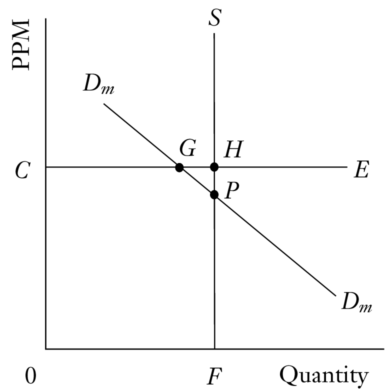

FIGURE 3. EFFECT OF GENERAL PRICE MAXIMA

0F is the money stock in the society; D_mD_m the social demand for money; *FP* is the equilibrium PPM (purchasing power of the monetary unit) set by the market. An imposed minimum PPM above the market (*0C*) impairs the clearing "mechanism" of the market. At *0C* the money stock exceeds the money demanded. As a result, the people possess a quantity of money *GH* in "unsold surplus." They try to sell their money by buying goods, but they cannot. Their money is anesthetized. To the extent that a government's overall price maximum is upheld, a part of the people's money becomes useless, for it cannot be exchanged. But a mad scramble inevitably takes place, with each one hoping that *his* money can be used.[2] Favoritism, lining up, bribes, etc., inevitably abound, as well as great pressure for the "black" market (i.e., *the* market) to provide a channel for the surplus money.

[2]Ironically, the government's destruction of part of the people's money almost always takes place after the government has pumped in new money and used it for its own purposes. The injury that the government imposes on the public is thus twofold: (1) it takes resources away from the public by inflating the currency; and (2) after the money has percolated down to the public, it destroys part of the money's usefulness.

A general price minimum is equivalent to a *maximum* control on the PPM. This sets up an unsatisfied, excess demand for money over the stock of money available—specifically, in the form of unsold stocks of goods in every field.

The principles of maximum and minimum price control apply to *all* prices, whatever they may be: consumer goods, capital goods, land or labor services, or the "price" of money in terms of other goods. They apply, for example, to minimum wage laws. When a minimum wage law is effective, i.e., where it imposes a wage above the market value of a type of labor (above the laborer's discounted marginal value product), the supply of labor services exceeds the demand, and this "unsold surplus" of labor services means *involuntary mass unemployment.* Selective, as opposed to general, minimum wage rates create unemployment in particular industries and tend to perpetuate these pockets by attracting labor to the higher rates. Labor is eventually forced to enter less remunerative, less value-productive lines. The result is the same whether the effective minimum wage is imposed by the State or by a labor union.

Our analysis of the effects of price control applies also, as Mises has brilliantly shown, to control over the price ("exchange rate") of one money in terms of another.[3] This was partially seen in Gresham's Law, but few have realized that this Law is merely a specific case of the general law of the effect of price controls. Perhaps this failure is due to the misleading formulation of Gresham's Law, which is usually phrased: "Bad money drives good money out of circulation." Taken at its face value, this is a paradox that violates the general rule of the market that the best methods of satisfying consumers tend to win out over the poorer. Even those who generally favor the free market have used this phrasing to justify a State monopoly over the coinage of gold and silver. Actually, Gresham's Law should read: "Money overvalued by the State will drive money undervalued by the

[3]Ludwig von Mises, *Human Action* (New Haven: Yale University Press, 1949), pp. 432 n., 447, 469, 776.

State out of circulation." Whenever the State sets an arbitrary value or price on one money in terms of another, it thereby establishes an effective minimum price control on one money and a maximum price control on the other, the "prices" being in terms of each other. This, for example, was the essence of bimetallism. Under bimetallism, a nation recognized gold and silver as moneys, but set an arbitrary price, or exchange ratio, between them. When this arbitrary price differed, as it was bound to do, from the free-market price (and such a discrepancy became ever more likely as time passed and the free-market price changed, while the government's arbitrary price remained the same), one money became overvalued and the other undervalued by the government. Thus, suppose that a country used gold and silver as money, and the government set the ratio between them at 16 ounces of silver to one ounce of gold. The market price, perhaps 16:1 at the time of the price control, then changes to 15:1. What is the result? Silver is now being arbitrarily undervalued by the government, and gold arbitrarily overvalued. In other words, silver is forced to be cheaper than it really is in terms of gold on the market, and gold is forced to be more expensive than it really is in terms of silver. The government has imposed a maximum price on silver and a minimum price on gold, in terms of each other.

The same consequences now follow as from any effective price control. With a maximum price on silver (and a minimum price on gold), the gold demand for silver in exchange exceeds the silver demand for gold. Gold goes begging for silver in unsold surplus, while silver becomes scarce and disappears from circulation. Silver disappears to another country or area where it can be exchanged at the free-market price, and gold, in turn, flows into the country. If the bimetallism is worldwide, then silver disappears into the "black" market, and official or open exchanges are made only with gold. No country, therefore, can maintain a bimetallic system in practice, because one money will always be under- or overvalued in terms of the other. The overvalued will always displace the undervalued from circulation.

It is possible to move, by government decree, from a specie money to a fiat paper currency. In effect, almost every government of the world has done so. As a result, each country has been saddled with its own money. In a free market, each fiat money will tend to exchange for another according to the fluctuations in their respective purchasing-power parities. Suppose, however, that Currency X has an arbitrary valuation placed by its government on its exchange rate with Currency Y. Thus, suppose five units of X exchange for one unit of Y on the free market. Now suppose that Country X artificially overvalues its currency and sets a fixed exchange rate of three X's to one Y. What is the result? A minimum price has been set on X's in terms of Y, and a maximum price on Y's in terms of X. Consequently, everyone scrambles to exchange X's for Y's at this cheap price for Y and thus profit on the market. There is an excess demand for Y in terms of X, and a surplus of X in relation to Y. Here is the explanation of that supposedly mysterious "dollar shortage" that plagued Europe after World War II. The European governments all overvalued their national currencies in terms of American dollars. As a consequence of the price control, dollars became short in terms of European currency, and the latter became a glut looking for dollars without finding them.

Another example of money-ratio price control is seen in the ancient problem of new versus worn coins. There grew up the custom of stamping coins with some *name* designating their weight in specie in terms of some unit of weight. Eventually, to "simplify" matters, governments began to decree worn coins to be equal in value to newly minted coins of the same denomination.[4] Thus, suppose that a 20-ounce silver coin was declared equal in value to a worn-out coin now weighing 18 ounces. What ensued was the inevitable effect of price control. The

[4]Perhaps one of the reasons was that State mint monopolies, instead of serving customers with desired coins, arbitrarily designated a few denominations that they would mint and circulate. A coin of slightly lighter weight was then treated as an intruder.

government had arbitrarily undervalued new coins and overvalued old ones. New coins were far too cheap, and old ones too expensive. As a result, the new coins promptly disappeared from circulation, to flow abroad or to remain under cover at home; and the old worn coins flooded in. This proved discouraging for the State mints, which could not keep coins in circulation, no matter how many they minted.[5]

The striking effects of Gresham's Law are partly due to a type of intervention adopted by almost every government—legal-tender laws. At any time in society there is a mass of unpaid debt contracts outstanding, representing credit transactions begun in the past and scheduled to be completed in the future. It is the responsibility of judicial agencies to enforce these contracts. Through laxity, the practice developed of stipulating in the contract that payment will be made in "money" without specifying which money. Governments then passed legal-tender laws, arbitrarily designating what is meant by "money" even when the creditors and debtors themselves would be willing to settle on something else. When the State decrees as money something other than what the parties to a transaction have in mind, an intervention has taken place, and the effects of Gresham's Law will begin to appear. Specifically, assume the existence of the bimetallic system mentioned above. When contracts were originally made, gold was worth 16 ounces of silver; now it is worth only 15. Yet the legal-tender laws specify "money" as being an equivalent of 16:1. As a result of these laws, everyone pays all his debts in the overvalued gold. Legal-tender laws reinforce the consequences of exchange-rate control, and the debtors have gained a privilege at the expense of their creditors.[6]

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[5]A modern example of the impossibility of keeping undervalued coins in circulation is the disappearance of silver dollars, half-dollars, and other coins that circulated in the United States during the 1960's. William F. Rickenbacker, *Wooden Nickels* (New Rochelle, N.Y.: Arlington House, 1966).

[6]On legal-tender laws, *see* Lord Farrer, *Studies in Currency 1898* (London: Macmillan & Co., 1898), p. 43, and Mises, *Human Action*, pp. 432 n., 444, 447.

Usury laws are another form of price control tinkering with the market. These laws place legal maxima on interest rates, outlawing any lending transactions at a higher rate. The amount and proportion of saving and the market rate of interest are basically determined by the time-preference rates of individuals. An effective usury law acts like other maxima—to induce a shortage of the service. For time preferences—and therefore the "natural" interest rate—remain the same. The fact that this interest rate is now illegal means that the marginal savers—those whose time preferences were highest—now stop saving, and the quantity of saving and investing in the economy declines. This results in lower productivity and lower standards of living in the future. Some people stop saving; others even dissave and consume their capital. The extent to which this happens depends on how effective the usury laws are, i.e., how far they hamper and distort voluntary market relations.

Usury laws are designed, at least ostensibly, to help the borrower, particularly the most risky borrower, who is "forced" to pay high interest rates to compensate for the added risk. Yet it is precisely these borrowers who are most hurt by usury laws. If the legal maximum is not too low, there will not be a serious decline in aggregate savings. But the maximum *is* below the market rate for the most risky borrowers (where the entrepreneurial component of interest is highest), and hence they are deprived of all credit facilities. When interest is voluntary, the lender will be able to charge very high interest rates for his loans, and thus anyone will be able to borrow if he pays the price. Where interest is controlled, many would-be borrowers are deprived of credit altogether.[7]

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[7]In recent years, the myth has developed that usury laws in the Middle Ages were justifiable because they dealt with the consumer who had to borrow rather than with productive business. On the contrary, it is precisely the risky consumer-borrower (who most "needs" the loan) who is most injured by the usury laws because he is the one deprived of credit.

Usury laws not only diminish savings available for lending and investment, but create an artificial "shortage" of credit, a perpetual condition where there is an excessive demand for credit at the legal rate. Instead of going to those most able and efficient, the credit will therefore have to be "rationed" by the lenders in some artificial and uneconomic way.

Although there have rarely been minimum interest rates imposed by government, their effect is similar to that of maximum rate control. For whenever time preferences and the natural interest rate fall, this condition is reflected in increased savings and investment. But when the government imposes a legal minimum, the interest rate cannot fall, and the people will not be able to carry through their increased investment, which would bid up factor prices. Minimum interest rates, therefore, also stunt economic development and impede a rise in living standards. Marginal borrowers would likewise be forced out of the market and deprived of credit.

To the extent that the market illegally reasserts itself, the interest rate on the loan will be higher to compensate for the extra risk of arrest under usury laws.

To sum up our analysis of the effects of price control: Directly, the utility of at least one set of exchangers will be impaired by the control. Further analysis reveals that the hidden, but just as certain, effects are to injure a substantial number of people who had *thought* they would gain in utility from the imposed controls. The announced aim of a maximum price control is to benefit the consumer by insuring his supply at a lower price; yet the objective result is to prevent many consumers from acquiring the good at all. The announced aim of a minimum price control is to insure higher prices for the sellers; yet the effect will be to prevent many sellers from selling any of

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On usury laws, *see* Rudolph C. Blitz and Millard F. Long, "The Economics of Usury Regulation," *Journal of Political Economy*, December, 1965, pp. 608–19.

their surplus. Furthermore, price controls distort production and the allocation of resources and factors in the economy, thereby injuring again the bulk of consumers. And we must not overlook the army of bureaucrats who must be financed by the binary intervention of taxation, and who must administer and enforce the myriad of regulations. This army, in itself, withdraws a mass of workers from productive labor and saddles them onto the backs of the remaining producers—thereby benefiting the bureaucrats, but injuring the rest of the people. This, of course, is the consequence of establishing an army of bureaucrats for any interventionary purpose whatever.

2. Product Control: Prohibition

Another form of triangular intervention is interference with the nature of production directly, rather than with the terms of exchange. This occurs when the government prohibits any production or sale of a certain product. The consequence is injury to all parties concerned: to the consumers, who lose utility because they cannot purchase the product and satisfy their most urgent wants; and to the producers, who are prevented from earning a higher remuneration in this field and must therefore be content with lower earnings elsewhere. This loss is borne not so much by entrepreneurs, who earn from ephemeral adjustments, or by capitalists, who tend to earn a uniform interest rate throughout the economy, as by laborers and landowners, who must accept permanently lower income. The only ones who benefit from the regulation, then, are the government bureaucrats themselves—partly from the tax-created jobs that the regulation creates, and perhaps also from the satisfaction gained from repressing others and wielding coercive power over them. Whereas with price control one could at least make out a *prima facie* case that one *set* of exchangers—producers or consumers—is being benefited, no such case can be made out for *prohibition*, where *both* parties to the exchange, producers and consumers, invariably lose.

In many instances of product prohibition, of course, inevitable pressure develops for the reestablishment of the market illegally, i.e., as a "black" market. As in the case of price control, a black market creates difficulties because of its illegality. The supply of the product will be scarcer, and the price of the product will be higher to compensate the producers for the risk of violating the law; and the more strict the prohibition and penalties, the scarcer the product and the higher the price will be. Furthermore, the illegality hinders the process of distributing to the consumers information (e.g., by way of advertising) about the existence of the market. As a result, the organization of the market will be far less efficient, the service to the consumer will decline in quality, and prices again will be higher than under a legal market. The premium on secrecy in the "black" market also militates against large-scale business, which is likely to be more visible and therefore more vulnerable to law enforcement. The advantages of efficient large-scale organization are thus lost, injuring the consumer and raising prices because of the diminished supply.[8] Paradoxically, the prohibition may serve as a form of grant of monopolistic privilege to the black marketeers, since they are likely to be very different entrepreneurs from those who would succeed in a legal market. For in the black market, rewards accrue to skill in bypassing the law or in bribing government officials.

There are various types of prohibition. There is *absolute prohibition*, where the product is completely outlawed. There are also forms of *partial prohibition*: an example is *rationing*, where consumption beyond a certain amount is prohibited by the State. The clear effect of rationing is to injure consumers and

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[8]It is interesting to note that the bulk of "organized crime" occurs not as invasions of persons and property (in natural law, the *mala per se*), but as attempts to circumvent government prohibitions in order to satisfy the desires of consumers and producers alike more efficiently (the *mala prohibita*). Entrepreneurs of the latter kind constitute the generally despised "black marketeers" and "racketeers."

lower the standard of living of everyone. Since rationing places legal maxima on specific items of consumption, it also distorts the pattern of consumers' spending. The unrationed, or less stringently rationed, goods are bought more heavily, whereas consumers would have preferred to buy more of the rationed goods. Thus, consumer spending is coercively shifted from the more to the less heavily rationed commodities. Moreover, the ration tickets introduce a new type of quasi money; the functions of money on the market are crippled and atrophied, and confusion reigns. The main function of money is to be bought by producers and spent by consumers; but, under rationing, consumers are estopped from using their money to the full and blocked from using their dollars to direct and allocate factors of production. They must also use arbitrarily designated and distributed ration tickets—an inefficient kind of double money. The pattern of consumer spending is particularly distorted, and since ration tickets are usually not transferable, people who do not want brand X are not permitted to exchange these coupons for goods not wanted by others.[9]

Priorities and allocations by the government are another type of prohibition, as well as another jumbling of the price system. Efficient buyers are prevented from obtaining goods, while inefficient ones find that they can acquire a plethora. Efficient firms are no longer allowed to bid away factors or resources from inefficient firms; the efficient firms are, in effect, crippled, and the inefficient ones subsidized. Government priorities again basically introduce another form of double money.

Maximum-hour laws enforce compulsory idleness and prohibit work. They are a direct attack on production, injuring the worker who wants to work, reducing his earnings, and lowering

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[9]The workings of rationing (as well as the socialist system in general) have never been more vividly portrayed than in Henry Hazlitt's novel, *The Great Idea* (New York: Appleton-Century-Crofts, 1951), reissued as *Time Will Run Back* (New Rochelle, N.Y.: Arlington House, 1967).

the living standards of the entire society.[10] *Conservation laws*, which also prevent production and cause lower living standards, will be discussed more fully below. In fact, the monopoly grants of privilege discussed in the next section are also prohibitions, since they grant the privilege of production to some by prohibiting production to others.

3. Product Control: Grant of Monopolistic Privilege

Instead of making the product prohibition absolute, the government may prohibit production and sale *except* by a certain firm or firms. These firms are then specially privileged by the government to engage in a line of production, and therefore this type of prohibition is a *grant of special privilege*. If the grant is to one person or firm, it is a *monopoly* grant; if to several persons or firms, it is a *quasi-monopoly* or *oligopoly* grant. Both types of grant may be called *monopolistic*. It is obvious that the grant benefits the monopolist or quasi monopolist because his competitors are barred by violence from entering the field; it is also evident that the would-be competitors are injured and are forced to accept lower remuneration in less efficient and value-productive fields. The consumers are likewise injured, for they are prevented from purchasing their products from competitors whom they would freely prefer. And this injury takes place apart from any effect of the grant on prices.

Although a monopolistic grant may openly and directly confer a privilege and exclude rivals, in the present day it is far more likely to be hidden or indirect, cloaked as a type of penalty on competitors, and represented as favorable to the "general welfare." The effects of monopolistic grants are the same, however, whether they are direct or indirect.

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[10]On maximum hour laws, *see* W.H. Hutt, "The Factory System of the Early Nineteenth Century" in F.A. Hayek, ed., *Capitalism and the Historians* (Chicago: University of Chicago Press, 1954), pp. 160–88.

The theory of monopoly price is illusory when applied to the free market, but it applies fully to the case of monopoly and quasi-monopoly grants. For *here* we have an identifiable distinction—not the spurious distinction between "competitive" and "monopoly" or "monopolistic" price—but one between the *free-market price* and the *monopoly price*. For the free-market price is conceptually identifiable and definable, whereas the "competitive price" is not.[11] The monopolist, as a receiver of a monopoly privilege, will be able to achieve a monopoly price for the product if his demand curve is inelastic, or sufficiently less elastic, above the free-market price. On the free market, *every* demand curve to a firm is *elastic* above the free-market price; otherwise the firm would have an incentive to raise its price and increase its revenue. But the grant of monopoly privilege renders the consumer demand curve less elastic, for the consumer is deprived of substitute products from other would-be competitors.

Where the demand curve to the firm remains highly elastic, the monopolist will not reap a *monopoly gain* from his grant. Consumers and competitors will still be injured because of the prevention of their trade, but the monopolist will not gain, because his price and income will be no higher than before. On the other hand, if his demand curve is now inelastic, then he institutes a monopoly price so as to maximize his revenue. His production has to be restricted in order to command the higher price. The restriction of production and the higher price for the product both injure the consumers. In contrast to conditions on the free market, we may no longer say that a restriction of production (such as in a voluntary cartel) benefits the consumers by arriving at the most value-productive point; on the contrary, the consumers are injured because their free choice would have resulted in the free-market price. Because of coercive force applied by the State, they may not purchase goods freely from all those willing to sell. In other words, any

[11]*See Man, Economy, and State*, chapter 10, for a refutation of monopoly theories on the free market.

approach *toward* the free-market equilibrium price and output point for any product benefits the consumers and thereby benefits the producers as well. Any movement *away* from the free-market price and output injures the consumers. The monopoly price resulting from a grant of monopoly privilege leads away from the free-market price; it lowers output and raises prices beyond what would be established if consumers and producers could trade freely.

We cannot *here* use the argument that the restriction of output is voluntary because the consumers make their own demand curve inelastic. For the consumers are fully responsible for their demand curve only on the *free market*; and only *this* demand curve can be treated as an expression of their voluntary choice. Once the government steps in to prohibit trade and grant privileges, there is no longer wholly voluntary action. Consumers are forced, willy-nilly, to deal with the monopolist for a certain range of purchases.

All the effects that the monopoly-price theorists have mistakenly attributed to voluntary cartels *do* apply to governmental monopoly grants. Production is restricted and factors misallocated. It is true that the nonspecific factors are again released for production elsewhere. But now we can say that this production will satisfy the consumers less than under free-market conditions; furthermore, the factors will earn less in the other occupations.

There can never be lasting monopoly *profits*, since profits are ephemeral, and all eventually reduce to a uniform interest return. In the long run, monopoly returns are imputed to some *factor*. What is the factor that is being monopolized in this case? It is obvious that this factor is the *right* to enter the industry. In the free market, this right is unlimited to all; here, however, the government has granted special privileges of entry and sale, and it is these special privileges or rights that are responsible for the extra monopoly gain from the monopoly price. The monopolist earns a monopoly gain, therefore, not for owning any productive factor, but from a special privilege granted by the government. And this gain does not disappear in the long run as do profits; it is permanent, so long as the privilege remains, and consumer valuations continue as they are. Of course, the monopoly gain will tend to be capitalized into the asset value of the firm, so that subsequent owners, who invest in the firm after the privilege is granted and the capitalization takes place, will be earning only the generally uniform interest return on their investment.

This whole discussion applies to the *quasi monopolist* as well as to the monopolist. The quasi monopolist has some competitors, but their number is restricted by the government privilege. Each quasi monopolist will now have a differently shaped demand curve for *his* product on the market and will be affected differently by the privilege. Those quasi monopolists whose demand curves become inelastic will reap a monopoly gain; those whose demand curves remain highly elastic will reap no gain from the privilege. *Ceteris paribus*, of course, a monopolist is more likely to achieve a monopoly gain than a quasi monopolist; but whether each achieves a gain, and how much, depends purely on the data of each particular case.

We must note again what we have said above: that even where no monopolist or quasi monopolist can achieve a monopoly price, the consumers are still injured because they are barred from buying from the most efficient and value-productive producers. Production is thereby restricted, and the decrease in output (particularly of the most efficiently produced output) raises the price to consumers. If the monopolist or quasi monopolist also achieves a monopoly price, the injury to consumers and the misallocation of production will be redoubled.

Since outright grants of monopoly or quasi monopoly would usually be considered baldly injurious to the public, governments have discovered a variety of methods of granting such privileges indirectly, as well as a variety of arguments to justify these measures. But they all have the effects common to monopoly or quasi-monopoly grants and monopoly prices when these are obtained.

The important types of *monopolistic grants* (monopoly and quasi monopoly) are as follows: (1) governmentally enforced *cartels* which every firm in an industry is compelled to join; (2) *virtual cartels* imposed by the government, such as the production quotas enforced by American agricultural policy; (3) *licenses*, which require meeting government rules before a man or a firm is permitted to enter a certain line of production, and which also require the payment of a fee—a payment that serves as a penalty tax on smaller firms with less capital, which are thereby debarred from competing with larger firms; (4) *"quality" standards*, which prohibit competition by what the government (not the consumers) defines as "lower-quality" products; (5) *tariffs* and other measures that levy a *penalty tax* on competitors outside a given geographical region; (6) *immigration restrictions*, which prohibit the competition of laborers, as well as entrepreneurs, who would otherwise move from another geographical region of the world market; (7) *child labor laws*, which prohibit the labor competition of workers below a certain age; (8) *minimum wage laws*, which, by causing the unemployment of the least value-productive workers, remove their competition from the labor markets; (9) *maximum hour laws*, which force partial unemployment on those workers who are willing to work longer hours; (10) *compulsory unionism*, such as the Wagner-Taft-Hartley Act imposes, causing unemployment among the workers with the least seniority or the least political influence in their union; (11) *conscription*, which forces many young men out of the labor force; (12) any sort of governmental penalty on any form of industrial or market organization, such as *antitrust laws*, special *chain store taxes*, *corporate income taxes*, laws *closing businesses* at specific hours or outlawing *pushcart peddlers* or *door-to-door salesmen*; (13) *conservation laws*, which restrict production by force; (14) *patents*, where independent later discoverers of a process are debarred from entering a field production.[12,13]

[12]For an interesting, though incomplete, discussion of many of these measures (an area largely neglected by economists), *see* Fritz Machlup,

A. Compulsory Cartels

Compulsory cartels are a forcing of all producers in an industry into one organization, or virtual organization. Instead of being directly barred from an industry, firms are forced to obey governmentally imposed quotas of maximum output. Such cartels invariably go hand in hand with a governmentally imposed program of minimum price control. When the government comes to realize that minimum price control by itself will lead to unsold surpluses and distress in the industry, it imposes quota restrictions on the output of producers. Not only does this action injure consumers by restricting production and lowering output; the output must also be produced by certain State-designated producers. Regardless of how the quotas are arrived at, they are arbitrary; and as time passes, they more and more distort the production structure that attempts to adjust to consumer demands. Efficient newcomers are prevented from serving consumers, and inefficient firms are preserved because they are exempted by their old quotas from the necessity of meeting superior competition. Compulsory cartels furnish a haven in which the inefficient firms prosper at the expense of the efficient firms and of the consumers.

B. Licenses

Little attention has been paid to licenses; yet they constitute one of the most important (and steadily growing) monopolistic impositions in the current American economy. Licenses deliberately restrict the supply of labor and of firms in the licensed occupations. Various rules and requirements are imposed for work in the occupation or for entry into a certain line of business. Those who cannot qualify under the rules are prevented

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The Political Economy of Monopoly (Baltimore: Johns Hopkins Press, 1952), pp. 249–329.

[13]Subsidies, of course, penalize competitors not receiving the subsidy, and thus have a decided monopolistic impact. But they are best discussed as part of the budgetary, binary intervention of government.

from entry. Further, those who cannot meet the price of the license are barred from entry. Heavy license fees place great obstacles in the way of competitors with little initial capital. Some licenses such as those required in the liquor and taxicab businesses in some states impose an absolute limit on the number of firms in the business. These licenses are negotiable, so that any new firm must buy from an older firm that wants to go out of business. Rigidity, inefficiency, and lack of adaptability to changing consumer desires are all evident in this arrangement. The market in license rights also demonstrates the burden that licenses place upon new entrants. Professor Machlup points out that the governmental administration of licensing is almost invariably in the hands of members of the trade, and he cogently likens the arrangements to the "self-governing" guilds of the Middle Ages.[14]

Certificates of convenience and necessity are required of firms in industries—such as railroads, airlines, etc.—regulated by governmental commissions. These act as licenses but are generally far more difficult to obtain. This system excludes would-be entrants from a field, granting a monopolistic privilege to the firms remaining; furthermore, it subjects them to the detailed orders of the commission. Since these orders countermand those of the free market, they invariably result in imposed inefficiency and injury to the consumers.[15]

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[14]*Ibid.* On licenses, *see also* Thomas H. Barber, *Where We Are At* (New York: Charles Scribners' Sons, 1950), pp. 89–93; George J. Stigler, *The Theory of Price* (New York: Macmillan & Co., 1946), p. 212; and Walter Gellhorn, *Individual Freedom and Governmental Restraints* (Baton Rouge: Louisiana State University Press, 1956), pp. 105–51, 194–210.

[15]A glaring example of a Commission's role in banning efficient competitors from an industry is the Civil Aeronautics Board decision to close up Trans-American Airlines, despite a perfect safety record. Trans-American had pioneered in rate reductions for airline service. On the CAB, *see* Sam Peltzman, "CAB: Freedom from Competition," *New Individualist Review*, Spring, 1963, pp. 16–23.

Licenses to *workers*, as distinct from businesses, differ from most other monopolistic grants, which *may* confer a *monopoly price*. For the former license *always* confers a *restrictionist price*. Unions gain restrictionist wage rates by restricting the labor supply in an occupation. Here, once again, the same conditions prevail: other factors are forcibly excluded, and, since the monopolist does not *own* these excluded factors, he is not losing any revenue. Since a license always restricts entry into a field, it thereby always lowers supply and raises prices, or wage rates. The reason that a monopolistic grant to a *business* does not *always* raise prices, is that businesses can always expand or contract their production at will. Licensing of grocers does not necessarily reduce total supply, because it does not preclude the indefinite enlargement of the *licensed* grocery firms, which can take up the slack created by the exclusion of would-be competitors. But, aside from hours worked, restriction of entry into a labor market must always reduce the total supply of that labor. Hence, licenses or other monopolistic grants to businesses may or may not confer a monopoly price—depending on the elasticity of the demand curve; whereas licenses to laborers *always* confer a higher, restrictionist price on the licensees.

C. Standards of Quality and Safety

One of the favorite arguments for licensing laws and other types of *quality standards* is that governments must "protect" consumers by insuring that workers and businesses sell goods and services of the highest quality. The answer, of course, is that "quality" is a highly elastic and relative term and is decided by the consumers in their free actions in the marketplace. The consumers decide according to their own tastes and interests, and particularly according to the price they wish to pay for the service. It may very well be, for example, that a certain number of years' attendance at a certain type of school turns out the best quality of doctors (although it is difficult to see why the government must guard the public from unlicensed cold-cream demonstrators or from plumbers without a college degree or with less than ten years' experience). But by prohibiting the practice of medicine by people who do not meet these requirements, the government is injuring consumers who would buy the services of the outlawed competitors, is protecting "qualified" but less value-productive doctors from outside competition, and also grants restrictionist prices to the remaining doctors.[16] Consumers are prevented from choosing lower-quality treatment of minor ills, in exchange for a lower price, and are also prevented from patronizing doctors who have a different theory of medicine from that sanctioned by the state-approved medical schools.

How much these requirements are designed to "protect" the health of the public, and how much to restrict competition, may be gauged from the fact that giving medical advice free without a license is rarely a legal offense. Only the *sale* of medical advice requires a license. Since someone may be injured as much, if not more, by free medical advice than by purchased advice, the major purpose of the regulation is clearly to restrict competition rather than to safeguard the public.[17]

Other quality standards in production have an even more injurious effect. They impose governmental definitions of products and require businesses to hew to the specifications laid down by these definitions. Thus, the government defines "bread" as being of a certain composition. This is supposed to be a safeguard against "adulteration," but in fact it prohibits *improvement*. If the government defines a product in a certain

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[16]It is hardly remarkable that we hear continual complaints about a "shortage" of doctors and teachers, but rarely hear complaints of shortages in unlicensed occupations. On licensing in medicine, *see* Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1963), pp. 149–60; Reuben A. Kessel, "Price Discrimination in Medicine," *Journal of Law and Economics*, October, 1958, pp. 20–53.

[17]For an excellent analysis of the workings of compulsory quality standards in a concrete case, *see* P.T. Bauer, *West African Trade* (Cambridge: Cambridge University Press, 1954), pp. 365–75.

way, it prohibits change. A change, to be accepted by consumers, *has* to be an improvement, either absolutely or in the form of a lower price. Yet it may take a long time, if not forever, to persuade the government bureaucracy to change the requirements. In the meantime, competition is injured, and technological improvements are blocked.[18] "Quality" standards, by shifting decisions about quality from the consumers to arbitrary government boards, impose rigidities and monopolization on the economic system.

In the free economy, there would be ample means to obtain redress for direct injuries or fraudulent "adulteration." No system of government "standards" or army of administrative inspectors is necessary. If a man is sold adulterated food, then clearly the seller has committed fraud, violating his contract to sell the food. Thus, if A sells B breakfast food, and it turns out to be straw, A has committed an illegal act of fraud by telling B he is selling him food, while actually selling straw. This is punishable in the courts under "libertarian law," i.e., the legal code of the free society that would prohibit all invasions of persons and property. The loss of the product and the price, plus suitable damages (paid to the *victim*, not to the State), would be included in the punishment of fraud. No administrator is needed to prevent nonfraudulent sales; if a man simply sells what he calls "bread," it must meet the *common definition* of bread held by consumers, and not some arbitrary specification. However, if he *specifies* the composition on the loaf, he is liable for prosecution if he is lying. It must be emphasized that the crime is not lying *per se*, which is a moral problem not under the province of a free-market defense agency, but *breaching a contract*—taking someone else's property under false pretenses and therefore being guilty of fraud. If, on the other hand, the adulterated product injures the health of the buyer (such as by an inserted

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[18]For case studies of the effects of such "quality" standards, *see* George J. Alexander, *Honesty and Competition* (Syracuse: Syracuse University Press, 1967).

poison), the seller is further liable for prosecution for injuring and assaulting the person of the buyer.[19]

Another type of quality control is the alleged "protection" of investors. SEC regulations force new companies selling stock, for example, to comply with certain rules, issue brochures, etc. The net effect is to hamper new and especially small firms and restrict them in acquiring capital, thereby conferring a monopolistic privilege upon existing firms. Investors are prohibited from investing in particularly risky enterprises. SEC regulations, "blue-sky laws," etc., thereby restrict the entry of new firms and prevent investment in risky but possibly successful ventures. Once again, efficiency in business and service to the consumer are hampered.[20]

Safety codes are another common type of quality standard. They prescribe the details of production and outlaw differences. The free-market method of dealing, say, with the collapse of a building killing several persons, is to send the owner of the building to jail for manslaughter. But the free market can countenance no arbitrary "safety" code promulgated in advance of any crime. The current system does *not* treat the building owner as a virtual murderer should a collapse occur; instead, he merely pays a sum of monetary damages. In that way, invasion of person goes relatively unpunished and undeterred. On the other hand, administrative codes proliferate, and their general effect is to prevent major improvements in the building industry and thus

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[19]On adulteration and fraud, *see* the definitive discussion by Wordsworth Donisthorpe, *Law in a Free State* (London: Macmillan & Co., 1895), pp. 132–58.

[20]Some people who generally adhere to the free market support the SEC and similar regulations on the ground that they "raise the moral tone of competition." Certainly they *restrict* competition, but they cannot be said to "raise the moral tone" until morality is successfully defined. How can morality in production be defined except as efficient service to the consumer? And how can anyone be "moral" if he is prevented by force from acting otherwise?

to confer monopolistic privileges on existing builders, as contrasted with potentially innovating competitors.[21] Evasion of safety codes through bribery then permits the actual aggressor (the builder whose property injures someone) to continue unpunished and go scot free.

It might be objected that free-market defense agencies must wait until *after* people are injured to *punish*, rather than *prevent*, crime. It is true that on the free market only overt acts can be punished. There is no attempt by anyone to tyrannize over anyone else on the ground that some future crime might possibly be prevented thereby. On the "prevention" theory, any sort of invasion of personal freedom can be, and in fact must be, justified. It is certainly a ludicrous procedure to attempt to "prevent" a few future invasions by committing permanent invasions against everyone.[22]

Safety regulations are also imposed on labor contracts. Workers and employers are prevented from agreeing on terms of hire unless certain governmental rules are obeyed. The result is a loss imposed on workers and employers, who are denied their freedom to contract, and who must turn to other, less remunerative employments. Factors are therefore distorted and misallocated in relation to both the maximum satisfaction of the consumers and maximum return to factors. Industry is rendered less productive and flexible.

Another use of "safety regulations" is to prevent geographic competition, i.e., to keep consumers from buying goods from efficient producers located in other geographical areas. Analytically, there is little distinction between competition in general

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[21]The building industry is so constituted that many laborers are quasi-independent entrepreneurs. Safety codes therefore compound the restrictionism of building unions.

[22]We might add here that on the purely free market even the "clear and present danger" criterion would be far too lax and subjective a definition for a punishable deed.

and in location, since location is simply one of the many advantages or disadvantages that competing firms possess. Thus, state governments have organized compulsory milk cartels, which set minimum prices and restrict output, and absolute embargoes are levied on out-of-state milk imports, under the guise of "safety." The effect, of course, is to cut off competition and permit monopoly pricing. Furthermore, safety requirements that go far beyond those imposed on local firms are often exacted on out-of-state products.[23]

D. Tariffs

Tariffs and various forms of import quotas prohibit, partially or totally, geographical competition for various products. Domestic firms are granted a quasi monopoly and, generally, a monopoly price. Tariffs injure the consumers within the "protected" area, who are prevented from purchasing from more efficient competitors at a lower price. They also injure the more efficient foreign firms and the consumers of all areas, who are deprived of the advantages of geographic specialization. In a free market, the best resources will tend to be allocated to their most value-productive locations. Blocking interregional trade will force factors to obtain lower remuneration at less efficient and less value-productive tasks.

Economists have devoted a great deal of attention to the "theory of international trade"—attention far beyond its analytic importance. For, on the free market, there would be no separate theory of "international trade" at all—and the free market is the locus of the fundamental analytic problems. Analysis of interventionary situations consists simply in comparing their effects to what would have occurred on the free market. "Nations" may be important politically and culturally, but economically they appear only as a consequence of government intervention, either in the form of tariffs or other barriers

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[23]*See* Stigler, *Theory of Price*, p. 211.

to geographic trade, or as some form of monetary intervention.[24]

Tariffs have inspired a profusion of economic speculation and argument. The arguments for tariffs have one thing in common: they all attempt to prove that the consumers of the protected area are *not* exploited by the tariff. These attempts are all in vain. There are many arguments. Typical are worries about the continuance of an "unfavorable balance of trade." But every individual decides on his purchases and therefore determines whether his balance should be "favorable" or "unfavorable"; "unfavorable" is a misleading term because any purchase is the action most *favorable* for the individual at the time. The same is therefore true for the consolidated balance of a region or a country. There can be no "unfavorable" balance of trade from a region unless the traders so will it, either by selling their gold reserve, or by borrowing from others (the loans being voluntarily granted by creditors).

The absurdity of the protariff arguments can be seen when we carry the idea of a tariff to its logical conclusion—let us say, the case of two individuals, Jones and Smith. This is a valid use of the *reductio ad absurdum* because the same qualitative effects take place when a tariff is levied on a whole nation as when it is levied on one or two people; the difference is merely one of degree.[25] Suppose that Jones has a farm, "Jones' Acres," and Smith works for him. Having become steeped in protariff ideas, Jones exhorts Smith to "buy Jones' Acres." "Keep the money in Jones' Acres," "don't be exploited by the flood of products from

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[24]*See* Henry George, *Protection or Free Trade* (New York: Robert Schalkenbach Foundation, 1946), pp. 37–44. On free trade and protection, *see* Leland B. Yeager and David Tuerck, *Trade Policy and The Price System* (Scranton, Pa.: International Textbook Co., 1966).

[25]The impact of a tariff is clearly greater the smaller the geographic area of traders it covers. A tariff "protecting" the whole world would be meaningless, at least until other planets are brought within our trading market.

the cheap labor of foreigners outside Jones' Acres," and similar maxims become the watchword of the two men. To make sure that their aim is accomplished, Jones levies a 1,000-percent tariff on the imports of all goods and services from "abroad," i.e., from outside the farm. As a result, Jones and Smith see their leisure, or "problems of unemployment," disappear as they work from dawn to dusk trying to eke out the production of all the goods they desire. Many they cannot raise at all; others they can, given centuries of effort. It is true that they reap the promise of the protectionists: "self-sufficiency," although the "sufficiency" is bare subsistence instead of a comfortable standard of living. Money is "kept at home," and they can pay each other very high *nominal* wages and prices, but the men find that the real value of their wages, in terms of goods, plummets drastically.

Truly we are now back in the situation of the isolated or barter economies of Crusoe and Friday. And that is effectively what the *tariff principle* amounts to. This principle is an attack on the market, and its logical goal is the self-sufficiency of individual producers; it is a goal that, if realized, would spell poverty for all, and death for most, of the present world population. It would be a regression from civilization to barbarism. A mild tariff over a wider area is perhaps only a push in that direction, but it *is* a push, and the arguments used to justify the tariff apply equally well to a return to the "self-sufficiency" of the jungle.[26,27]

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[26]The tariff advocates will not wish to push the argument to this length, since all parties clearly lose so drastically. With a milder tariff, on the other hand, the tariff-protected "oligopolists" may gain more (in the short run) from exploiting the domestic consumers than they lose from being consumers themselves.

[27]Our two-man example is similar to the illustration used in the keen critique of protection by Frederic Bastiat. *See* Bastiat, *Economic Sophisms* (Princeton, N.J.: D. Van Nostrand, 1964), pp. 242–50, 202–09. *Also see* the "Chinese Tale," and the famous "Candlemakers' Petition," *ibid.*, pp. 182–86, 56–60. *Also see* the critique of the tariff in George,

One of the keenest parts of Henry George's analysis of the protective tariff is his discussion of the term "protection":

> Protection implies prevention. . . . What is it that protection by tariff prevents? It is trade. . . . But trade, from which "protection" essays to preserve and defend us, is not, like flood, earthquake, or tornado, something that comes without human agency. Trade implies human action. There can be no need of preserving from or defending against trade, unless there are men who want to trade and try to trade. Who, then, are the men against whose efforts to trade "protection" preserves and defends us? . . . the desire of one party, however strong it may be, cannot of itself bring about trade. To every trade there must be two parties who actually desire to trade, and whose actions are reciprocal. No one can buy unless he finds someone willing to sell; and no one can sell unless there is some other one willing to buy. If Americans did not want to buy foreign goods, foreign goods could not be sold here even if there were no tariff. The efficient cause of the trade which our tariff aims to prevent is the desire of Americans to buy foreign goods, not the desire of foreign producers to sell them. . . . It is not from foreigners that protection preserves and defends us; it is from ourselves.[28]

Ironically, the long-run exploitative possibilities of the protective tariff are far less than those that arise from other forms of monopoly grant. For only firms *within* an area are protected; yet anyone is permitted to establish a firm there—even foreigners.

Protection or Free Trade, pp. 51–54; and Arthur Latham Perry, *Political Economy* (New York: Charles Scribners' Sons, 1892), pp. 509 ff.

[28]George, *Protection or Free Trade*, pp. 45–46. Also on free trade and protection, *see* C.F. Bastable, *The Theory of International Trade* (2nd ed.; London: Macmillan & Co., 1897), pp. 128–56; and Perry, *Political Economy*, pp. 461–533.

As a result, other firms, from within and without the area, will flock into the protected industry and the protected area, until finally the monopoly gain disappears, although misallocation of production and injury to consumers remain. In the long run, therefore, a tariff *per se* does not establish a lasting benefit even for the immediate beneficiaries.

Many writers and economists, otherwise in favor of free trade, have conceded the validity of the "infant industry argument" for a protective tariff. Few free-traders, in fact, have challenged the argument beyond warning that the tariff might be continued beyond the stage of "infancy" of the industry. This reply in effect concedes the validity of the "infant industry" argument. Aside from the utterly false and misleading biological analogy, which compares a newly established industry to a helpless new-born baby who needs protection, the substance of the argument has been stated by Taussig:

> The argument is that while the price of the protected article is temporarily raised by the duty, eventually it is lowered. Competition sets in . . . and brings a lower price in the end. . . . This reduction in domestic price comes only with the lapse of time. At the outset the domestic producer has difficulties, and cannot meet the foreign competition. In the end he learns how to produce to best advantage, and then can bring the article to market as cheaply as the foreigner, even more cheaply.[29]

Thus, older competitors are alleged to possess historically acquired skill and capital that enable them to outcompete any new rivals. Wise protection of the government granted to the new firms, therefore, will, in the long run, promote rather than hinder competition.

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[29]F.W. Taussig, *Principles of Economics* (2nd ed.; New York: Macmillan & Co., 1916), p. 527.

The infant industry argument reverses the true conclusion from a correct premise. The fact that capital has already been sunk in older locations does, it is true, give the older firms an advantage, even if today, in the light of present knowledge and consumer wants, the investments would have been made in the new locations. But the point is that we must always work with a given situation, with the capital handed down to us by the investment of our ancestors. The fact that our ancestors made mistakes—from the point of view of our present superior knowledge—is unfortunate, but we must always do the best with what we have. We do not and never can begin investing from scratch; indeed, if we did, we should be in the situation of Robinson Crusoe, facing land again with our bare hands and no inherited equipment. Therefore, we must make use of the advantages given us by the sunk capital of the past. To subsidize new plants would be to injure consumers by depriving them of the advantages of historically given capital.

In fact, if long-run prospects in the new industry are so promising, why does not private enterprise, ever on the lookout for a profitable investment opportunity, enter the new field? Only because entrepreneurs realize that such investment would be uneconomic, i.e., it would waste capital, land, and labor that could otherwise be invested to satisfy more urgent desires of the consumers. As Mises says:

> The truth is that the establishment of an infant industry is advantageous from the economic point of view only if the superiority of the new location is so momentous that it outweighs the disadvantages resulting from abandonment of nonconvertible and nontransferable capital goods invested in the older established plants. If this is the case, the new plants will be able to compete successfully with the old ones without any aid given by the government. If it is not the case, the protection granted to them is wasteful, even if it is only temporary and enables the new industry to hold its own at a later period. The tariff amounts virtually to a subsidy which the consumers

> are forced to pay as a compensation for the employment of scarce factors of production for the replacement of still utilizable capital goods to be scrapped and the withholding of these scarce factors from other employments in which they could render services valued higher by the consumers. . . . In the absence of tariffs the migration of industries [to better locations] is postponed until the capital goods invested in the old plants are worn out or become obsolete by technological improvements which are so momentous as to necessitate their replacement by new equipment.[30]

Logically, the infant industry argument must be applied to interlocal and interregional trade as well as international. Failure to realize this is one of the reasons for the persistence of the argument. Logically extended, in fact, the argument would have to imply that it is impossible for *any* new firm to exist and grow against the competition of older firms, wherever their locations. New firms, after all, have their own peculiar advantage to offset that of existing sunken capital possessed by the old firms. New firms can begin afresh with the latest and most productive equipment as well as on the best locations. The advantages and disadvantages of a new firm must be weighed against each other by entrepreneurs in each case, to discover the most profitable, and therefore the most serviceable, course.[31]

E. Immigration Restrictions

Laborers may also ask for geographical grants of oligopoly in the form of *immigration restrictions*. In the free market the inexorable trend is to equalize wage rates for the same value-productive work all over the earth. This trend is dependent on two modes of adjustment: businesses flocking from high-wage

[30]Mises, *Human Action*, p. 506.

[31]*See also* W.M. Curtiss, *The Tariff Idea* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1953), pp. 50–52.

to low-wage areas, and workers flowing from low-wage to high-wage areas. Immigration restrictions are an attempt to gain *restrictionist* wage rates for the inhabitants of an area. They constitute a restriction rather than monopoly because (*a*) in the labor force, each worker owns himself, and therefore the restrictionists have no control over the whole of the supply of labor; and (*b*) the supply of labor is large in relation to the possible variability in the hours of an individual worker, i.e., a worker cannot, like a monopolist, take advantage of the restriction by increasing his output to take up the slack, and hence obtaining a higher price is not determined by the elasticity of the demand curve. A higher price is obtained in any case by the restriction of the supply of labor. There is a connexity throughout the entire labor market; labor markets are linked with each other in different occupations, and the *general* wage rate (in contrast to the rate in specific industries) is determined by the total supply of all labor, as compared with the various demand curves for different types of labor in different industries. A reduced total supply of labor in an area will thus tend to shift all the various supply curves for individual labor factors to the left, thus increasing wage rates all around.

Immigration restrictions, therefore, may earn restrictionist wage rates for *all* people in the restricted area, although clearly the greatest relative gainers will be *those who would have directly competed in the labor market with the potential immigrants.* They gain at the expense of the excluded people, who are forced to accept lower-paying jobs at home.

Obviously, not every geographic area will gain by immigration restrictions—only a high-wage area. Those in relatively low-wage areas rarely have to worry about immigration: there the pressure is to emigrate.[32] The high-wage areas won their

[32] Many States have imposed *emigration restrictions* upon their subjects. These are not monopolistic; they are probably motivated by a desire to keep taxable and conscriptable people within a State's jurisdiction.

position through a greater investment of capital per head than the other areas; and now the workers in that area try to resist the lowering of wage rates that would stem from an influx of workers from abroad.

Immigration barriers confer gains at the expense of foreign workers. Few residents of the area trouble themselves about that.[33] They raise other problems, however. The process of equalizing wage rates, though hobbled, will continue in the form of an export of capital investment to foreign, low-wage countries. Insistence on high wage rates at home creates more and more incentive for domestic capitalists to invest abroad. In the end, the equalization process will be effected anyway, except that the location of resources will be completely distorted. Too many workers and too much capital will be stationed abroad, and too little at home, in relation to the satisfaction of the world's consumers. Secondly, the domestic citizens may very well lose more from immigration barriers as consumers than they gain as workers. For immigration barriers (*a*) impose shackles on the international division of labor, the most efficient location of production and population, etc., and (*b*) the population in the home country may well be below the "optimum" population for the home area. An inflow of population might well stimulate greater mass production and specialization and thereby raise the real income per capita. In the long run, of course, the equalization would still take place, but perhaps at a higher level, especially if the poorer countries were "overpopulated" in comparison with their optimum. In other words, the high-wage country may have a population *below* the optimum real income per head, and the low-wage country may have excessive population *over* the optimum. In that case, *both*

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[33]It is instructive to study the arguments of those "internationalist" Congressmen who advocate changes in American immigration barriers. The changes proposed do not even remotely suggest the removal of these barriers.

countries would enjoy increased real wage rates from the migration, although the low-wage country would gain more.

It is fashionable to speak of the "overpopulation" of some countries, such as China and India, and to assert that the Malthusian terrors of population pressing on the food supply are coming true in these areas. This is fallacious thinking, derived from focusing on "countries" instead of the world market as a whole. It is fallacious to say that there is overpopulation in *some* parts of the market and not in others. The theory of "over-" or "under-population (in relation to an arbitrary maximum of real income per person) applies properly to the market as a whole. If parts of the market are "under-" and parts "over" populated, the problem stems, not from human reproduction or human industry, but from artificial governmental barriers to migration. India is "overpopulated" only because its citizens will not move abroad or because other governments will not admit them. If the former, then, the Indians are making a voluntary choice: to accept lower money wages in return for the great psychic gain of living in India. Wages are equalized internationally only if we incorporate such psychic factors into the wage rate. Moreover, if other governments forbid their entry, the problem is not absolute "overpopulation," but coercive barriers thrown up against personal migration.[34]

The loss to everyone as consumers from shackling the interregional division of labor and the efficient location of production, should not be overlooked in considering the effects of immigration barriers. The *reductio ad absurdum*, though not quite as devastating as in the case of the tariff, is also relevant here. As Cooley and Poirot point out:

> If it is sound to erect a barrier along our national boundary lines, against those who see greater opportunities here than in their native land, why should we

[34]Advocates of the "free market" who also advocate immigration barriers have rarely faced the implications of their position. *See* Appendix B, on "Coercion and *Lebensraum*."

> not erect similar barriers between states and localities within our nation? Why should a low-paid worker . . . be allowed to migrate from a failing buggy shop in Massachusetts to the expanding automobile shops in Detroit. . . . He would compete with native Detroiters for food and clothing and housing. He might be willing to work for less than the prevailing wage in Detroit, "upsetting the labor market" there. . . . Anyhow, he was a native of Massachusetts, and therefore that state should bear the full "responsibility for his welfare." Those are matters we might ponder, but our honest answer to all of them is reflected in our actions. . . . We'd rather ride in automobiles than in buggies. It would be foolish to try to buy an automobile or anything else on the free market, and at the same time deny any individual an opportunity to help produce those things we want.[35]

The advocate of immigration laws who fears a reduction in his standard of living is actually misdirecting his fire. Implicitly, he believes that his geographic area now exceeds its optimum population point. What he really fears, therefore, is not so much immigration as *any* population growth. To be consistent, therefore, he would have to advocate compulsory birth control, to slow down the rate of population growth desired by individual parents.

F. Child Labor Laws

Child labor laws are a clear-cut example of restrictions placed on the employment of some labor for the benefit of restrictive wage rates for the remaining workers. In an era of much discussion about the "unemployment problem," many of those who worry about unemployment also advocate child labor laws, which coercively *prevent* the employment of a whole body

[35]Oscar W. Cooley and Paul Poirot, *The Freedom to Move* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1951), pp. 11–12.

of workers. Child labor laws, then, amount to *compulsory unemployment.* Compulsory unemployment, of course, reduces the general supply of labor and raises wage rates restrictively as the connexity of the labor market diffuses the effects throughout the market. Not only is the child prevented from laboring, but the income of families with children is arbitrarily lowered by the government, and childless families gain at the expense of families with children. Child labor laws penalize families with children because the period of time in which children remain net monetary liabilities to their parents is thereby prolonged.

Child labor laws, by restricting the supply of labor, lower the production of the economy and hence tend to reduce the standard of living of everyone in the society. Furthermore, the laws do not even have the beneficial effect that compulsory birth control might have in reducing population, when it is above the optimum point. For the total population is not reduced (except from the indirect effects of the penalty on children), but the *working* population is. To reduce the working population while the *consuming* population remains undiminished is to lower the general standard of living.

Child labor laws may take the form of outright prohibition or of requiring "working papers" and all sorts of red tape before a youngster can be hired, thus partially achieving the same effect. The child labor laws are also bolstered by *compulsory school attendance laws.* Compelling a child to remain in a State or State-certified school until a certain age has the same effect of prohibiting his employment and preserving adult workers from younger competition. Compulsory attendance, however, goes even further in compelling a child to absorb a certain service—schooling—when he or his parents would prefer otherwise, thus imposing a further loss of utility upon these children.[36,37]

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[36]For a brilliant discussion of the anti-child-labor Factory Acts in early nineteenth-century Britain, *see* Hutt, "The Factory System." On the merits of child labor, *see also* D.C. Coleman, "Labour in the English

G. Conscription

It has rarely been realized that *conscription* is an effective means of granting a monopolistic privilege and imposing restrictionist wage rates. Conscription, like child labor laws, removes a part of the labor force from competition in the labor market—in this case, the removal of healthy, adult members. Coerced removal and compulsory labor in the armed forces at only nominal pay increases the wage rates of those remaining, especially in those fields most directly competitive with the jobs of the drafted men. Of course, the general productivity of the economy also decreases, offsetting the increases for at least some of the workers. But, as in other cases of monopoly grants, some of the privileged will probably gain from the governmental action. Directly, conscription is a method by which the government can commandeer labor at far less than market wage rates—the rate it would have to pay to induce the enlistment of a volunteer army.[38]

Economy of the Seventeenth Century," *The Economic History Review*, April, 1956, p. 286.

[37]A news item illustrates the connection between child labor laws and restrictionist wage rates for adults—particularly for unions:

> Through the co-operation of some 26,000 grocers, plus trade unions, thousands of teenage boys *will get a chance to earn* summer spending money, Deputy Police Commission James B. Nolan, president of the Police Athletic League, disclosed yesterday. . . . The program was worked out by PAL, with the assistance of *Grocer Graphic*, a trade newspaper. Raymond Bill, publisher of the trade paper, explained that thousands of groceries can employ one and in some cases two or three boys in odd jobs which do not interfere with union jobs. (*New York Daily News*, July 19, 1955; italics mine)

See also Paul Goodman, *Compulsory Mis-Education and the Community of Scholars* (New York: Vintage Books, 1964), p. 54.

[38]*See also* James C. Miller III, ed., *Why the Draft?* (Baltimore: Penguin Books, 1968).

H. Minimum Wage Laws and Compulsory Unionism

Compulsory unemployment is achieved indirectly through *minimum wage laws*. On the free market, everyone's wage tends to be set at his discounted marginal value productivity. A minimum wage law means that those whose DMVP is below the legal minimum are *prevented from working*. The worker was willing to take the job, and the employer to hire him. But the decree of the State prevents this hiring from taking place. Compulsory unemployment thus removes the competition of marginal workers and raises the wage rates of the other workers remaining. Thus, while the announced *aim* of a minimum wage law is to improve the incomes of the marginal workers, the actual effect is precisely the reverse—it is to render them unemployable at legal wage rates. The higher the minimum wage rate relative to free-market rates, the greater the resulting unemployment.[39]

Unions aim for restrictionist wage rates, which on a partial scale cause distortions in production, lower wage rates for nonmembers, and pockets of unemployment, and on a general scale lead to greater distortions and permanent mass unemployment. By enforcing restrictive production rules, rather than allowing individual workers voluntarily to accept work rules laid down by the enterpriser in the use of his property, unions reduce general productivity and hence the living standards of the economy. Any governmental encouragement of unions, therefore, such as is imposed under the Wagner-Taft-Hartley Act, leads to a regime of restrictive wage rates, injury to production, and general unemployment. The indirect effect on employment is similar to that of a minimum wage law, except that fewer workers are affected, and it is then the union-enforced minimum wage that is being imposed.

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[39]On minimum wage laws, *see* Yale Brozen and Milton Friedman, *The Minimum Wage: Who Pays?* (Washington, D.C.: The Free Society Association, 1966). *See also* John M. Peterson and Charles T. Stewart, Jr., *Employment Effects of Minimum Wage Rates* (Washington, D.C.: American Enterprise Institute, August, 1969).

I. Subsidies to Unemployment

Government unemployment benefits are an important means of subsidizing unemployment caused by unions or minimum wage laws. When restrictive wage rates lead to unemployment, the government steps in to prevent the unemployed workers from injuring union solidarity and union-enforced wage rates. By receiving unemployment benefits, the mass of potential competitors with unions are removed from the labor market, thus permitting an indefinite extension of union policies. And this removal of workers from the labor market is financed by the taxpayers—the general public.

J. Penalties on Market Forms

Any form of governmental *penalty* on a type of market production or organization injures the efficiency of the economic system and prevents the maximum remuneration to factors, as well as maximum satisfaction to consumers. The most efficient are penalized, and, indirectly, the least efficient producers are subsidized. This tends not only to stifle market forms that are efficient in adapting the economy to changes in consumer valuations and given resources, but also to perpetuate inefficient forms. There are many ways in which governments have granted quasi-monopoly privileges to inefficient producers by imposing special penalties on the efficient. Special *chain store taxes* hobble chain stores and injure consumers for the benefit of their inefficient competitors; numerous ordinances *outlawing pushcart peddlers* destroy an efficient market form and efficient entrepreneurs for the benefit of less efficient but more politically influential competitors; *laws closing businesses at specific hours* injure the dynamic competitors who wish to stay open, and prevent consumers from maximizing their utilities in the time-pattern of their purchases; *corporation income taxes* place an extra burden on corporations, penalizing these efficient market forms and privileging their competitors; *government requirements of reports* from businesses place artificial restrictions on small firms with relatively little capital, and constitute an indirect grant of privilege to large business competitors.[40]

All forms of government regulation of business, in fact, penalize efficient competitors and grant monopolistic privileges to the inefficient. An important example is regulation of *insurance companies*, particularly those selling life insurance. Insurance is a speculative enterprise, as is any other, but based on the relatively greater certainty of biological mortality. All that is necessary for life insurance is for *premiums* to be currently levied in sufficient amount to pay benefits to the actuarially expected beneficiaries. Yet life insurance companies have, peculiarly, launched into the investment business, by contending that they need to build up a net reserve so large as to be almost sufficient to pay all benefits if half the population died immediately. They are able to accumulate such reserves by charging premiums far higher than would be needed for mere insurance protection. Furthermore, by charging constant premiums over the years they are able to phase out their own risks and place them on the shoulders of their unwitting policyholders (through the accumulating cash surrender values of their policies). Moreover, the companies, not the policyholders, keep the returns on the invested reserves. The insurance companies have been able to charge and collect the absurdly high premiums required by such a policy because state governments have *outlawed*, in the name of consumer protection, any possible competition from the low rates of nonreserve insurance companies. As a result, existing half-insurance, half-uneconomic "investment" companies have been granted special privilege by the government.

[40]The withholding tax is an example of a "wartime" measure that now appears to be an indestructible part of our tax system; it compels businesses to be tax collectors for the government without pay. It is thus a type of binary intervention that particularly penalizes small firms, which are burdened more than proportionately by the overhead requirements of running their business.

K. Antitrust Laws

It may seem strange to the reader that one of the most important governmental checks on efficient competition, and therefore grants of quasi monopolies, are the *antitrust laws*. Very few, whether economists or others, have questioned the principle of the antitrust laws, particularly now that they have been on the statute books for some years. As is true of many other measures, evaluation of the antitrust laws has not proceeded from an analysis of their nature or of their necessary consequences, but from an impressionistic reaction to their announced aims. The chief criticism of these laws is that "they haven't gone far enough." Some of those most ardent in the proclamation of their belief in the "free market" have been most clamorous in calling for stringent antitrust laws and the "breakup of monopolies." Even the most "right-wing" economists have only gingerly criticized certain antitrust procedures, without daring to attack the principle of the laws *per se*.

The only viable definition of monopoly is a grant of privilege from the government.[41] It therefore becomes quite clear that it is impossible for the government to *decrease* monopoly by passing punitive laws. The only way for the government to decrease monopoly, if that is the desideratum, is to remove its own monopoly grants. The antitrust laws, therefore, do not in the least "diminish monopoly." What they do accomplish is to impose a continual, capricious harassment of efficient business enterprise. The law in the United States is couched in vague, indefinable terms, permitting the Administration and the courts to omit defining in advance what is a "monopolistic" crime and what is not. Whereas Anglo-Saxon law has rested on a structure of clear definitions of crime, known in advance and discoverable by a jury after due legal process, the antitrust laws thrive on deliberate vagueness and *ex post facto* rulings. No businessman

[41]For further elaboration, *see Man, Economy, and State*, chapter 10.

knows when he has committed a crime and when he has not, and he will never know until the government, perhaps after another shift in its own criteria of crime, swoops down upon him and prosecutes. The effects of these arbitrary rules and *ex post facto* findings of "crime" are manifold: business initiative is hampered; businessmen are fearful and subservient to the arbitrary rulings of government officials; and business is not permitted to be efficient in serving the consumer. Since business always tends to adopt those practices and that scale of activity which maximize profits and income and serve the consumers best, any harassment of business practice by government can only hamper business efficiency and reward inefficiency.[42]

It is vain, however, to call simply for clearer statutory definitions of monopolistic practice. For the vagueness of the law results from the impossibility of laying down a cogent definition of monopoly on the market. Hence the chaotic shift of the government from one unjustifiable criterion of monopoly to another: size of firm, "closeness" of substitutes, charging a price "too high" or "too low" or the same as a competitor, merging that "substantially lessens competition," etc. All these criteria are meaningless. An example is the criterion of *substantially lessening competition*. This implicitly assumes that "competition" is some sort of *quantity*. But it is not; it is a process, whereby individuals and firms supply goods on the market without using force.[43] To preserve "competition" does not mean to dictate arbitrarily that a certain number of firms of a certain size have to exist in an industry or area; it means to see to it that men are free to compete (or not) unrestrained by the use of force.

The original Sherman Act stressed "collusion" in "restraint of trade." Here again, there is nothing anticompetitive *per se*

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[42]*See* John W. Scoville and Noel Sargent, *Fact and Fancy in the T.N.E.C. Monographs* (New York.: National Association of Manufacturers, 1942), pp. 298–321, 671–74.

[43]F.A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), chap. V.

about a cartel, for there is conceptually no difference between a cartel, a merger, and the formation of a corporation: all consist of the voluntary pooling of assets in one firm to serve the consumers efficiently. If "collusion" must be stopped, and cartels must be broken up by the government, i.e., if to maintain competition it is necessary that *co-operation* be destroyed, then the "anti-monopolists" must advocate the complete prohibition of all corporations and partnerships. Only individually owned firms would then be tolerated. Aside from the fact that this compulsory competition and outlawed co-operation is hardly compatible with the "free market" that many antitrusters profess to advocate, the inefficiency and lower productivity stemming from the outlawing of pooled capital would send the economy a good part of the way from civilization to barbarism.

An individual becoming idle instead of working may be said to "restrain" trade, although he is simply *not engaging* in it rather than "restraining" it. If antitrusters wish to prevent idleness, which is the logical extension of the W.H. Hutt concept of consumers' sovereignty, then they would have to pass a law compelling labor and outlawing leisure—a condition certainly close to slavery.[44] But if we confine the definition of "restraint" to restraining the trade of *others*, then clearly there can be no restraint of trade at all on the free market—and only the *government* (or some other institution using violence) can restrain trade. *And one conspicuous form of such restraint is antitrust legislation itself!*

One of the few cogent discussions of the antitrust principle in recent years has been that of Isabel Paterson. As Mrs. Paterson states:

> Standard Oil did not restrain trade; it went out to the ends of the earth to make a market. Can the corporations be said to have "restrained trade" when the

[44]Municipal ordinances against "vagrancy" or "loitering" are certainly a beginning in this direction and are used to impose forced labor upon the poorest sectors of the population.

> trade they cater to had no existence until they produced and sold the goods? Were the motor car manufacturers restraining trade during the period in which they made and sold fifty million cars, where there had been no cars before? . . . Surely . . . nothing more preposterous could have been imagined than to fix upon the American corporations, which have created and carried on, in ever-increasing magnitude, a volume and variety of trade so vast that it makes all previous production and exchange look like a rural roadside stand, and call this performance "restraint of trade," further stigmatizing it as a crime![45]

And Mrs. Paterson concludes:

> Government cannot "restore competition" or "ensure" it. Government is monopoly; and all it can do is to impose restrictions which may issue in monopoly, when they go so far as to require permission for the individual to engage in production. This is the essence of the Society-of-Status. The reversion to status law in the antitrust legislation went unnoticed . . . the politicians . . . had secured a law under which it was impossible for the citizen to know beforehand what constituted a crime, and which therefore made all productive effort liable to prosecution if not to certain conviction.[46]

In the earlier days of the "trust problem," Paul de Rousiers commented:

> Directly the formation of Trusts is not induced by the natural action of economic forces; as soon as they depend on artificial protection (such as tariffs), the most effective method of attack is to simply reduce the number and force of these protective accidents to

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[45]Isabel Paterson, *The God of the Machine* (New York: G.P. Putnam's Sons, 1943), pp. 172, 175. *See also* Scoville and Sargent, *Fact and Fancy in the T.N.E.C. Monographs*, pp. 243–44.

[46]Paterson, *God of the Machine*, pp. 176–77.

> the greatest possible extent. We can attack artificial conditions, but are impotent when opposing natural conditions. . . . America has hitherto pursued the exactly reverse methods, blaming economic forces tending to concentrate industry, and joining issue by means of antitrust legislation, a series of entirely artificial measures. Thus there is to be no understanding between competing companies, etc. The results have been pitiful—a violent restriction of fruitful initiative. . . . [The legislation] does not touch the rest of the evil, enlarges, in place of restraining, artificial conditions, and finally regulates and complicates matters whose supreme needs are simplification and removal of restrictions.[47]

L. Outlawing Basing-Point Pricing

An important example of the monopolizing effects of a program supposedly designed to *combat* monopoly is the court decision outlawing *basing-point pricing.* On the free market, price uniformity means uniformity *at each consuming center*, and not uniformity at each mill. In commodities where freight costs are a large proportion of final price, this distinction becomes important, and many firms adopt such price uniformity, enabling firms further away from a consuming center to "absorb" some freight charges in order to compete with local firms. One of the forms of freight absorption is called "basing-point pricing." Ruling this practice "monopolistic" and virtually decreeing that every firm must charge uniform prices "at the mill" not only prevents interlocational competition in such industries, but confers an artificial monopolistic privilege on local firms. Each local firm is granted the area of its own location, with a haven set by the freight costs of out-of-town rivals, within which it can charge its customers a monopoly price.

[47]Paul de Rousiers, *Les Industries Monopolisées aux Etats-Unis*, as quoted in Gustave de Molinari, *The Society of Tomorrow* (New York: G.P. Putnam's Sons, 1904), p. 194.

Firms better able to absorb freight costs and prosper in a wider market are penalized and prevented from doing so. Furthermore, the decreasing-cost advantages of a large-scale market and large-scale production are eliminated, as each firm is confined to a small compass. Firms' locations are altered, and they are forced to cluster near large consuming areas, despite the greater advantages that other locations had offered to these companies.[48] Furthermore, such a ruling penalizes small businesses, since only large firms can afford to build many branches to compete in each local area.[49]

M. Conservation Laws

Conservation laws restrict the use of depleting resources and force owners to invest in the maintenance of replaceable "natural" resources. The effect of both cases is similar: the restriction of present production for the supposed benefit of future production. This is obvious in the case of depleting resources; factors are also compelled to maintain replaceable resources (such as trees) when they could have more profitably engaged in other forms of production. In the latter case there is a double distortion: factors are forcibly shifted to future production, and they are also forced into a certain *type* of future production—the replacement of these particular resources.[50]

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[48]*See United States Steel Corporation, T.N.E.C. Papers* (New York: U.S. Steel Corp., 1940), II, 102–35.

[49]*See* William M. Simon, "The Case Against the Federal Trade Commission," *University of Chicago Law Review*, 1952, pp. 320–22. On basing points, *see also* Scoville and Sargent, *Fact and Fancy in the T.N.E.C. Monographs*, pp. 776–82; Wayne A. Leeman, "Review of Paul Giddens' *Standard Oil Company* (Indiana)," *American Economic Review*, September, 1956, p. 733; and Donald Dewey, "A Reappraisal of F.O.B. Pricing and Freight Absorption," *Southern Economic Journal*, July, 1955, pp. 48–54.

[50]Economists have, until recently, almost completely neglected conservation laws, leaving the field to romantic "conservationists." But *see* the brilliant analysis by Anthony Scott, "Conservation Policy and Capital

Clearly, one *aim* of conservation laws is to force the ratio of consumption to saving (investment) lower than the market would prefer. People's voluntary allocations made according to their time preferences are forcibly altered, and relatively more investment is forced into production for future consumption. In short, the State decides that the present generation must be made to allocate its resources more to the future than it wishes to do; for this service the State is held up as being "farseeing," compared to "shortsighted" free individuals. But, presumably, depleting resources must be used at some time, and some balance must always be struck between present and future production. Why does the claim of the present generation weigh so lightly in the scales? Why is the future generation so much more worthy that it can compel the present to carry a greater load? What did the future ever do to deserve privileged treatment?[51] Indeed, since the future is likely to be wealthier than the present, the reverse might well apply! The same reasoning applies to all attempts to change the market's time-preference ratio. Why should the future be able to enforce greater sacrifices on the present than the present is willing to undergo? Furthermore, after a span of years, the future will become the present; must the future generations then also be restricted in their production and consumption because of another wraithlike "future"? It must not be forgotten that the aim of all productive activity is goods and services that will and can be consumed only *in some present.* There is no rational basis for penalizing consumption in one present and privileging *one future present*; and

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Theory," *Canadian Journal of Economics and Political Science*, November, 1954, pp. 504–13, and *idem*, *Natural Resources: The Economics of Conservation* (Toronto: University of Toronto Press, 1955); *see also* Mises, *Human Action*, pp. 652–53.

[51]Scott points out that this attitude rests on the contemptuous and unsupported view that future generations will not be as competent to take care of themselves as is the present generation. *See* Scott, *Natural Resources*, p. 94.

there is still less reason for restricting *all* presents in favor of some will-o'-the-wisp "future" that can never appear and lies always beyond the horizon. Yet this is the goal of conservation laws. Conservation laws are truly "pie-in-the-sky" legislation.[52]

Individuals in the market decide on the time structure in their allocation of factors in accordance with the estimated revenue that their resources will bring in present as against future use. In other words, they will tend to maximize the present value, at any time, of their land and capital assets.[53] The time structure of rental income from assets is determined by the interest rate, which in turn is determined by the time-preference schedules of all individuals on the market. Time preference, in addition to the specific estimated demands for each good, will determine the allocations of factors to each use. Since a lower time preference will connote more investment in future consumers' goods, it will also mean more "conservation" of natural resources. A high time preference will lead to less investment and more consumption in the present, and consequently to less "conservation."[54]

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[52]As Scott aptly asks: Why agree "to preserve resources as they would be in the absence of their human users?" Scott, "Conservation Policy," p. 513. And further: "Most of [our] progress has taken the form of converting natural resources into more desirable forms of wealth. If man had prized natural resources above his own product, he would doubtless have remained savage, practicing 'conservatism.'" Scott, *Natural Resources*, p. 11. If the logic of tariffs is to destroy the market, then the logic of conservation laws is to destroy all human production and consumption.

[53]Strictly, investors will attempt to maximize their "internal rates of return," but maximizing the present value is close enough for our purposes. On the difference between the two goals in "Austrian" vs. "neo-classical" thought, *see* André Gabor and I.F. Pearce, "A New Approach to the Theory of the Firm," *Oxford Economic Papers*, October, 1952, pp. 252–65.

[54]In some cases, however, lower time preferences and greater investment activity will deplete natural resources at a more rapid rate, if there is a particularly great demand for their use in the new activity. This is likely to be true of such resources as coal and oil. *See* Scott, *Natural Resources*, pp. 95–97.

Most conservationist arguments evince almost no familiarity with economics. Many assume that entrepreneurs have no foresight and would blithely use natural resources only to find themselves some day suddenly without any property. Only the wise, providential State can foresee depletion. The absurdity of this argument is evident when we realize that the present value of the entrepreneur's land is dependent on the expected future rents from his resources. Even if the entrepreneur himself should be unaccountably ignorant, the market will not be, and its valuation (i.e., the valuation of interested experts with money at stake) will tend to reflect its value accurately. In fact, it is the entrepreneur's business to forecast, and he is rewarded for correct forecasting by profits. Will entrepreneurs on the market have less foresight than bureaucrats comfortably ensconced in their seizure of the taxpayers' money?[55]

Another error made by the conservationists is to assume a technology fixed for all time. Human beings use what resources they have; and as technological knowledge grows, the types of usable resources multiply. If we have less timber to use than past generations, we need less too, for *we* have found other materials that can be used for construction or fuel. Past generations possessed an abundance of oil in the ground, but for *them* oil was valueless and hence not a resource. Our modern advances

[55]Entrepreneurs with poor foresight are quickly expelled from their positions through losses. It is ironic that the "plight of the Okies" in the 1930's, widely publicized as a plea for conservation laws and the result of "cruel capitalism," actually resulted from the fact that bad entrepreneurs (the Okies) farmed land that was valueless and submarginal. Forced "conservation" investment on this submarginal land or government subsidization of the "Okies" would have aggravated a dislocation that the market quickly eliminated.

Much American soil erosion, furthermore, has stemmed from failure to preserve full private property rights in land. Tenant farmers, moving every few years, often milked the capital of the landlord's property, wasting the resource, in default of proper enforcement of the contractual necessity to return the land to its owner intact. *See* Scott, *National Resources*, pp. 118, 168.

have taught us how to use oil and have enabled us to produce the equipment for this purpose. Our oil resources, therefore, are *not* fixed; they are infinitely greater than those of past generations. Artificial conservation will wastefully prolong resources beyond the time when they have become obsolete.

How many writers have wept over capitalism's brutal ravaging of the American forests! Yet it is clear that American land has had more value-productive uses than timber production, and hence the land was diverted to those ends that better satisfied consumer wants.[56] What standards can the critics set up instead? If they think too much forest has been cut down, how can they arrive at a quantitative standard to determine how much is "too much"? In fact, it is impossible to arrive at any such standard, just as it is impossible to arrive at any quantitative standards for market action outside the market. Any attempt to do so must be arbitrary and unsupported by any rational principle.

America has been the prime home of conservation laws, particularly on behalf of its "public domain." Under a purely free-enterprise system, there would be no such thing as a governmentally owned public domain. Land would simply remain unowned until it first came into use, after which it would be owned by the first user and his heirs or assigns.[57]

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[56]A typical conservationist complainer was J.D. Brown who, in 1832, worried over the consumption of timber: "Whence shall we procure supplies of timber fifty years hence for the continuance of our navy?" Quoted in Scott, *National Resources*, p. 37. Scott also notes that the critics never seemed to realize that a nation's timber can be purchased from abroad. Scott, "Conservation Policy."

[57]This system was dimly adumbrated by the Homestead Law of 1862. However, this law imposed an arbitrary and pointless maximum on the size of farm that could be staked out by the first user. This limitation had the result of nullifying the law further West, where the minimum acreage needed for cattle or sheep grazing was far larger than the antiquated legal maximum would allow. Furthermore, the maximum limitation and the requirement that the land be used for farming led to the very "ravaging" of the forests that conservationists now deplore, for it hobbled private ownership of large forest tracts.

The consequences of government ownership of the public domain will be further explored below. Here we may state a few of them. When the government owns the land and permits private individuals to use it freely, the result is indeed a wasteful overexploitation of the resource. More factors are employed to use up the resource than on a free market, since the only gains to the users are immediate; and if they wait, other users will deplete the limited resource. Free use of a governmentally owned resource truly inaugurates a "war of all against all," as more and more users, eager for the free bargain, attempt to exploit the scarce resource. To have a scarce resource and to make everyone believe (because of the free gift of use) that its supply is unlimited, causes overuse of the resource, favoritism, figurative queuing up, etc. A striking example was the Western grazing lands in the latter half of the nineteenth century. The government prevented cattlemen from owning the land and fencing it in, and insisted it be kept as "open range" owned by the government. The result was excessive use of the range and its untimely depletion.[58] Another example is the rapid depletion of the fisheries. Since no one is permitted to own any segment of the sea, no one sees any sense in preserving the value of the resource, as each is benefited only by rapid use, in advance of his competitors.[59]

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[58]*See* E. Louise Peffer, *The Closing of the Public Domain* (Stanford: Stanford University Press, 1951), pp. 25–27. On the advantages of private ownership of grazing land, *see* the petition of the American Cattle Growers Association, March, 1902, *ibid.*, pp. 78–79. *See also* Samuel P. Hays, *Conservation and the Gospel of Efficiency* (Cambridge: Harvard University Press, 1959), pp. 50–51. The government's failure to extend the homestead principle to the larger areas had another important social effect: it led to constant squabbles between the users—the cattlemen and the other homesteaders who came later and demanded their "just share" of the free land.

[59]For an illuminating discussion of private property rights in fisheries, *see* Gordon Tullock, *The Fisheries* (Columbia: University of South Carolina Bureau of Business and Economic Research, February, 1962). *See also* Anthony Scott, "The Fishery, A Sole Resource," *Journal of Political Economy*, April, 1955, and *idem*, *Natural Resources*, pp. 117–29.

Leasing is hardly a superior form of land use. If the government owns the land and leases it to grazers or timber users, once again there is no incentive for the lessee to preserve the value of the resource, since he does not own it. It is to his best interest as a lessee to use the resource as intensively as possible *in the present*. Hence, leasing also depletes natural resources excessively.

In contrast, if private individuals were to own all the lands and resources, then it would be to the owners' interest to *maximize the present value* of each resource. Excessive depletion of the resource would lower its capital value on the market. Against the preservation of the capital value of the resource as a whole, the resource owner balances the income to be presently obtained from its use. The balance is decided, *ceteris paribus*, by the time preference and the other preferences of the market.[60] If private individuals can only use but not own the land, the balance is destroyed, and the government has provided an impetus to excessive present use.

Not only is the announced *aim* of conservation laws—to aid the future at the expense of the present—illegitimate, and the arguments in favor of it invalid, but compulsory conservation would not achieve even this goal. For the future is already provided for through present saving and investment. Conservation laws will indeed coerce greater investment in natural resources: using other resources to maintain renewable resources and forcing a greater inventory of stock in depletable resources. But *total* investment is determined by the time preferences of individuals, and these will not have changed. Conservation laws, then, do *not* really increase total provisions for the future; they merely shift investment from capital goods, buildings, etc., to natural

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[60]High demand for the product increases the value of the resource, and thereby stimulates its preservation, investment in it, and exploration for it. High-cost sources of supply will now be tapped, thus further increasing the effective supply of the product on the market. *See* Scott, *Natural Resources*, p. 14.

resources. They thereby impose an inefficient and distorted investment pattern on the economy.[61]

Given the nature and consequences of conservation laws, why should anyone advocate this legislation? Conservation laws, we must note, have a very "practical" aspect. They restrict production, i.e., the use of a resource, by force and thereby create a monopolistic privilege, which leads to a restrictionist price to owners of this resource or of substitutes for it. Conservation laws can be more effective monopolizers than tariffs because, as we have seen, tariffs permit new entry and unlimited production by domestic competitors.[62] Conservation laws, on the other hand, serve to cartelize a land factor and absolutely restrict production, thereby helping to insure permanent (and continuing) monopoly gains for the owners. These monopoly gains, of course, will tend to be capitalized into an increase in the capital value of the land. The person who later buys the monopolized factor, then, will simply earn the going rate of interest on his investment, even though the monopoly gain will be included in his earnings.

Conservation laws, therefore, must also be looked upon as grants of monopolistic privilege. One outstanding example is the American government's policy, since the end of the nineteenth century, of "reserving" vast tracts of the "public domain"—i.e., the government's land holdings.[63] Reserving means that the government keeps land under its ownership and abandons its earlier policy of keeping the domain open for homesteading by private owners. Forests, in particular, have been reserved, ostensibly for the purpose of conservation. What is the effect of withholding huge tracts of timberland from production? It is to confer a monopolistic privilege, and therefore

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[61]*See ibid*., pp. 21–22.

[62]There is another similarity between tariffs and conservation laws: both aim at national self-sufficiency, and both try to foster national or local industries by coercive intervention in the free market.

[63]For an analysis of government land ownership and government ownership in general, see below.

a *restrictionist price*, on competing private lands and on competing timber.

We have seen that limiting the labor supply confers a restrictionist wage on the privileged workers (while the workers pushed out by union wage rates or by licenses or immigration laws must find lower-paying and less value-productive jobs elsewhere). A monopoly or quasi-monopoly privilege for the production of capital or consumer goods, on the other hand, may or may not confer a monopoly price, depending on the configuration of the demand curves for the individual firms, as well as their costs. Since a firm can contract or expand its supply at will, it sets its supply with the knowledge that lowering output to achieve a monopoly price must also lower the total amount of goods sold.[64] The laborer need bother with no such consideration (aside from a negligible variation in demands for each laborer's total hours of service). What about the privileged landowner? Will he achieve a definite restrictionist, or a possible monopoly, price? A prime characteristic of a piece of land is that it cannot be increased by labor; if it is augmentable, then it is a capital good, not land. The same, in fact, applies to labor, which, in all but long periods of time, can be regarded as fixed in its total supply. Since labor in its totality cannot be increased (except, as we have noted, in regard to hours of work per day), government restriction on the labor supply—child labor laws, immigration barriers, etc.—therefore confers a restrictionist wage increase on the workers remaining. Capital or consumer goods can be increased or decreased, so that privileged firms must take their demand curves into account. Land, on the other hand, cannot be increased; restriction of the supply of land, therefore, also confers a restrictionist price of land above

[64]On the free market, the demand curve *for each firm* in equilibrium must be elastic above the equilibrium price; otherwise the firm would reduce output. This does not, of course, mean that the demand curve *for the entire industry* must be elastic. When we refer to a possible monopoly price, the demand curve consulted by each monopolistic firm is its own.

the free-market price.[65] The same is true for depleting natural resources, which cannot have their supply increased and are therefore considered part of land. If the government forces land or natural resources out of the market, therefore, it inevitably lowers the supply available on the market and just as inevitably confers a monopoly gain and a restrictionist price on the remaining landowners or resource owners. In addition to all of their other effects, conservation laws force labor to abandon good lands and, instead, cultivate the remaining submarginal land. This coerced shift lowers the marginal productivity of labor and consequently reduces the general standard of living.

Let us return to the government's policy of reserving timber lands. This confers a restrictionist price and a monopoly gain on the lands remaining in use. Land markets are specific and do not have the same general connexity as labor markets. Therefore, the restrictionist price rise is confined far more to lands that directly competed, or would compete, with the withdrawn or "reserved" lands. In the case of American conservation policy, the particular beneficiaries were (*a*) the land-grant Western railroads and (*b*) the existing timber-owners. The land-grant railroads had received vast subsidies of land from the government: not only rights-of-way for their roads, but fifteen-mile tracts on either side of the line. Government reservation of public lands greatly raised the price received by the railroads when

[65]Another example of government creation of a monopoly gain in land has been cited by the Georgist economist, Mason Gaffney: "City governments all over the country deliberately keep 'dead lands' off the market, with the avowed purpose of 'protecting' other land prices." Gaffney cites the head of the American Society of Planning Officials as advising that a vacant one-third of urban land be "more or less permanently removed from private ownership" in order to keep up land values for the owners of the remaining two-thirds. Gaffney concludes: "Following this advice, many state and local governments avoid returning tax-reverted lands to use." Mason Gaffney, "Vituperation Well Answered," *Land and Liberty*, December, 1952, p. 126; reprinted in Spencer Heath, *Progress and Poverty Reviewed* (2nd ed.; New York: The Freeman, 1953).

they later sold this land to new inhabitants of the area. The railroads thus received another gift from the government—this time in the form of a monopoly gain, at the expense of the consumers.

The railroads were not ignorant of the monopolistic advantages that would be conferred upon them by conservation laws; in fact, the railroads were the financial "angel" of the entire conservation movement. Thus, Peffer writes:

> There was a definite basis for the charge that the railroads were interested in a repeal of [various laws permitting easy transfer of the public domain to the hands of private settlers]. The National Irrigation Association, which was the most vigorous advocate of land law reform outside of the Administration, was financed in part by the transcontinental railroads and by the Burlington and the Rock Island railroads, to the amount of $39,000 a year, out of a total budget of around $50,000. The program of this association and the railroads, as announced by James J. Hill [a preeminent railroad magnate] was almost more advanced than that of [the leading conservationists].[66]

The timber owners also understood the gains they would acquire from forest "conservation." President Theodore Roosevelt himself announced that "the great users of timber are themselves forwarding the movement for forest preservation." As one student of the problem declared, the

> lumber manufacturers and timber owners . . . had arrived at a harmonious understanding with Gifford Pinchot [the leader in forest conservation] as early as

[66]Peffer, *Closing of the Public Domain*, p. 54. Senator H.C. Hansbrough also pointed out that the railroads paid $45,000 annually to a leading conservationist magazine, *The Talisman*, and financed the Washington conservation lobby. H.C. Hansbrough, *The Wreck: An Historical and Critical Study of the Administrations of Theodore Roosevelt and William Howard Taft* (1913), p. 52.

> 1903. . . . In other words, the government by withdrawing timber lands from entry and keeping them off the market would aid in appreciating the value of privately owned timber.[67]

N. Patents[68]

A *patent* is a grant of monopoly privilege by the government to first discoverers of certain types of inventions.[69] Some defenders of patents assert that they are not monopoly privileges but simply property rights in inventions, or even in "ideas." But in free-market, or libertarian, law everyone's right to property is defended without a patent. If someone has an idea or plan and produces an invention, which is then stolen from his house, the stealing is an act of theft illegal under general law. On the other hand, patents actually invade the property rights of those *independent* discoverers of an idea or an invention who happen to make the discovery after the patentee. These later inventors and innovators are prevented by force from employing their own ideas and their own property. Furthermore, in a free society the innovator could market his invention and stamp it "copyright," thereby preventing buyers from reselling the same or a duplicate product.

Patents, therefore, invade rather than defend property rights. The speciousness of the argument that patents protect property rights in ideas is demonstrated by the fact that not all,

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[67]J.H. Cox, "Organization of the Lumber Industry in the Pacific Northwest, 1889–1914" (Ph.D. diss., University of California, 1937), pp. 174–77; cited in Peffer, *Closing of the Public Domain*, p. 57. *See also* Hays, *Conservation and the Gospel of Efficiency*.

[68]On patents and copyrights, *see Man, Economy, and State*, pp. 745–54.

[69]The patent was instituted in England by King Charles I as a transparent means of evading the Parliamentary prohibition of grants of monopoly in 1624.

but only certain types of original ideas, certain types of innovations, are considered legally patentable. Numerous new ideas are never treated as subject to patent grants.

Another common argument for patents is that "society" simply makes a contract with the inventor to purchase his secret, so that "society" will have use of it. But in the first place, "society" could then pay a straight subsidy, or price, to the inventor; it does not have to prevent all later inventors from marketing *their* inventions in this field. Secondly, there is nothing in the free economy to prevent any individual or group of individuals from purchasing secret inventions from their creators. No monopolistic patent is therefore necessary.

The most popular argument for patents among economists is the utilitarian one that a patent for a certain number of years is necessary to encourage a sufficient amount of research expenditure toward inventions and innovations in new processes and products.

This is a curious argument, because the question immediately arises: By what standard do you judge that research expenditures are "too much," "too little," or just about enough? Resources in society are limited, and they may be used for countless alternative ends. By what standards does one determine that certain uses are "excessive," that certain uses are "insufficient," etc.? Someone observes that there is little investment in Arizona but a great deal in Pennsylvania; he indignantly asserts that Arizona deserves "more investment." But what standards can he use to justify such a statement? The *market* does have a rational standard: the highest money incomes and highest profits, for these may be achieved only through maximum service to the consumers. This principle of maximum service to consumers and producers alike (i.e., to everybody) governs the seemingly mysterious market allocation of resources: how much to devote to one firm or another, to one area or another, to the present or the future, to one good or another, to research rather than other forms of investment. The observer who criticizes this allocation can have no rational standards for decision; he has only his arbitrary whim. This is particularly true of criticism of production relations in contrast to interference with consumption. Someone who chides consumers for buying too many cosmetics may have, rightly or wrongly, some rational basis for his criticism. But someone who thinks that more or less of a certain resource should be used in a certain manner, or that business firms are "too large" or "too small," or that too much or too little is spent on research or is invested in a new machine, can have no rational basis for his criticism. Businesses, in short, are producing for a market, guided by the valuations of consumers on that market. Outside observers may criticize the ultimate valuations of consumers if they choose—although if they interfere with consumption based on these valuations, they impose a loss of utility upon the consumers—but they cannot legitimately criticize the *means*, the allocations of factors, by which these ends are served.

Capital funds are limited, as are all other resources, and they must be allocated to various uses, one of which is research expenditures. On the market, rational decisions are made with regard to setting research expenditures, in accordance with the best entrepreneurial expectations of future returns. To subsidize research expenditures by coercion would restrict the satisfaction of consumers and producers on the market.

Many advocates of patents believe that the ordinary competitive processes of the market do not sufficiently encourage the adoption of new processes, and that therefore innovations must be coercively promoted by the government. But the market decides on the rate of introduction of new processes just as it decides on the rate of industrialization of a new geographic area. In fact, this argument for patents is very similar to the "infant industry" argument for tariffs—that market procedures are not sufficient to permit the introduction of worthy new processes. And again the answer is the same: that people must balance the superior productivity of the new processes against the cost of installing them, i.e., against the advantage possessed by the old process in being already in existence. Conferring special coercive privileges upon innovation would needlessly scrap valuable plants already in existence and impose an excessive burden upon consumers.

Nor is it by any means self-evident even that patents encourage an increase in the absolute quantity of research expenditures. But certainly we can say that patents distort the allocation of factors on the *type* of research being conducted. For while it is true that the *first* discoverer benefits from the privilege, it is also true that his competitors are excluded from production in the area of the patent for many years. And since a later patent can build on an earlier, related one in the same field, competitors can often be discouraged indefinitely from further research expenditures in the general area covered by the patent. Moreover, the patentee himself is discouraged from engaging in further research in this field, for the privilege permits him to rest on his laurels for the entire period of the patent, with the assurance that no competitor can trespass on his domain. The competitive spur to further research is eliminated. Research expenditures, therefore, are *overstimulated* in the early stages before anyone has a patent and *unduly restricted* in the period after the patent is received. In addition, some inventions are considered patentable, while others are not. The patent system thus has the further effect of artificially stimulating research expenditures in the *patentable* areas, while artificially restricting research in the *nonpatentable* areas.

As Arnold Plant summed up the problem of competitive research expenditures and innovations:

> Neither can it be assumed that inventors would cease to be employed if entrepreneurs lost the monopoly over the use of their inventions. Businesses employ them today for the production of nonpatentable inventions, and they do not do so merely for the profit which priority secures. In active competition . . . no business can afford to lag behind its competitors. The reputation of a firm depends upon its ability to keep ahead, to be first in

> the market with new improvements in its products and new reductions in their prices.[70]

Finally, of course, the market itself provides an easy and effective course for those who feel that there are not enough expenditures being made in certain directions on the free market. *They are free to make these expenditures themselves.* Those who would like to see more inventions made and exploited are at liberty to join together and subsidize such efforts in any way they think best. In doing so, they would, as consumers, add resources to the research and invention business. And they would not then be forcing other consumers to lose utility by conferring monopoly grants and distorting the allocation of the market. Their voluntary expenditures would become part of the market and help to express its ultimate consumer valuations. Furthermore, later inventors would not be restricted. The friends of invention could accomplish their aims without calling in the State and imposing losses on the mass of consumers.

Patents, like any monopoly grant, confer a privilege on one and restrict the entry of others, thereby distorting the freely competitive pattern of industry. If the product is sufficiently demanded by the public, the patentee will be able to achieve a monopoly price. Patentees, instead of marketing their invention themselves, may elect either to (1) sell their privilege to another or (2) keep the patent privilege but sell licenses to other firms, permitting them to market the invention. The patent privilege thereby becomes a capitalized monopoly gain. It will tend to sell at the price that capitalizes the expected future monopoly gain to be derived from it. Licensing is equivalent to renting capital, and a license will tend to sell at a price equal to the discounted sum of the rental income that the patent will earn for the period of the license. A system of general licensing is equivalent to a tax on the use of the new process, except that the *patentee* receives the

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[70]Arnold Plant, "The Economic Theory concerning Patents for Inventions," *Economica*, February, 1934, p. 44.

tax instead of the government. This tax restricts production in comparison with the free market, thereby raising the price of the product and reducing the consumer's standard of living. It also distorts the allocation of resources, keeping factors out of these processes and forcing them to enter less value-productive fields.

Most current critics of patents direct their fire not at the patents themselves, but at alleged "monopolistic abuses" in their use. They fail to realize that the patent itself is the monopoly and that, when someone is granted a monopoly privilege, it should occasion neither surprise nor indignation when he makes full use of it.

O. Franchises and "Public Utilities"

Franchises are generally grants of permission by the government for the use of its streets. Where the franchises are *exclusive* or restrictive, they are grants of monopoly or quasi-monopoly privilege. Where they are *general* and not exclusive, however, they cannot be called monopolistic. For the franchise question is complicated by the fact that the government *owns* the streets and therefore must give permission before anyone uses them. In a truly free market, of course, streets would be privately, not governmentally, owned, and the problem of franchises would not arise.

The fact that the government must give permission for the use of its streets has been cited to justify stringent government regulations of "public utilities," many of which (like water or electric companies) must make use of the streets. The regulations are then treated as a voluntary *quid pro quo*. But to do so overlooks the fact that governmental ownership of the streets is itself a permanent act of intervention. Regulation of public utilities or of any other industry discourages investment in these industries, thereby depriving consumers of the best satisfaction of their wants. For it distorts the resource allocations of the free market. Prices set below the free market create an artificial shortage of the utility service; prices set above those determined by the free market impose restrictions and a monopoly price on the consumers. Guaranteed rates of return exempt the utility from the free play of market forces and impose burdens on the consumers by distorting market allocations.

The very term "public utility," furthermore, is an absurd one. *Every* good is useful "to the public," and almost every good, if we take a large enough chunk of supply as the unit, may be considered "necessary." Any designation of a few industries as "public utilities" is completely arbitrary and unjustified.[71]

P. The Right of Eminent Domain

In contrast to the franchise, which may be made general and nonexclusive (as long as the central organization of force continues to own the streets), the *right of eminent domain* could not easily be made general. If it were, then chaos would truly ensue. For when the government confers a privilege of eminent domain (as it has done on railroads and many other businesses), it has virtually granted a license for theft. If everyone had the right of eminent domain, every man would be legally empowered to compel the sale of property that he wanted to buy. If A were compelled to sell property to B at the latter's will, and *vice versa*, then neither could be called the owner of his own property. The entire system of private property would then be scrapped in favor of a society of mutual plunder. Saving and accumulation of property for oneself and one's heirs would be severely discouraged, and rampant plunder would cut ever more sharply into whatever property remained. Civilization would soon revert to barbarism, and the standards of living of the barbarian would prevail.

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[71]On the inherent absurdities of the very concept of "public utility" and the impossibility of definition, as well as for an excellent critique of public utility regulation by government, *see* Arthur S. Dewing, *The Financial Policy of Corporations* (5th ed.; New York: Ronald Press, 1953), I, 309–10, and the remainder of the chapter.

The government itself is the original holder of the "right of eminent domain," and the fact that the government can despoil any property holder at will is evidence that, in current society, the right to private property is only flimsily established. Certainly no one can say that the inviolability of private property is protected by the government. And when the government confers this power on a particular business, it is conferring upon it the special privilege of taking property by force.

Evidently, the use of this privilege greatly distorts the structure of production. Instead of being determined by voluntary exchange, self-ownership, and efficient satisfaction of consumer wants, prices and the allocation of productive resources are now determined by brute force and government favor. The result is an overextension of resources (a malinvestment) in the privileged firm or industry and an underinvestment in other firms and industries. At any given time, as we have stressed, there is a limited amount of capital—a limited supply of all resources—that can be devoted to investment. Compulsory increase in investment in one field can be achieved only by an arbitrary decline in investment in other fields.[72]

Many advocates of eminent domain contend that "society," in the last analysis, has the right to use any land for "its" purposes. Without knowing it, they have thus conceded the validity of a major Henry Georgist plank: that every person, by virtue of

[72]Inevitably, someone will point to the plight of the railroad or highway company that must pay "extortionate rates" to the man who "merely" owns the property along the way. Yet these same people do not complain (and properly so) of the fact that property values have enormously increased in downtown areas of cities, thus benefiting someone who "merely" happens to own them. The fact is that all property is available to everyone who finds or buys it; if the property owner in these cases is penalized because of his speculation, then *all* entrepreneurs must be penalized for their correct forecasting of future events. Furthermore, economic progress imputes gains to original factors—land and labor. To render land artificially cheap is to lead to its overuse, and the government is then actually imposing a maximum price on the land in question.

his birth, has a right to his aliquot share of God-given land.[73] Actually, however, since "society" does not exist as an entity, it is impossible for each individual to translate his theoretical aliquot right into real ownership.[74] Therefore, the ownership of the property devolves, not on "everybody," but on the government, or on those individuals whom it specially privileges.

Q. Bribery of Government Officials

Because it is illegal, *bribery of government officials* receives practically no mention in economic works. Economic science, however, should analyze all aspects of mutual exchange, whether these exchanges are legal or illegal. We have seen above that "bribery" of a *private* firm is not actually bribery at all, but simply payment of the market price for the product. Bribery of government officials is also a *price* for the payment of a service. What is this service? It is the failure to enforce the government edict as it applies to the particular person paying the bribe. In short, the acceptance of a bribe is equivalent to the sale of permission to engage in a certain line of business. Acceptance of a bribe is therefore praxeologically identical with the sale of a government *license* to engage in a business or occupation. And the economic effects are similar to those of a license. There is no economic difference between the purchase of a government permission to operate by buying a license or by paying

[73]Except that the eminent-domain thesis is on even shakier ground, since the Georgists at least exempt or try to exempt from the social claim the *improvements* that the owner has made.

[74]See below on the myth of public ownership. As Benjamin R. Tucker pointed out years ago, the Georgist "equal rights" thesis (or eminent domain) leads logically, *not* to a Single Tax, but to each individual's right to appropriate his theoretical share of the value of everybody else's land. The State's appropriation of this value then becomes sheer robbery of the *other* individual claims rather than of just the claim of the landowner. *See* Benjamin R. Tucker, *Individual Liberty* (New York: Vanguard Press, 1926), pp. 241–42.

government officials informally. What the briber receives, therefore, is an informal, oral license to operate. The fact that different government officials receive the money in the two cases is irrelevant to our discussion.

The extent to which an informal license acts as a grant of monopolistic privilege depends on the conditions under which it is granted. In some instances, the official accepts a bribe by one person and in effect grants him a monopoly in a particular area or occupation; in other cases, the official may grant the informal license to anybody who is willing to pay the necessary price. The former is an example of a clear monopoly grant followed by a possible monopoly price; in the latter case, the bribe acts as a lump-sum tax penalizing poorer competitors who cannot pay. They are forced out of business by the bribe system. However, we must remember that bribery is a consequence of the outlawing of a certain line of production and, therefore, that it serves to mitigate some of the loss of utility imposed on consumers and producers by the government prohibition. Given the state of outlawry, bribery is the chief means for the market to reassert itself; bribery moves the economy closer to the free-market situation.[75]

In fact, we must distinguish between an *invasive bribe* and a *defensive bribe*. The defensive bribe is what we have been discussing; that is, the purchase of a permission to operate after an activity is outlawed. On the other hand, a bribe to attain an *exclusive* or quasi-exclusive permission, barring others from the field, is an example of an invasive bribe, a payment for a grant of monopolistic privilege. The former is a significant movement *toward* the free market; the latter is a movement *away* from it.

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[75]The same is true of an official license: a firm's payment for a license is the only means for it to exist. A licensed firm cannot be stamped as a willing party to the monopolistic privilege unless it had helped to lobby for the licensing law's establishment or continuance, as very often happens.

R. Policy Toward Monopoly

Economic historians often inquire about the extent and importance of monopoly in the economy. Almost all of this inquiry has been misdirected, because the concept of monopoly has never been cogently defined. In this chapter we have traced types of monopoly and quasi monopoly and their economic effects. It is clear that the term "monopoly" properly applies only to governmental grants of privilege, direct and indirect. Truly gauging the extent of monopoly in an economy means studying the degree and extent of monopoly and quasi-monopoly privilege that the government has granted.

American opinion has been traditionally "antimonopoly." Yet it is clearly not only pointless but deeply ironic to call upon the government to "pursue a positive antimonopoly policy." Evidently, all that is necessary to abolish monopoly is that the government abolish its own creations.

It is certainly true that in many (if not all) cases the privileged businesses or laborers had themselves agitated for the monopolistic grant. But it is still true that they could not become quasi monopolists *except through the intervention of the State*; it is therefore the action of the State that must bear prime responsibility.[76]

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[76]Historians, however, will go sadly astray if they ignore the monopolistic motivation for passage of such measures by the State. Historians who are in favor of the free market often neglect this problem and thus leave themselves wide open to opposition charges that they are "apologists for monopoly capital." Actually, of course, advocates of the free market are "probusiness," as they are pro *any* voluntary relationship, *only* when it is carried on *in* the free market. They oppose governmental grants of monopolistic privilege to businesses or others, for to this extent business is no longer free, but a partner of the coercive State.

On business responsibility for interventions generally thought to be "antibusiness," *see* Gabriel Kolko, *The Triumph of Conservatism* (Glencoe, Ill.: The Free Press, 1963), and *idem*, *Railroads and Regulations, 1877–1916* (Princeton: Princeton University Press, 1965). *See also* James Weinstein, *The Corporate Ideal in the Liberal State: 1900–1918* (Boston: Beacon Press, 1968).

Finally, the question may be raised: Are corporations themselves mere grants of monopoly privilege? Some advocates of the free market were persuaded to accept this view by Walter Lippmann's *The Good Society*.[77] It should be clear from previous discussion, however, that corporations are not at all monopolistic privileges; they are free associations of individuals pooling their capital. On the purely free market, such men would simply announce to their creditors that their liability is *limited* to the capital specifically invested in the corporation, and that beyond this their personal funds are not liable for debts, as they would be under a partnership arrangement. It then rests with the sellers and lenders to this corporation to decide whether or not they will transact business with it. If they do, then they proceed at their own risk. Thus, the government does not *grant* corporations a privilege of limited liability; anything announced and freely contracted for in advance is a *right* of a free individual, not a special privilege. It is not necessary that governments grant charters to corporations.[78]

Appendix A
On Private Coinage

The common, erroneous phrasing of Gresham's Law ("bad money drives out good money") has often been used to attack the concept of private coinage as unworkable and thereby to defend the State's age-old monopolization of the minting business. As we have seen, however, Gresham's Law applies to the effect of government policy, not to the free market.

The argument most often advanced against private coinage is that the public would be burdened by fraudulent coin and

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[77]Walter Lippmann, *The Good Society* (3rd ed.; New York: Grosset and Dunlap, 1943), pp. 277 ff.

[78]It is true that limited liability for torts is the illegitimate conferring of a special privilege, but this does not loom large among the total liabilities of any corporation.

would be forced to test coins frequently for their weight and fineness. The government's stamp on the coin is supposed to certify its fineness and weight. The long record of the abuse of this certification by governments is well known. Moreover, the argument is hardly unique to the minting business; it proves far too much. In the first place, those minters who fraudulently certify the weight or fineness of coins will be prosecuted for fraud, just as defrauders are prosecuted now. Those who *counterfeit* the certifications of well-established private minters will meet a fate similar to those who counterfeit money today. Numerous products of business depend upon their weight and purity. People will either safeguard their wealth by testing the weight and purity of their coins, as they do their money bullion, or they will mint their coins with private minters who have established a reputation for probity and efficiency. These minters will place *their* stamps on the coins, and the best minters will soon come into prominence as coiners and as assayers of previously minted coins. Thus, ordinary prudence, the development of good will toward honest and efficient business firms, and legal prosecutions against fraud and counterfeiting would suffice to establish an orderly monetary system. There are numerous industries where the use of instruments of precise weight and fineness are essential and where a mistake would be of greater import than an error involving coins. Yet prudence and the process of market selection of the best firms, coupled with legal prosecution against fraud, have facilitated the purchase and use of the most delicate machine-tools, for example, without any suggestion that the government must nationalize the machine-tool industry in order to ensure the quality of the products.

Another argument against private coinage is that standardizing the denominations of coin is more convenient than permitting the diversity of coins that would ensue under a free system. The answer is that if the market finds standardization more convenient, private mints will be led by consumer demand to confine their minting to certain standard denominations. On the other hand, if greater variety is preferred, consumers will demand and obtain a more diverse range of coins. Under the government mintage monopoly, the desires of consumers for various denominations are ignored, and the standardization is compulsory rather than in accord with public demand.[79]

APPENDIX B
COERCION AND *LEBENSRAUM*

Tariffs and immigration barriers as a cause of war may be thought far afield from our study, but actually this relationship may be analyzed praxeologically. A tariff imposed by Government A prevents an exporter residing under Government B from making a sale. Furthermore, an immigration barrier imposed by Government A prevents a resident of B from migrating. Both of these impositions are effected by coercion. Tariffs as a prelude to war have often been discussed; less understood is the *Lebensraum* argument. "Overpopulation" of one particular country (insofar as it is not the result of a voluntary choice to remain in the homeland at the cost of a lower standard of living) is always the result of an immigration barrier imposed by another country. It may be thought that this barrier is purely a "domestic" one. But is it? By what right does the government of a territory proclaim the power to keep other people away? Under a purely free-market system, only individual property owners have the right to keep people off their property. The government's power rests on the implicit assumption that the government *owns* all the territory that it rules. Only then can the government keep people out of that territory.

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[79]*See* Herbert Spencer, *Social Statics* (New York: D. Appleton, 1890), pp. 438–39. For historical examples of successful private coinage, *see* B.W. Barnard, "The Use of Private Tokens for Money in the United States," *Quarterly Journal of Economics*, 1916–17, pp. 617–26; Charles A. Conant, *The Principles of Money and Banking* (New York: Harper & Bros., 1905), I, 127–32; and Lysander Spooner, *A Letter to Grover Cleveland* (Boston: Benjamin R. Tucker, 1886), p. 79.

Caught in an insoluble contradiction are those believers in the free market and private property who still uphold immigration barriers. They can do so only if they concede that the State is the owner of all property, but in that case they cannot have true private property in their system at all. In a truly free-market system, such as we have outlined above, only first cultivators would have title to unowned property; property that has never been used would remain unowned until someone used it. At present, the State owns all unused property, but it is clear that this is conquest incompatible with the free market. In a truly free market, for example, it would be inconceivable that an Australian agency could arise, laying claim to "ownership" over the vast tracts of unused land on that continent and using force to prevent people from other areas from entering and cultivating that land. It would also be inconceivable that a State could keep people from other areas out of property that the "domestic" property owner wishes them to use. No one but the individual property owner himself would have sovereignty over a piece of property.

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BINARY INTERVENTION: TAXATION

1. Introduction: Government Revenues and Expenditures

AN INTERVENTIONARY AGENCY, SUCH AS the government, must spend funds; in the monetary economy, this means spending money. This money can be derived only from *revenues* (or income). The bulk of the revenue (and the reason the agency is called interventionary) must come from two sources: in the case of the government, *taxation* and *inflation*. Taxation is a coerced levy that the government extracts from the populace; inflation is the basically fraudulent issue of pseudo warehouse-receipts for money, or new money. Inflation, which poses special problems of its own, has been dealt with elsewhere.[1] This chapter focuses on taxation.

We are discussing the government for the most part, since empirically it is the prime organization for coercive intervention. However, our analysis will actually apply to all coercive organizations. If governments budget their revenues and expenditures, so must criminals; where a government levies taxes, criminals extract their own brand of coerced levies; where a government issues fraudulent or fiat money, criminals may counterfeit. It should be understood that, praxeologically, there

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[1]*See Man, Economy, and State*, pp. 989–1023.

is no difference between the nature and effects of taxation and inflation on the one hand, and of robberies and counterfeiting on the other. Both intervene coercively in the market, to benefit one set of people at the expense of another set. But the government imposes its jurisdiction over a wide area and usually operates unmolested. Criminals, on the contrary, usually impose their jurisdiction on a narrow area only and generally eke out a precarious existence. Even this distinction does not always hold true, however. In many parts of many countries, bandit groups win the passive consent of the majority in a particular area and establish what amounts to effective governments, or States, within the area. The difference between a government and a criminal band, then, is a matter of degree rather than kind, and the two often shade into each other. Thus, a defeated government in a civil war may often take on the status of a bandit group, clinging to a small area of the country. And there is no praxeological difference between the two.[2]

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[2]The striking title of Mr. Chodorov's pamphlet is, therefore, praxeologically, accurate: *see* Frank Chodorov, *Taxation is Robbery* (Chicago: Human Events Associates, 1947), reprinted in Chodorov, *Out of Step* (New York: Devin-Adair, 1962), pp. 216–39. As Chodorov says:

> A historical study of taxation leads inevitably to loot, tribute, ransom—the economic purpose of conquest. The barons who put up toll-gates along the Rhine were tax-gatherers. So were the gangs who "protected," for a forced fee, the caravans going to market. The Danes who regularly invited themselves into England, and remained as unwanted guests until paid off, called it Dannegeld; for a long time that remained the basis of English property taxes. The conquering Romans introduced the idea that what they collected from subject peoples was merely just payment for maintaining law and order. For a long time the Norman conquerors collected catch-as-catch-can tribute from the English, but when by natural processes an amalgam of the two peoples resulted in a nation, the collections were regularized in custom and law and were called taxes. (*Ibid.*, p. 218)

Some writers maintain that only government *expenditures*, not *revenues*, constitute a burden on the rest of society. But the government cannot spend money until it obtains it as revenue—whether that revenue comes from taxation, inflation, or borrowing from the public. On the other hand, all revenue is spent. Revenue can differ from expenditure only in the rare case of *deflation* of part of the government funds (or government hoarding, if the standard is purely specie). In that case, as we shall see below, revenues are not a full burden, but government expenditures are more burdensome than their monetary amount would indicate, because the *real* proportion of government expenditures to the national income will have increased.

For the rest of this chapter, we shall assume that there is no such fiscal deflation and, therefore, that every increase in taxes is matched by an increase in government expenditures.

2. The Burdens and Benefits of Taxation and Expenditures

As Calhoun brilliantly pointed out (see chapter 2 above), there are two groups of individuals in society: the *taxpayers* and the *tax consumers*—those who are burdened by taxes and those who benefit. Who is burdened by taxation? The direct or immediate answer is: those who pay taxes. We shall postpone the questions of the *shifting* of tax burdens to a later section.

Who benefits from taxation? It is clear that the primary beneficiaries are those who live full-time off the proceeds, e.g., the politicians and the bureaucracy. These are the full-time rulers. It should be clear that regardless of legal forms, the bureaucrats pay no taxes; they consume taxes.[3] Additional beneficiaries of

[3]If a bureaucrat receives a salary of $5,000 a year and pays $1,000 in "taxes" to the government, it is quite obvious that he is simply receiving a salary of $4,000 and pays no taxes at all. The heads of the government have simply chosen a complex and misleading accounting device to make it appear that he pays taxes in the same way as any other men making the

government revenue are those in society subsidized by the government; these are the part-time rulers. Generally, a State cannot win the passive support of a majority unless it supplements its full-time employees, i.e., its members, with subsidized adherents. The hiring of bureaucrats and the subsidizing of others are essential in order to win active support from a large group of the populace. Once a State can cement a large group of active adherents to its cause, it can count on the ignorance and apathy of the remainder of the public to win passive adherence from a majority and to reduce any active opposition to a bare minimum.

The problem of the diffusion of expenditures and benefits is, however, more complicated when the government spends money for its various activities and enterprises. In this case, it acts always as a *consumer* of resources (e.g., military expenditures, public works, etc.), and it puts tax money into circulation by spending it on factors of production. Suppose, to make the illustration clearer, the government taxes the codfish industry and uses the proceeds of this tax to spend money on armaments. The first receiver of the money is the armament manufacturer, who pays it out to his suppliers and the owners of original factors, etc. In the meantime, the codfish industry, stripped of capital, reduces its demand for factors. In both cases, the burdens and benefits diffuse themselves throughout the economy. "Consumer" demand, by virtue of State coercion, has shifted from codfish to armaments. The result imposes short-run losses on the codfish industry and those who supply it, and short-run gains on the armaments industry and those who supply it. As the ripples of expenditure are pushed further and further back, the impact dies out, having been strongest at the points of first contact, i.e., the codfish and the armament industries. In the long run, however, all firms and all industries earn a uniform

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same income. The UN's arrangement, whereby all its employees are exempt from any income taxation, is far more candid.

return, and any gains or losses are imputed back to original factors. The nonspecific or convertible factors will tend to shift out of the codfish and into the armaments industry.[4] The purely specific or nonconvertible original factors will remain to bear the full burden of the loss and to reap the gain respectively. Even the nonspecific factors will bear losses and reap gains, though to a lesser degree. The major effect of the change, however, will eventually be felt by the owners of the specific original factors, largely the landowners of the two industries. Taxes are compatible with equilibrium, and therefore we may trace the long-run effects of a tax and expenditure in this manner.[5] In the short run, of course, entrepreneurs suffer losses and earn profits because of the shift in demand.

All government expenditure for resources is a form of *consumption* expenditure, in the sense that the money is spent on various items because the government officials so decree. The purchases may therefore be called the consumption expenditure of government officials. It is true that the officials do not consume the product directly, *but their wish* has altered the production pattern to make these goods, and therefore they may be called its "consumers."[6] As will be seen further below, all talk of government "investment" is fallacious.

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[4]The shift will not necessarily, or even probably, be from the codfish to the armament industry directly. Rather, factors will shift from the codfish to other, related industries and to the armament industry from its related lines.

[5]The diffusion effect of inflation differs from that of taxation in two ways: (*a*) it is *not* compatible with a long-run equilibrium, and (*b*) the new money always benefits the first half of the money receivers and penalizes the last half. Taxation-diffusion has the same effect at first, but shifting alters incidence in the final reckoning.

[6]On the other hand, since the officials do not usually consume the products directly, they often *believe* that they are acting on behalf of the consumers. Hence, their choices are liable to an enormous degree of error. Alec Nove has pointed out that if these choices were simply the consumer preferences of the government planners themselves, they would not, as

Taxation always has a two-fold effect: (1) it distorts the allocation of resources in the society, so that consumers can no longer most efficiently satisfy their wants; and (2) for the first time, it severs "distribution" from production. It brings the "problem of distribution" into being.

The first point is clear; government coerces consumers into giving up part of their income to the State, which then bids away resources from these same consumers. Hence, the consumers are burdened, their standard of living is lowered, and the allocation of resources is distorted away from consumer satisfaction toward the satisfaction of the ends of the government. More detailed analysis of the distorting effects of different types of taxes will be presented below. The essential point is that the object of many economists' quest, *a neutral tax*, i.e., a tax that will leave the market exactly the same as it was without taxation, must always be a chimera. No tax can be truly neutral; every one will cause distortion. Neutrality can be achieved only on a purely free market, where governmental revenues are obtained by voluntary purchase only.[7]

It is often stated that "capitalism has solved the problem of production," and that the State must now intervene to "solve the problem of distribution." A more clearly erroneous formulation would be difficult to conceive. For the "problem of production" will never be solved until we are all in the Garden of Eden. Furthermore, there is *no* "problem of distribution" on the free market. In fact, there is no "distribution" at all.[8] On the

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they do now, realize that they can and do make grievous *errors*. Thus, the choices made by government officials do not even possess the virtue of satisfying their *own* consumption preferences. Alec Nove, "Planners' Preferences, Priorities, and Reforms," *Economic Journal*, June, 1966, pp. 267–77.

[7]Two other types of revenue are consonant with neutrality and a purely free market: *fines* on criminals, and the *sale of products of prison labor*. Both are methods for making the criminals pay the cost of their own apprehension.

[8]*See* above and Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," pp. 250–51.

free market, a man's monetary assets have been acquired precisely because his or his predecessors' services have been purchased by others. There is no distributional process apart from the production and exchange of the market; hence, the very concept of "distribution" as something separate becomes meaningless. Since the free-market process benefits all participants on the market and increases social utility, it follows directly that the "distributional" results of the free market—the pattern of income and wealth—also increases social utility and, in fact, *maximizes* it at any given time. When the government takes from Peter and gives to Paul, it then *creates* a separate distribution process and a "problem" of distribution. No longer do income and wealth flow purely from service rendered on the market; they now flow from special privilege created by the coercion of the State. Wealth is now *distributed* to "exploiters" at the expense of the "exploited."[9]

The crucial point is that the extent of the distortion of resources, and of the State's plunder of producers, is in direct proportion to the level of taxation and government expenditures in the economy, as compared with the level of private income and wealth. It is a major contention of our analysis—in contrast to many other discussions of the subject—that by far the most important impact of taxation results not so much from the type of tax as from its amount. It is the *total level* of taxation, of government income compared with the income of the private sector, that is the most important consideration. Far too much significance has been attached in the literature to the *type* of tax—to whether it is an income tax, progressive or proportional, sales tax, spending tax, etc. Though important, this is subordinate to the significance of the total level of taxation.

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[9]It might be objected that, while bureaucrats are solely exploiters and not producers, other subsidized groups may also be producers as well. Their exploitation extends, however, to the degree that they are net tax consumers rather than taxpayers. Their other productive activities are beside the point.

3. The Incidence and Effects of Taxation

Part I: Taxes on Incomes

A. The General Sales Tax and the Laws of Incidence

One of the oldest problems connected with taxation is: *Who pays the tax?* It would seem that the answer is clear-cut, since the government knows on whom it levies a tax. The problem, however, is not who pays the tax *immediately*, but who pays it in the long run, i.e., whether or not the tax can be "shifted" from the immediate taxpayer to somebody else. Shifting occurs if the immediate taxpayer is able to raise his selling price to cover the tax, thus "shifting" the tax to the buyer, or if he is able to lower the buying price of something he buys, thus "shifting" the tax to some other seller.

In addition to this problem of the *incidence* of taxation, there is the problem of analyzing other economic effects of various types and amounts of taxes.

The first law of incidence can be laid down immediately, and it is a rather radical one: *No tax can be shifted forward*. In other words, no tax can be shifted from seller to buyer and on to the ultimate consumer. Below, we shall see how this applies specifically to excise and sales taxes, which are commonly thought to be shifted forward. It is generally considered that any tax on production or sales increases the cost of production and therefore is passed on as an increase in price to the consumer. Prices, however, are never determined by costs of production, but rather the reverse is true. The price of a good is determined by its total stock in existence and the demand schedule for it on the market. But the demand schedule is not affected at all by the tax. The selling price is set by any firm at the maximum net revenue point, and any higher price, given the demand schedule, will simply decrease net revenue. A tax, therefore, *cannot* be passed on to the consumer.

It is true that a tax *can* be shifted forward, in a sense, if the tax causes the supply of the good to decrease, and therefore the price to rise on the market. This can hardly be called shifting *per se*, however, for shifting implies that the tax is passed on with little or no trouble to the producer. If some producers must go out of business in order for the tax to be "shifted," it is hardly shifting in the proper sense but should be placed in the category of other *effects* of taxation.

A general sales tax is the classic example of a tax on producers that is believed to be shifted forward. The government, let us say, imposes a 20-percent tax on all sales at retail. We shall assume that the tax can be equally well enforced in all branches of sales.[10] To most people, it seems obvious that the business will simply add 20 percent to their selling prices and merely serve as unpaid collection agencies for the government. The problem is hardly that simple, however. In fact, as we have seen, there is no reason whatever to believe that prices can be raised at all. Prices are already at the point of maximum net revenue, the stock has not been decreased, and demand schedules have not changed. Therefore, prices cannot be increased. Furthermore, if we look at the general array of prices, these are determined by the supply of and the demand for money. For the array of prices to rise, there must be an increase in the supply of money, a decrease in the schedule of the demand for money, or both. Yet neither of these alternatives has occurred. The demand for money to hold has not decreased, the supply of goods available for money has not declined, and the supply of money has remained constant. There is no possible way that a general price increase can be obtained.[11]

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[10]Usually, of course, it cannot, and the result will be equivalent to a specific excise tax on some branches of sales, but not on others.

[11]Whereas a partial excise tax will eventually cause a drop in supply and therefore a rise in the price of the product, there is no way by which resources can escape a *general* tax except into idleness. Since, as we shall see, a sales tax is a tax on incomes, the rise in the opportunity cost of leisure may push some workers into idleness, and thereby lower the quantity of goods produced. To this tenuous extent, prices *will* rise. *See* the

It should be quite evident that if businesses were able to pass tax increases along to the consumer in the form of higher prices, they would have raised these prices already without waiting for the spur of a tax increase. Businesses do not deliberately peg along at the lowest selling prices they can find. If the state of demand had permitted higher prices, firms would have taken advantage of this fact long before. It might be objected that a sales tax increase is *general* and therefore that all the firms together can shift the tax. Each firm, however, follows the state of the demand curve for its *own* product, and none of these demand curves has changed. A tax increase does nothing to make higher prices more profitable.

The myth that a sales tax can be shifted forward is comparable to the myth that a general union-imposed wage increase can be shifted forward to higher prices, thereby "causing inflation." There is no way that the general array of prices can rise, and the only result of such a wage increase will be mass unemployment.[12]

Many people are misled by the fact that the price the consumer pays must necessarily *include* the tax. When someone goes to a movie and sees prominently posted the information that the $1.00 admission covers a "price" of 85cents and a tax of 15 cents, he tends to conclude that the tax has simply been added on to the "price." But $1.00 is the price, not 85cents, the latter sum being the income accruing to the firm after taxes. This income might well have been *reduced* to allow for payment of taxes.

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pioneering article by Harry Gunnison Brown, "The Incidence of a General Sales Tax," reprinted in R.A. Musgrave and C.S. Shoup, eds., *Readings in the Economics of Taxation* (Homewood, Ill.: Richard D. Irwin, 1959), pp. 330–39. This was the first modern attack on the fallacy that sales taxes are shifted forward, but Brown unfortunately weakened the implications of this thesis toward the end of his article.

[12]Of course, if the money supply is increased and credit expanded, prices can be raised so that money wages are no longer above their discounted marginal value products.

In fact, this is precisely the effect of a general sales tax. Its immediate impact lowers the gross revenue of firms by the amount of the tax. In the long run, of course, firms cannot pay the tax, for their loss in gross revenue is imputed back to interest income by capitalists and to wages and rents earned by original factors—labor and ground land. A decrease in the gross revenue of retail firms is reflected back to a decreased demand for the products of all the higher-order firms. All the firms, however, earn, in the long run, a pure uniform interest return.

Here a difference arises between a general sales tax and, say, a corporate income tax. There has been no change in time-preference schedules or other components of the interest rate. While an income tax compels a lower percent interest return, a sales tax can and will be shifted completely from investment and back to the original factors. The result of a general sales tax is a general reduction in the net revenue accruing to original factors: to all wages and ground rents. The sales tax has been *shifted backwards* to original factor returns. No longer does every original factor of production earn its discounted marginal value product. Now, original factors earn *less* than their DMVPs, the reduction consisting of the sales tax paid to the government.

It is necessary now to integrate this analysis of the incidence of a general sales tax with our previous general analysis of the benefits and burdens of taxation. This is accomplished by remembering that the proceeds of taxation are, in turn, spent by the government.[13] Whether the government spends the money for resources for its own activities or simply transfers the money to people it subsidizes, the result is to *shift* consumption and investment demand from private hands to the government or to government-supported individuals, by the amount of the tax revenue. In this case, the tax has been ultimately levied on the *incomes* of original factors, and the money transferred from their

[13]If the government does not spend all of its revenue, then deflation is added to the impact of taxation. See below.

hands to the government. The income of the government and/or those it subsidizes has been increased at the expense of those taxed, and therefore consumption and investment demands on the market have been shifted from the latter to the former by the amount of the tax. As a consequence, the value of the money unit will remain unchanged (barring a difference in demands for money between the taxpayers and the tax consumers), but the array of prices will shift in accordance with the shift in demands. Thus, if the market has been spending heavily on clothing, and the government uses the revenue mostly for the purchase of arms, there will be a fall in the price of clothes, a rise in the price of arms, and a tendency for nonspecific factors to shift out of clothing and into the production of armaments.

As a result, there will not be, as might be assumed, a proportional 20-percent fall in the incomes of all original factors as a result of a 20-percent general sales tax. Specific factors in industries that have lost business as a result of the shift from private to governmental demand will lose proportionately more in income. Specific factors in industries gaining in demand will lose proportionately less, and some may gain so much as to gain absolutely as a result of the change. Nonspecific factors will not be affected as much proportionately, but they too will lose and gain according to the difference that the concrete shift in demand makes in their marginal value productivity.

The knowledge that taxes can never be shifted forward is a consequence of adhering to the "Austrian" analysis of value, i.e., that prices are determined by ultimate demands for stock, and not in any sense by the "cost of production." Unhappily, all previous discussions of the incidence of taxation have been marred by hangovers of classical "cost-of-production" theory and the failure to adopt a consistent "Austrian" approach. The Austrian economists themselves never really applied their doctrines to the theory of tax incidence, so that this discussion breaks new ground.

The shifting-forward doctrine has actually been carried to its logical, and absurd, conclusion that producers shift taxes to consumers, and consumers, in turn, can shift them to their employers, and so on *ad infinitum*, with no one really paying *any* tax at all.[14]

It should be carefully noted that the general sales tax is a conspicuous example of *failure to tax consumption.* It is commonly supposed that a sales tax penalizes consumption rather than income or capital. But we find that the sales tax reduces, not just consumption, but the *incomes* of original factors. The *general sales tax is an income tax*, albeit a rather haphazard one, since there is no way that its impact on income classes can be made uniform. Many "right-wing" economists have advocated general sales taxation, as opposed to income taxation, on the ground that the former taxes consumption but not savings-investment; many "left-wing" economists have opposed sales taxation for the same reason. Both are mistaken; the sales tax is an income tax, though of more haphazard and uncertain incidence. The major effect of the general sales tax will be that of the income tax: to reduce the consumption *and* the savings-investment of the taxpayers.[15] In fact, since, as we shall see, the

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[14]For example, *see* E.R.A. Seligman, *The Shifting and Incidence of Taxation* (2nd ed.; New York: Macmillan & Co., 1899), pp. 122–33.

[15]Mr. Frank Chodorov, in his *The Income Tax—Root of All Evil* (New York: Devin-Adair, 1954), fails to indicate what other type of tax would be "better" from a free-market point of view than the income tax. It will be clear from our discussion that there are few taxes indeed that will not be as bad as the income tax from the viewpoint of an advocate of the free market. Certainly, sales or excise taxation will not fill the bill.

Chodorov, furthermore, is surely wrong when he terms income and inheritance taxes *unique* denials of the right of individual property. Any tax whatever infringes on property rights, and there is nothing in an "indirect tax" which makes that infringement any less clear. It is true that an income tax forces the subject to keep records and disclose his personal dealings, thus imposing a further loss in his utility. The sales tax, however, also forces record-keeping; the difference again is one of degree rather than of kind, for here the extent of directness covers only retail storekeepers instead of the bulk of the population.

income tax by its nature falls more heavily on savings-investment than on consumption, we reach the paradoxical and important conclusion that a tax on *consumption* will also fall more heavily on *savings-investment*, in its ultimate incidence.

B. Partial Excise Taxes; Other Production Taxes

The partial excise tax is a sales tax levied on *some*, rather than all, commodities. The chief distinction between this and the general sales tax is that the latter does not, *in itself*, distort productive allocations on the market, since a tax is levied proportionately on the sale of all final products. A partial excise, on the other hand, penalizes certain lines of production. The general sales tax, of course, distorts market allocations insofar as government expenditures from the proceeds differ in structure from private demands in the absence of the tax. The excise tax has this effect, too, and, *in addition*, penalizes the particular industry taxed. The tax cannot be shifted forward, but tends to be shifted backward to the factors working in the industry. Now, however, the tax exerts pressure on nonspecific factors and entrepreneurs to leave the taxed industry and enter other, nontaxed industries. *During the transition period*, the tax may well be added to cost. As the price, however, cannot be directly increased, the *marginal* firms in this industry will be driven out of business and will seek better opportunities elsewhere. The exodus of nonspecific factors, and perhaps firms, from the taxed industry *reduces the stock of the good that will be produced.* This reduction in stock, or supply, will raise the market price of the good, given the consumers' demand schedule. Thus, there is a sort of "indirect shifting" in the sense that the price of the good to consumers will ultimately increase. However, as we have stated, it is not appropriate to call this "shifting," a term better reserved for an effortless, direct passing on of a tax in the price.

Everyone in the market suffers as a result of an excise tax. Nonspecific factors must shift to fields of lower income; since the discounted marginal value product is lower there, specific factors are hit particularly hard, and consumers suffer as the allocations of factors and the price structure are distorted in comparison with what would have satisfied their desires. The supply of factors in the taxed industries becomes excessively low, and the selling price in these industries too high; while the supply of factors in other industries becomes excessively large, and their product prices too low.

In addition to those specific effects, the excise tax also has the same general effect as *all other taxes*, viz., that the pattern of market demands is distorted from private to government or government-subsidized wants by the amount of the tax intake.

Far too much has been written on the *elasticity* of demand in relation to the effect of taxation. We know that the demand schedule for one firm is *always* elastic above the free-market price. And the cost of production is not something fixed, but is in itself *determined* by the selling price. Most important, since the demand curve for a good is always falling, any decrease in the stock will raise the market price, and any increase in the stock will lower the price, regardless of the elasticity of demand for the product. Elasticity of demand is a topic that warrants only a relatively minor role in economic theory.[16]

In sum, an excise tax (*a*) injures consumers in the same way that all taxes do, by shifting resources and demands from private consumers to the State; and (*b*) injures consumers and producers in its own particular way by distorting market allocations, prices, and factor revenues; but (*c*) cannot be considered a *tax* on consumption in the sense that the tax is shifted to consumers. The excise tax is also a tax on *incomes*, except that in this case the effect is not general because the impact falls most heavily on the factors specific to the taxed industry.

Any partial tax on production will have effects similar to an excise tax. A license tax imposed on an industry, for example, granting a monopolistic privilege to firms with a large amount

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[16]Perhaps the reason for the undeserved popularity of the elasticity concept is that economists need to employ it in their vain search for quantitative laws and measurements in economics.

of capital, will restrict the supply of the product and raise the price. Factors and pricing will be misallocated as in an excise tax. In contrast to the latter, however, the indirect grant of monopolistic privilege will *benefit* the specific, quasi-monopolized factors that are able to remain in the industry.

C. General Effects of Income Taxation

In the dynamic real economy, *money income* consists of wages, ground rents, interest, and profits, counterbalanced by losses. (Ground rents are also capitalized on the market, so that income from rents is resolvable into interest and profit, minus losses.) The *income tax* is designed to tax all such net income. We have seen that sales and excise taxes are really taxes on some original-factor incomes. This has been generally ignored, and perhaps one reason is that people are accustomed to thinking of income taxation as being uniformly levied on all incomes of the same amount. Later, we shall see that the uniformity of such a levy has been widely upheld as an important "canon of justice" for taxation. Actually, no such uniformity does or need exist. Excise and sales taxes, as we have seen, are not uniformly levied, but are imposed on some income receivers and not others of the same income class. It must be recognized that the *official income tax*, the tax that is generally known as the "income tax," is by no means the only form in which income is, or can be, taxed by the government.[17]

An income tax cannot be shifted to anyone else. The taxpayer himself bears the burden. He earns profits from entrepreneurial activity, interest from time preference, and other income from marginal productivity, and none can be increased to cover the tax. Income taxation reduces every taxpayer's money income and real income, and hence his standard of living. His income from working is more expensive, and leisure cheaper, so that he will

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[17]Even the official tax is hardly uniform, being interlarded with extra burdens and exemptions. See below for further discussion of uniformity of taxation.

tend to work less. Everyone's standard of living in the form of exchangeable goods will decline. In rebuttal, much has been made of the fact that every man's marginal utility of money rises as his money assets fall and, therefore, that there may be a rise in the marginal utility of the reduced income obtainable from his current expenditure of labor. It is true, in other words, that the same labor now earns every man less money, but this very reduction in money income may also raise the marginal utility of a unit of money to the extent that the marginal utility of his total income will be *raised*, and he will be induced to work *harder* as a result of the income tax. This may very well be true in some cases, and there is nothing mysterious or contrary to economic analysis in such an event. However, it is hardly a blessing for the man or for society. For, if more work is expended, leisure is lost, and people's standards of living are lower because of this coerced loss.

In the free market, in short, individuals are always balancing their money income (or real income in exchangeable goods) against their real income in the form of leisure activities. Both are basic components of the standard of living. The greater their exchangeable-goods income, in fact, the higher will be their marginal utility of a unit of leisure time (nonexchangeable goods), and the more proportionately will they "take" their income in the form of leisure. It is not surprising, therefore, that a coerced lower income may force individuals to work harder. Whichever the effect, the tax lowers the standard of living of the taxpayers, either depriving them of leisure or of exchangeable goods.

In addition to penalizing work relative to leisure, an income tax also penalizes work for *money* as against work for a return in kind. Obviously, a relative advantage is conferred on work done for a nonmonetary reward. Working women are penalized as compared with housewives; people will tend to work for their families rather than enter into the labor market, etc. "Do-it-yourself" activities are stimulated. In short, the income tax tends to bring about a reduction in specialization and a breakdown of the market, and hence a retrogression in living standards.[18] Make the income tax high enough, and the market will disintegrate altogether, and primitive economic conditions will prevail.

The income tax confiscates a certain portion of a person's income, leaving him free to allocate the remainder between consumption and investment. It might be thought that, since we may assume time-preference schedules as given, the proportion of consumption to savings-investment—and the pure interest rate—will remain unaffected by the income tax. But this is not so. For the taxpayer's real income and the value of his monetary assets have been lowered. The lower the level of a man's real monetary assets, the higher will his time-preference rate be (given his time-preference schedule) and the higher the proportion of his consumption to investment spending. The taxpayer's position may be seen in the diagram in Figure 4.

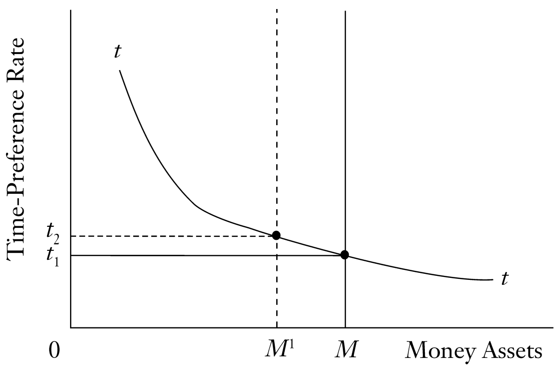

FIGURE 4. AN INDIVIDUAL TIME-PREFERENCE SCHEDULE

[18]*See* C. Lowell Harriss, "Public Finance" in Bernard F. Haley, ed., *A Survey of Contemporary Economics* (Homewood, Ill.: Richard D. Irwin, 1952), II, 264. For a practical example, *see* P.T. Bauer, "The Economic Development of Nigeria," *Journal of Political Economy*, October, 1955, pp. 400 ff.

Figure 4 is a portrayal of an *individual* taxpayer's time-preference schedule, related to his monetary assets. Let us say that the taxpayer's initial position is a stock of *0M*; *tt* is his time-preference curve. His *effective time-preference rate*, determining the ratio of his consumption to his savings-investment is t_1. Now the government levies an income tax, reducing his initial monetary assets at the start of his spending period to $0M^1$. His effective time-preference rate is now higher, at t_2. We have seen that an individual's *real* as well as nominal money assets must decline in order for this result to take place; if there is deflation, the value of the monetary unit will increase roughly in proportion, and, in the long run, time-preference ratios, *ceteris paribus*, will not be changed. In the case of income taxation, however, there will be no change in the value of the monetary unit, since the government will spend the proceeds of taxation. As a result, the taxpayer's *real* as well as nominal money assets decline, and decline to the same extent.

It might be objected that the government officials or those subsidized receive additional money, and the fall in their time-preference ratios may well offset, or balance, the rise in the rate from the taxpayers' side. It could not be concluded, then, that the social rate of time-preference will rise, and savings-investment particularly decrease. Government expenditures, however, constitute diversion of resources from private to government purposes. Since the government, by definition, desires this diversion, this is a *consumption* expenditure by the government.[19] The reduction in income (and therefore in consumption *and* savings-investment) imposed on the taxpayers will

[19]These expenditures are commanded by the government, and not by the free action of individuals. They therefore may satisfy the utility (or are expected to satisfy the utility) only of the government officials, and we cannot be sure that anyone else's is satisfied.

The Keynesians, on the contrary, classify all government resource-using expenditure as "investment," on the ground that these, like investment expenditures, are "independent," and not passively tied to income by means of a psychological "function."

therefore be counterbalanced by government consumption-expenditure. As for the *transfer* expenditures made by the government (including the salaries of bureaucrats and subsidies to privileged groups), it is true that some of this will be saved and invested. These investments, however, will not represent the voluntary desires of consumers, but rather investments in fields of production *not* desired by the *producing* consumers. They represent the desires, *not* of the producing consumers on the free market, but of exploiting consumers fed by the unilateral coercion of the State. Once let the tax be eliminated, and the producers are free to earn and consume again. The new investments called forth by the demands of the specially privileged will turn out to be *malinvestments*. At any rate, the amount consumed by the government insures that the effect of income taxation will be to raise time-preference ratios and to reduce saving and investment.

Some economists maintain that income taxation reduces saving and investment in the society in a third way. They assert that income taxation, by its very nature, imposes a "double" tax on savings-investment as against consumption.[20] The reasoning runs as follows: Saving and consumption are not really symmetrical. All saving is directed toward enjoying more consumption in the future. Otherwise, there would be no point at all in saving. Saving is abstaining from possible present consumption in return for the expectation of increased consumption at some time in the future. No one wants capital goods for their own sake.[21] They are only the embodiment of an

[20]Thus, *see* Irving and Herbert W. Fisher, *Constructive Income Taxation* (New York: Harper & Bros., 1942). "Double" is used in the sense of *two* instances, not arithmetically twice.

[21]Although there is much merit in Professor Due's critique of this general position, he is incorrect in believing that people may own capital for its own sake. If people, because of the uncertainty of the future, wish to hold wealth for its service in relieving risk, they will hold wealth in its most marketable form—cash balances. Capital is far less marketable and is desired only for its fructification in consumers' goods and earnings

increased consumption in the future. Savings-investment is Crusoe's building a stick to obtain more apples at a future date; it fructifies in increased consumption later. Hence, the imposition of an income tax excessively penalizes savings-investment as against consumption.[22]

This line of reasoning is correct in its explanation of the investment-consumption process. It suffers, however, from one grave defect: it is irrelevant to problems of taxation. It is true that saving is a fructifying agent. But the point is that everyone knows this; that is precisely why people save. Yet, even though they know that saving is a fructifying agent, they do not save *all* their income. Why? Because of their time preference for present consumption. Every individual, given his current income and value scales, allocates that income in the most desired proportion among consumption, investment, and addition to his cash balance. Any other allocation would satisfy his desires to a lesser extent and lower his position on his value scale. There is therefore no reason here to say that an income tax especially penalizes savings-investment; it penalizes the individual's entire standard of living, encompassing present consumption, future consumption, and his cash balance. It does not *per se* penalize saving any more than it does the other avenues of income allocation.

There *is* another way, however, in which an income tax does, in fact, levy a particular burden on saving. For the interest return on savings-investment, like all other earnings, is subject to the income tax. The net interest rate received, therefore, is lower than the free-market rate. The return is not consonant with free-market time preferences; instead, the imposed lower return induces people to bring their savings-investment into line with the reduced return; in short, the marginal savings and

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from the sale of these goods. John F. Due, *Government Finance* (Homewood, Ill.: Richard D. Irwin, 1954), pp. 123–25, 368 ff.

[22]These economists generally go on to advocate taxation of consumption alone as the only "real" income. For further discussion of such a consumption tax, see below.

investments, now not profitable at the lower rate, will not be made.

The above Fisher-Mill argument is an example of a curious tendency among economists generally devoted to the free market to be unwilling to consider its ratio of consumption to investment allocations as optimal. The economic case for the free market is that market allocations tend at all points to be optimal with respect to consumer desires. The economists who favor the free market recognize this in most areas of the economy but for some reason show a predilection for and special tenderness toward savings-investment, as against consumption. They tend to feel that a tax on saving is far more of an invasion of the free market than a tax on consumption. It is true that saving embodies future consumption. But people voluntarily choose between present and future consumption in accordance with their time preferences, and this voluntary choice is their optimal choice. *Any tax levied particularly on their consumption, therefore, is just as much a distortion and invasion of the free market as a tax on their savings.* There is nothing, after all, especially sacred about savings; they are simply the road to future consumption. But they are *no more* important than present consumption, the allocation between the two being determined by the time preferences of all individuals. The economist who shows more concern for free-market savings than he does for free-market consumption is implicitly advocating statist interference and a coerced distortion of resource allocation in favor of greater investment and lower consumption. The free-market advocate should oppose with equal fervor coerced distortion of the ratio of consumption to investment in *either* direction.[23]

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[23]Thus, one of the standard conservative arguments against *progressive* income taxation (see below) is that savings would be taxed in greater proportion than consumption; many of these writers leave the reader with the inference that if (present) consumption were taxed more heavily, everything would be all right. Yet what is so worthy about *future*, as against *present*, consumption, and what principle do these economists

As a matter of fact, we have seen that income taxation, by other routes, tends to distort the allocation of resources into more consumption and less savings-investment, and we have seen above that *attempts* to tax consumption in the form of sales or production taxation must fail and end as levies on incomes instead.

D. Particular Forms of Income Taxation

(1) *Taxes on Wages*

A tax on wages is an income tax that cannot be shifted away from the wage earner. There is no one to shift it to, especially not the employer, who always tends to earn a uniform interest rate. In fact, there are *indirect* taxes on wages that are shifted to the *wage earner* in the form of lower wage incomes. An example is that part of social security, or of unemployment compensation premiums, *levied on the employer*. Most employees believe that they completely escape this part of the tax, which the employer pays. They are wholly mistaken. The employer, as we have seen, *cannot* shift the tax forward to the consumer. In fact, since the tax is levied in proportion to wages paid, the tax is shifted backward *wholly* on the wage earners themselves. The employer's part is simply a collected tax levied at the expense of a reduction of the net wages of the employees.

(2) *Corporate Income Taxation*

Taxation of corporate net income imposes a "double" tax on the owners of corporations: once on the official "corporate" income and once on the remaining distributed net income of the owners themselves. The extra tax cannot be shifted forward onto the consumer. Since it is levied on net income itself, it can hardly be shifted backward. It has the effect of penalizing corporate income as opposed to income from other market forms

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adopt that permits them to alter by force the voluntary time-preference ratios between present and future?

(single ownership, partnerships, etc.), thereby penalizing efficient forms of enterprise and encouraging the inefficient. Resources shift from the former to the latter until the expected rate of net return is equalized throughout the economy—at a lower level than originally. Since interest return is forcibly lower than before, the tax penalizes savings and investment as well as an efficient market form.[24]

The penalty, or "double-taxation," feature of corporate income taxes could be eliminated only by abolishing the tax and treating any net incomes accruing to a corporation as *pro rata* income to its stockholder-owners. In other words, a corporation would be treated as a partnership, and not according to the absurd fiction that it is some sort of separate real entity functioning apart from the actions of its actual owners. Income accruing to the corporation obviously accrues pro rata to the owners. Some writers have objected that the stockholders do not really receive the income on which they would be taxed. Thus, suppose that the Star Corporation earns a net income of $100,000 in a certain period, and that it has three stockholders—Jones, with 40 percent of the stock; Smith, holding 35 percent of the stock; and Robinson, owning 25 percent. The majority stockholders, or their management representatives, decide to retain $60,000 as "undistributed" earnings "in the firm," while paying only $40,000 as dividends. Under present law, Jones' net income from the Star Corporation is considered as $16,000, Smith's as $14,000, and Robinson's as $10,000; the "corporation's" is listed at $100,000. Each of these entities is then taxed on these amounts. Yet, since there is no real corporate entity separate from its owners, the incomes would be more properly recorded as follows: Jones, $40,000; Smith, $35,000;

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[24]Some writers have pointed out that the penalty lowers future consumption from what it would have been, reducing the supply of goods and raising prices to consumers. This can hardly be called "shifting," however, but is rather a manifestation of the ultimate effect of the tax in reducing consumer standards of living from the free-market level.

Robinson, $25,000. The fact that these stockholders do not actually *receive* the money is no objection; for what happens is the equivalent of someone's earning money yet keeping it on account without bothering to draw it out and use it. Interest that piles up in someone's savings bank account is considered as income and taxed accordingly, and there is no reason why "undistributed" earnings should not be considered individual income as well.

The fact that total corporate income is first taxed and then "distributed" as dividend income to be taxed again, encourages a further distortion of market investment and organization. For this practice encourages stockholders to leave a greater proportion of their earnings undistributed than they would have done in a free market. Earnings are "frozen in" and either held or invested in an uneconomic fashion in relation to the satisfaction of consumer wants. To the reply that this at least fosters investment, there are two rejoinders: (1) that a distortion in favor of investment is as much a distortion of optimum market allocations as anything else; and (2) that not "investment" is encouraged, but rather *frozen investment* by owners back into their original firms at the expense of mobile investment. This distorts and renders inefficient the pattern and allocation of investment funds and tends to freeze them in the original firms, discouraging the diffusion of funds to different concerns. Dividends, after all, are not necessarily consumed: they may be reinvested in other firms and other investment opportunities. The corporate income tax greatly hampers the adjustment of the economy to dynamic changes in conditions.

(3) *"Excess" Profit Taxation*

This tax is generally levied on that part of business net income, dubbed "excess," which is greater than a base income in a previous period of time. A penalty tax on "excess" business income directly penalizes efficient adjustment of the economy. The profit drive by entrepreneurs is the motive power that adjusts, estimates, and coordinates the economic system so as to maximize producer income in the service of maximizing consumer satisfactions. It is the process by which malinvestments are kept to a minimum, and good forecasts encouraged, so as to arrange advance production to be in close harmony with consumer desires at the date when the final product appears on the market. Attacking profits "doubly" disrupts and hampers the whole market-adjustment process. Such a tax penalizes efficient entrepreneurship. Furthermore, it helps to freeze market patterns and entrepreneurial positions as they were in some previous time period, thus distorting the economy more and more as time passes. No economic justification can be found for attempting to freeze market patterns in the mould of some previous period. The greater the changes in economic data that have occurred, the more important it is *not* to tax "excess" profits, or any form of "excess" revenue for that matter; otherwise, adaptation to the new conditions will be blocked just when rapid adjustment is particularly required. It is difficult to find a tax more indefensible from more points of view than this one.

(4) *The Capital Gains Problem*

Much discussion has raged over the question: Are capital gains income? It seems evident that they are; indeed, capital gain is one of the leading forms of income. In fact, *capital gain is the same as profit*. Those who desire uniformity of income-pattern taxation would therefore have to include capital gains if all forms of monetary profit are to be brought into the category of taxable income.[25] Using as an example the Star Corporation

[25]It must not be inferred that the present author is an advocate of uniform taxation. Uniformity, in fact, will be sharply criticized below as an ideal *impossible* of attainment. (An ethical goal absolutely impossible of attainment is an absurd goal; to this extent we may engage, not in ethical exhortation, but in praxeological criticism of the possibility of realizing certain ethical goals.) However, it is analytically more convenient to treat various types of income taxation in relation to uniform treatment of all income.

described above, let us consider $Time_1$ to be the period just after the corporation has earned \$100,000 net income and just before it decides where to allocate this income. In short, it is at a decision point in time. It has earned a profit of \$100,000.[26] At $Time_1$, its capital value has therefore increased by \$100,000. The stockholders have, in the aggregate, earned a capital gain of \$100,000, but this is the same as their aggregate profit. Now the Star Corporation keeps \$60,000 and distributes \$40,000 in dividends, and for the sake of simplicity we shall assume that the stockholders consume this amount. What is the situation at $Time_2$, after this allocation has taken place? In comparison with the situation prevailing originally, say at $Time_0$, we find that the capital value of the Star Corporation has increased by \$60,000. This is unquestionably part of the *income* of the stockholders; yet, if uniform income taxation is desired, there is no need to levy a tax on it, for it was already included in the \$100,000 income of the stockholders subject to tax.

The stock market always tends toward an accurate reflection of the capital value of a firm; one might think, therefore, that the quoted value of the firm's shares would increase, in the aggregate, by \$60,000. In the dynamic world, however, the stock market reflects anticipations of future profit, and therefore its values will diverge from the relatively *ex post* accounting of the firm's balance sheet. Furthermore, entrepreneurship, in addition to profits and losses, will be reflected in the valuations of the stock market as well as in business enterprises directly. A firm may be making slim profits now, but a farseeing entrepreneur will purchase stock from more shortsighted ones. A rise in price will net him a capital gain, and this is a reflection of his

[26]For the sake of convenience, we are assuming that this income is pure profit, and that interest income has already been disposed of. Only pure profit increases capital value, for in the evenly rotating economy there will be no *net* savings, and the interest income will just pay for maintaining the capital income structure intact.

entrepreneurial wisdom in directing capital. Since it would be impossible administratively to identify the profits of the firm, it would be better from the point of view of uniform income taxation *not* to tax the business income of corporate stockholders at all, but to tax a stockholder's capital gains instead. Whatever gains the owners reap will be reflected in capital gains on their stock anyway, so that taxation of the business income itself becomes unnecessary. On the other hand, taxation of business income while exempting capital gains would exclude from "income" the entrepreneurial gains reaped on the stock market. In the case of partnerships and single enterprises that are not owned in shares of stock, the business income of the owners would, of course, be taxed directly. Taxation of both business income (i.e., profits accruing to stockholders) *and* capital gains on stock would impose a double tax on efficient entrepreneurs. A genuinely uniform income tax, then, would not tax a stockholder's pro rata business income at all, but rather the capital gain from his shares of stock.

If business profits (or capital gains) are income subject to tax, then, of course, business losses or capital losses are a negative income, deductible from other income earned by any particular individual.

What of the problem of land and housing? Here, the same situation obtains. Landlords earn income annually, and this may be included in their net income as business profits. However, real estate, while not given to stock ownership, also has a flourishing capital market. Land is capitalized, and capital values increase or dwindle on the capital market. It is clear that, once again, the government has an alternative if it desires to impose uniform personal income taxes: either it can impose the tax on net profits from real estate, or it can forgo this and impose a tax on increases in the capital values of real estate. If it does the former, it will omit the entrepreneurial gains and losses made on the capital market, the regulator and anticipator of investment and demand; if it does both, it imposes a double tax on this form of business. The best solution (once again within the context of a uniform income tax) is to impose a tax on the capital gain minus the capital loss on the land values.

It must be emphasized that a capital gains tax is truly an income tax only when it is levied on *accrued*, rather than on *realized*, capital gains or losses. In other words, if a man's capital assets have increased during a certain period, from 300 ounces of gold to 400 ounces, his income is 100 ounces, whether or not he has sold the asset to "take" the profit. In any period, his earnings consist not simply in what he may use for spending. The situation is analogous to that of a corporation's undistributed profits, which as we have seen, must be included in each stockholder's accumulation of income. Taxing *realized* gains and losses introduces great distortions into the economy; it then becomes highly advantageous to investors never to sell their stock, but to hand it down to future generations. Any sale would require the old owner to pay the capital gains levy accumulated for an entire period. The effect is to "freeze" an investment in the hands of one person, and particularly of one family, for generations. The result is rigidity in the economy and failure of the hampered market to meet flexibly the continual changes in data that always take place. As time goes on, the distortive effects of the economic rigidity grow worse and worse.

Another serious hampering of the capital market results from the fact that, once the capital gain is "taken" or realized, the income tax on this particular gain is actually far higher and not uniform. For the capital gains accrue over a long stretch of time, and not simply at the point of sale. But the income tax is based only on each year's realized income. In other words, a man who realizes his gain in a certain year must pay a far bigger tax in that year than would be "justified" by a tax on his actually acquired income during the year. Suppose, for example, that a man buys a capital asset at 50 and its market value increases by 10 each year, until he finally sells it for 90 in four years' time. For three years, his income of 10 goes untaxed, while in the fourth year he