the short run would frustrate the aims sought by the various interventionist measures.¹⁶

It is an illusion to believe that a nation would lastingly tolerate other nations' policies which harm the vital interest of its own citizens. Let us assume that the United Nations had been established in the year 1600 and that the Indian tribes of North America had been admitted as members of this organization. Then the sovereignty of these Indians would have been recognized as inviolable. They would have been given the right to exclude all aliens from entering their territory and from exploiting its rich natural resources which they themselves did not know how to utilize. Does anybody really believe that any international covenant or charter could have prevented the Europeans from invading these countries?

Many of the richest deposits of various mineral substances are located in areas whose inhabitants are too ignorant, too inert, or too dull to take advantage of the riches nature has bestowed upon them. If the governments of these countries prevent aliens from exploiting these deposits, or if their conduct of public affairs is so arbitrary that no foreign investments are safe, serious harm is inflicted upon all those foreign peoples whose material well-being could be improved by a more adequate utilization of the deposits concerned. It does not matter

16.Cf. above, pp. 366-368, and below, pp. 823-825.

whether the policies of these governments are the outcome of a general cultural backwardness or of the adoption of the now fashionable ideas of interventionism and economic nationalism. The result is the same in both cases.

There is no use in conjuring away these conflicts by wishful thinking. What is needed to make peace durable is a change in ideologies. What generates war is the economic philosophy almost universally espoused today by governments and political parties. As this philosophy sees it, there prevail within the unhampered market economy irreconcilable conflicts between the interests of various nations. Free trade harms a nation; it brings about impoverishment. It is the duty of government to prevent the evils of free trade by trade barriers. We may, for the sake of argument, disregard the fact that protectionism also hurts the interests of the nations which resort to it. But there can be no doubt that protectionism aims at damaging the interests of foreign peoples and really does damage them. It is an illusion to assume that those injured will tolerate other nations' protectionism if they believe that they are strong enough to brush it away by the use of arms. The philosophy of protectionism is a philosophy of war. The wars of our age are not at variance with popular economic doctrines; they are, on the contrary, the inescapable result of a consistent application of these doctrines.

The League of Nations did not fail because its organization was deficient. It failed because it lacked the spirit of genuine liberalism. It was a convention of governments imbued with the spirit of economic nationalism and entirely committed to the principles of economic warfare. While the delegates indulged in mere academic talk about good will among the nations, the governments whom they represented inflicted a good deal of evil upon all other nations. The two decades of the League's functioning were marked by each nation's adamant economic warfare against all other nations. The tariff protectionism of the years before 1914 was mild indeed when compared with what developed in the 'twenties and 'thirties—viz., embargoes, quantitative trade control, foreign exchange control, monetary devaluation, and so on.¹⁷

The prospects for the United Nations are not much better, but rather worse. Every nation looks upon imports, especially upon imports of manufactured goods, as upon a disaster. It is the avowed goal of almost all

17. For an appraisal of the abortive attempts of the League to do away with economic warfare, cf. Rappard, *Le Nationalisme économique et la Société des Nations* (Paris, 1938).

countries to bar foreign manufactures as much as possible from access to their domestic markets. Almost all nations are fighting against the specter of an unfavorable balance of trade. They do not want to cooperate; they want to protect themselves against the alleged dangers of cooperation.

Part Five

Social Cooperation Without a Market

XXV. 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 regime*. 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 Orleans 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 naive 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

1. Cf. below, pp. 717-718.

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

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 naive 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 name 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.

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

3. Cf. Marx, *Das Kapital*, (7th ed. Hamburg, 1914), I, 728.

4. *Ibid.*

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 omniscient 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?

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 man-power 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.

XXVI. 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 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 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 concern-

ing 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 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 19890 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 attain-

ment of the ultimate ends sought. What is called conscious planning is precisely the elimination of conscious purposive action.

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 Schaffle, 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 their 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

1. Cf. above, pp. 246-250.

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 operation 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.

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.

2. It would hardly be worth while 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.

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.

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 better³ 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.

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

3. "Better" means, of course, more satisfactory from the point of view of the consumers buying on the market.

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

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.

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

5. Cf. above, pp. 305-308.

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

6. Cf. Mises, *Socialism*, pp. 137-142; 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.

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"⁷ and "omniscient." 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

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

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. 816-820.

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 at 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_I 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_I and V_n , the total supply⁹ of all original factors of production O_I and O_n , the total supply of all produced factors of production P_I and P_n , and summarize $O_I + P_I$ as M_I and $O_n + P_n$ as M_n . Finally we call the state of technological knowledge, T_I and T_n . For the solution of the equations a knowledge of V_n , $O_n + P_n = M_n$, and T_n is required. But what we know today is merely V_I , $O_I + P_I = M_I$, and T_I .

It would be impermissible to assume that these magnitudes for D_I 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_I 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_I 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 which must be produced in order to establish equilibrium. Equilibrium will emerge only when these disturbing parts of P_I , 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

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 T_I is equal to T_n if we are prepared to imply that technological knowledge has reached its final stage.

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

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. 207-214. - Therefore the construction of electronic computers does not affect our problem.

Part Six

The Hampered Market Economy

XXVII. 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

1. See above, pp. 258-259.

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?

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 (*Betriebsfuhrer* 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 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.

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. *De lege 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* 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 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-round planning.

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. Non cooperation 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? Of 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

2. See below, pp. 758-767.

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 well-being. 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 nonphilosopher 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 well-being, 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.

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!

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. 315-316.

5. (3rd. ed. Oxford, 1934), p. 74.

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

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

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

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.

6. 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 α 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 God-sent 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 naive 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.

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 common weal. 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 office-holders 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

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.

XXVIII. 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 construc-

tion 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.

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

of 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 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.

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

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 of 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.

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

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.*

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 XXXII.

XXIX. 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 teaching 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.

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

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. 614-617.

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 decreed 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.

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 benefitted 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 benefitted 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 rigidity and immutability of all data and oppose any change, including any therapeutical and technological improvement.³ If in acting 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

3. This consistency was displayed by some Nazi philosophers. Cf. Sombart, *A New Social Philosophy*, pp. 242-245.

4. See above, pp. 479-488.