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

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

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

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

impair the standard of living of the American wage earner in an adverse sense.

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

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

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

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

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

Let us assume that there are two countries only—Ruritania and Laputania. In Ruritania the final wage rate is double what it is in Laputania.

6. See above, pp. 448-452.

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

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

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

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

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

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

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

4. Restriction as an Economic System

There are, as has been shown, cases in which a restrictive measure can attain the end sought by its application. If those resorting to such a measure think that the attainment of this goal is more important than the disadvantages brought about by the restriction—i.e., the curtailment in the quantity of material goods available for consumption—the recourse to restriction is

7. See also what has been said about the function of cartels on pp. 365-369.

justified from the point of view of their value judgments. They incur costs and pay a price in order to get something that they value more than what they had to expend or to forego. Nobody, and certainly not the theorist, is in a position to argue with them about the propriety of their value judgments.

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

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

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

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

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

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

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

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

8. As for the objections raised against this thesis from the point of view of the Ricardo effect, see below, pp. 773-776.

XXX. INTERFERENCE WITH THE STRUCTURE OF PRICES

1. The Government and the Autonomy of the Market

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2. The Market's Reaction to Government Interference

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

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

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

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

measure in order to make it possible even for poor people to be amply supplied with them. But the result of the government's interference is that production of these commodities drops or stops altogether. It is a complete failure.

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

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

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

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

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

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

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

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

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

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

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

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

Observations on the Causes of the Decline of Ancient Civilization

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

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

What brought about the decline of the empire and the decay of its civilization was the disintegration of this economic interconnectedness, not the barbarian invasions. The alien aggressors merely took advantage of an opportunity which the internal weakness of the empire offered to them. From a military point of view the tribes which invaded the empire in the fourth and fifth centuries were not more formidable than the armies which the

2. Cf. above, pp. 395-397.

legions had easily defeated in earlier times. But the empire had changed. Its economic and social structure was already medieval.

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

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

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

division of labor. The highly developed economic structure of ancient civilization retrograded to what is now known as the manorial organization of the Middle Ages.

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

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

3. Minimum Wage Rates

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

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

police, the public attorneys, and the penal courts preserve a lofty neutrality or openly side with the strikers.

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

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

5. Cf. W.H. Beveridge, *Full Employment in a Free Society* (London, 1944), pp. 92 f.
6. Cf. Hutt, *The Theory of Collective Bargaining,* pp. 10-21.

unionism could improve the conditions and raise the standard of living of *all* those eager to earn wages.

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

The problems of labor unionism have been obfuscated and utterly confused by pseudo-humanitarian blather. The advocates of minimum wage rates, whether decreed and enforced by government or by violent action, contend that they are fighting for the improvement of the conditions of the working masses. They do not permit anyone to question their dogma that

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

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

9. Cf. Marx, *op. cit.*, pp. 126-127.

minimum wage rates are the only appropriate means of raising wage rates permanently and for all those eager to earn wages. They pride themselves on being the only true friends of "labor," of the "common man," of "progress," and of the eternal principles of "social justice."

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

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

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

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

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

Many economists approve of the Ricardian proposition although few of them are consistent enough to endorse the inference the union apologists draw from it. The Ricardo effect is by and large a stock-in-trade of popular

10.Cf. below, pp. 804-820.

11.Cf. above, pp. 310-303.

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

economics. Nonetheless, the theorem involved is one of the worst economic fallacies.

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

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

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

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

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

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

Real wage rates can rise only to the extent that, other things being equal, capital becomes more plentiful. If the government or the unions succeed in

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

14.See above, pp. 522-523

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

enforcing wage rates which are higher than those the unhampered labor market would have determined, the supply of labor exceeds the demand for labor. Institutional unemployment emerges.

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

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

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

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

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

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

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

The Catallactic Aspects of Labor Unionism

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

In all countries the labor unions have actually acquired the privilege of violent action. The governments have abandoned in their favor the essential attribute of government, the exclusive power and right to resort to violent coercion and compulsion. Of course, the laws which make it a criminal offense for any citizen to resort—except in case of self-defense—to violent action have not been formally repealed or amended. However, actually labor union violence is tolerated within broad limits. The labor unions are practically free to prevent by force anybody from defying their orders concerning wage rates and other labor conditions. They are free to inflict with impunity

16.Cf. Keynes, *The General Theory of Employment, Interest, and Money* (London, 1936), p. 264. For a critical examination of this idea see Albert Hahn, *Deficit Spending and PRivate Enterprise*, Postwar Readjustments Bulletin No. 8, U.S. Chamber of Commerce, pp. 28-29; Henry Hazlitt, *The Failure of the 'New Economics'* (Princeton, 1959), pp. 263-295. About the success of the Keynesian stratagen in the 'thirties, cf. below, pp. 792-793.

bodily evils upon strikebreakers and upon entrepreneurs and mandataries of entrepreneurs who employ strikebreakers. They are free to destroy property of such employers and even to injure customers patronizing their shops. The authorities, with the approval of public opinion, condone such acts. The police do not stop such offenders, the state attorneys do not arraign them, and no opportunity is offered to the penal courts to pass judgment on their actions. In excessive cases, if the deeds of violence go too far, some lame and timid attempts at repression and prevention are ventured. But as a rule they fail. Their failure is sometimes due to bureaucratic inefficiency or to the insufficiency of the means at the disposal of the authorities, but more often to the unwillingness of the whole governmental apparatus to interfere successfully.[17]

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

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

If the unions were really bargaining agencies, their collective bargaining could not raise the height of wage rates above the point of the unhampered

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

market. As long as there still are unemployed workers available, there is no reason for an employer to raise his offer. Real collective bargaining would not differ catallactically from the individual bargaining. It would, like individual bargaining, give a virtual voice to those job-seekers who have not yet found the fobs they are looking for.

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

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

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

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

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

XXXI. CURRENCY AND CREDIT MANIPULATION

1. The Government and the Currency

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

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

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

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

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

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

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

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

2. The Interventionist Aspect of Legal Tender Legislation

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

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

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

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

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

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

1. See above, pp. 411-413.

3. The Evolution of Modern Methods of Currency Manipulation

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

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

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

In dealing with problems of the gold exchange standard all economists—including the author of this book—failed to realize the fact that it places in the hands of governments the power to manipulate their nations' currency easily. Economists blithely assumed that no government of a civilized nation would use the gold exchange standard intentionally as an instrument of inflationary policy. Of course, one must not exaggerate the role that the gold exchange standard played in the inflationary ventures of the last decades.

The main factor was the proinflationary ideology. The gold exchange standard was merely a convenient vehicle for the realization of the inflationary plans. Its absence did not hinder the adoption of inflationary measures. The United States was in 1933 by and large still under the classical gold standard. This fact did not stop the New Deal's inflationism. The United States at one stroke—by confiscating its citizens' gold holdings—abolished the classical gold standard and devalued the dollar against gold.

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

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

The characterization of the flexible standard from the catallactic point of view must not be confused with its description from the legal point of view. The catallactic aspects of the issue are not affected by the constitutional problems involved. It is immaterial whether the power to alter the parity is vested in the legislative or in the administrative branch of the government. It is immaterial whether the authorization given to the administration is

2. See above, p. 461.

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

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

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

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

4. The Objectives of Currency Devaluation

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

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

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

The objectives of devaluation were:

1. To preserve the height of nominal wage rates or even to create the conditions required for their further increase, while real wage rates should rather sink.

2. To make commodity prices, especially the prices of farm products, rise in terms of domestic money or, at least, to check their further drop.

3. To favor the debtors at the expense of the creditors.

3. See below, section 6 of this chapter.

4. To encourage exports and to reduce imports.

5. To attract more foreign tourists and to make it more expensive (in terms of domestic money) for the country's own citizens to visit foreign countries.

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

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

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

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

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

The devaluation, say its champions, reduces the burden of debts. This is certainly true. It favors debtors at the expense of creditors. In the eyes of those who still have not learned that under modern conditions the creditors must not be identified with the rich not the debtors with the poor, this is beneficial. The actual effect is that the indebted owners of real estate and farm land and the shareholders of indebted corporations reap gains at the expense of the majority of people whose savings are invested in bonds, debentures, saving-bank deposits, and insurance policies.

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

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

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

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

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

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

5. Credit Expansion

It has been pointed out that it would be an error to look upon credit expansion exclusively as a mode of government interference with the market. The fiduciary media did not come into existence as instruments of government policies deliberately aiming at high prices and high nominal wage rates, at lowering the market rate of interest and at debt abatement. They evolved out of the regular business of banking. When the bankers, whose receipts for call money

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

deposited were dealt with by the public as money-substitutes, began to lend a part of the funds deposited with them, they had nothing else in view than their own business. They considered it harmless not to keep the whole equivalent of the receipts issued as a cash reserve in their vaults. They were confident that they would always be in a position to comply with their obligations and, without delay, redeem the notes issued even if they were to lend a part of the deposits. Banknotes became fiduciary media within the operation of the unhampered market economy. The begetter of credit expansion was the banker, not the authority.

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

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

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

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

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

The idea which generated what is called *qualitative credit control* is to

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

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

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

The typical course of events under credit expansion was until a few decades ago determined by two facts: that it was credit expansion under the gold standard, and that it was not the outcome of concerted action on the part of the various national governments and the central banks whose conduct these governments directed. The first of these facts meant that governments were not prepared to abandon the convertibility of their country’s banknotes according to the rigidly fixed parity. The second fact resulted in a lack of quantitative uniformity in the size of credit expansion. Some countries got ahead of other countries and their banks were faced with the danger of a serious external drain upon their reserves in gold and foreign exchange. In order to preserve their own solvency, these banks were forced to take recourse to drastic credit restriction. Thus they created the panic and

6. Cf. Machlup, *The Stock Market, Credit and Capital Formation,* pp. 256-261

inaugurated the depression on the domestic market. The panic very soon spread to other countries. Businessmen in these other countries became frightened and increased their borrowing in order to strengthen their liquid funds for all possible contingencies. It was precisely this increased demand for new credits which impelled the monetary authorities of their own countries, already alarmed by the crisis in the first country, also to resort to contraction. Thus within a few days or weeks the depression became an international phenomenon.

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

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

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

The Chimera of Contracyclical Policies

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

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

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

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

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

The fundamental error of these projects consists in the fact that they ignore the shortage of capital goods. In their eyes the depression is merely caused by a mysterious lack of the people's propensity both to consume and to invest. While the only real problem is to produce more and to consume less in order to increase the stock of capital goods available, the interventionists want to increase both consumption and investment. They want the government to embark upon projects which are unprofitable precisely because the factors of production needed for their execution must be

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

withdrawn from other lines of employment in which they would fulfill wants the satisfaction of which the consumers consider more urgent. They do not realize that such public works must considerably intensify the real evil, the shortage of capital goods.

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

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

6. Foreign Exchange Control and Bilateral Exchange Agreements

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

It is the characteristic mark of an economic good that the supply available

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

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

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

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

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

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

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

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

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

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

XXXII. CONFISCATION AND REDISTRIBUTION

1. The Philosophy of Confiscation

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

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

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

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

2. Land Reform

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

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

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

3. Confiscatory Taxation

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

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

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

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

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

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

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

Economists approach the issue from a different angle. They ask first: what are the effects of confiscatory taxation on capital accumulation? The greater part of that portion of the higher incomes which is taxed away would have been used for the accumulation of additional capital. If the treasury employs the proceeds for current expenditure, the result is a drop in the amount of capital accumulation. The same is valid, even to a greater extent, for death taxes. They force the heirs to sell a considerable part of the testator's estate. This capital is, of course, not destroyed; it merely changes ownership. But

1. There is no need to emphasize again that the use of the terminology of political rule is entirely inadequate in the treatment of economic problems.

2. Cf. A.B. Lerner, *The Economics of Control, Principles of Welfare Economics* (New York, 1944), pp. 307-308.

the savings of the purchasers, which are spent for the acquisition of the capital sold by the heirs, would have constituted a net increment in capital available. Thus the accumulation of new capital is slowed down. The realization of technological improvement is impaired; the quota of capital invested per worker employed is reduced; a check is placed upon the rise in the marginal productivity of labor and upon the concomitant rise in real wage rates. It is obvious that the popular belief that this mode of confiscatory taxation harms only the immediate victims, the rich, is false.

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

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

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

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

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

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

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

Confiscatory Taxation and Risk-Taking

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

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

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

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

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

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

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

3. Cf. above, pp. 539-540.

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

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

4. Cf. above, pp. 521-523.

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

XXXIII. SYNDICALISM AND CORPORATIVISM

1. The Syndicalist Idea

THE term s*yndicalism* is used to signify two entirely different things.

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

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

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

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

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

2. The Fallacies of Syndicalism

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

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

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

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

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

3. Syndicalist Elements in Popular Policies

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

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

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

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

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

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

4. Guild Socialism and Corporativism

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

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

The second source of guild socialism is to be found in specific political conditions of Great Britain. When the conflict with Germany became aggravated and finally in 1914 led to war, the younger British socialists began to feel uneasy about their program. The state idolatry of the Fabians and their glorification of German and Prussian institutions was paradoxical indeed at a time when their own country was involved in a pitiless struggle against Germany. What was the use of fighting the Germans when the most "progressive" intellectuals of the country longed for the adoption of German social policies? Was it possible to praise British liberty as against Prussian bondage and at the same time to recommend the methods of Bismark and

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

his successors? British socialists yearned for a specifically British brand of socialism as different as possible from the Teutonic brand. The problem was to construct a socialist scheme without totalitarian state supremacy and omnipotence, an individualistic variety of collectivism.

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

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

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

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

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

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

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

However, within a system of social cooperation under the division of labor there are no such things as matters of concern only to those engaged

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

3. Mussolini declared on January 13, 1934, in the Senate: "Solo in un secondo tempo, quando le categorie non abbiano trovato la via dell' accordo e dell' equilibrio, lo stato porta intervenire," (Quoted by Papi, *op. cit.*, p. 225).

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

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

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

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

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

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

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

XXXIV. THE ECONOMICS OF WAR

1. Total War

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

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

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

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

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

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

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

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

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

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

There is perfect agreement with regard to the fact that total war is an offshoot of aggressive nationalism. But this is merely circular reasoning. We call aggressive nationalism that ideology which makes for modern total war. Aggressive nationalism is the necessary derivative of the policies of interventionism and national planning. While laissez faire eliminates the causes of international conflict, government interference with business and socialism creates conflicts for which no peaceful solution can be found. While

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

under free trade and freedom of migration no individual is concerned about the territorial size of his country, under the protective measures of economic nationalism nearly every citizen has a substantial interest in these territorial issues. The enlargement of the territory subject to the sovereignty of his own government means material improvement for him or at least relief from restrictions which a foreign government has imposed upon his well-being. What has transformed the limited war between royal armies into total war, the clash between peoples, is not technicalities of military art, but the substitution of the welfare state for the laissez-faire state.

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

Under laissez faire peaceful coexistence of a multitude of sovereign nations is possible. Under government control of business it is impossible. The tragic error of President Wilson was that he ignored this essential point. Modern total war has nothing in common with the limited war of the old dynasties. It is a war against trade and migration barriers, a war of the comparatively overpopulated countries against the comparatively underpopulated. It is a war to abolish those institutions which prevent the emergence of a tendency toward an equalization of wage rates all over the world. It is a war of the farmers tilling poor soil against those governments which bar them from access to much more fertile soil lying fallow. It is, in short, a war of wage earners and farmers who describe themselves as underprivileged "have-nots" against the wage earners and farmers of other nations whom they consider privileged "haves."

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

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

2. War and the Market Economy

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

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

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

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

The realization of this program did not require the establishment of controls and priorities. If the government had raised all the funds needed for the conduct of war by taxing the citizens and by borrowing from them, everybody would have been forced to cut down his consumption drastically.

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

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

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

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

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

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

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

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

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

3. War and Autarky

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

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

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

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

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

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

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

The *Wehrwirtschaftslehre*, the German doctrine of the economics of war, contends that neither cost of production nor quality are important in matters of warfare. Profit-seeking business is concerned with costs of production and with the quality of the products. But the heroic spirit of a superior race

2. In this sense wheat produced, under the protection of an import duty, within the Reich's territory is *Ersatz* too: it is produced at higher costs than foreign wheat. The notion of *Ersatz* is a catallactic notion, and must be defined with regard to technological physical properties of the articles.

does not care about such specters of the acquisitive mind. What counts alone is war preparedness. A warlike nation must aim at autarky in order to be independent of foreign trade. It must foster the production of substitutes irrespective of mammonist considerations. It cannot do without full government control of production because the selfishness of the individual citizens would thwart the plans of the leader. Even in peacetime the commander-kin-chief must be entrusted with economic dictatorship.

Both theorems of the Ersatz doctrine are fallacious.

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

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

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

4. The Futility of War

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

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

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

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

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

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

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

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

3. Cf. Hegel *Vorlesungen über die Philosophie der Weltgeschichte* ed Lasson (Leipzig, 1920), IV, 930-931.

XXXV. THE WELFARE PRINCIPLE VERSUS THE MARKET PRINCIPLE

1. The Case Against the Market Economy

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

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

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

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

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

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

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

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

2. Poverty

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3. Inequality

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

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

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

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

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

2. Cf. above, pp. 288-289 and pp. 806-808.
3. Cf. above, p. 312.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The policies advocated by the welfare school remove the incentive to saving on the part of private citizens. On one hand, the measures directed toward a curtailment of big incomes and fortunes seriously reduce or destroy

4. Cf. above, pp. 804-809.

entirely the wealthier people's power to save. On the other hand, the sums which people with moderate incomes previously contributed to capital accumulation are manipulated in such a way as to channel them into the lines of consumption. When in the past a man saved by entrusting money to a savings bank or by taking out an insurance policy, the bank or the insurance company invested the equivalent. Even if the saver at a later date consumed the sums saved, no disinvestment and capital consumption resulted. The total investments of the savings banks and the insurance companies steadily increased in spite of these withdrawals.

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

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

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

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

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

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

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

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

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

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

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

will be either dead or elder statesmen glorying in their wonderful achievement, social security.

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

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

When pushed hard by economists, some welfare propagandists and socialists admit that impairment of the average standard of living can only be avoided by the maintenance of capital already accumulated and that economic improvement depends on accumulation of additional capital. Maintenance of capital and accumulation of new capital, they say, will henceforth be a task of government. They will not longer be left to the selfishness of individuals, exclusively concerned with their own enrichment and that of their families; the authorities

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

8. Cf. F.H. Knight, "Professor Mises and the Theory of Capital," *Economica,* VIII (1941), 409-427.

will deal with them from the point of view of the common weal.

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

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

If such a country is under a democratic government, the problems of capital preservation and accumulation of additional capital become the main issue of political antagonisms. There will be demagogues to contend that more could be dedicated to current consumption than those who happen to be in power or the other parties are disposed to allow. They will always be ready to declare that "in the present emergency" there cannot be any question of piling up capital for later days and that, on the contrary, consumption of a part of the capital already available is fully justified. The various parties will outbid one another in promising the voters more government spending and at the same time a reduction of all taxes which do not exclusively burden the rich. In the days of

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

laissez faire people looked upon government as an institution whose operation required an expenditure of money which must be defrayed by taxes paid by the citizens. In the individual citizens' budgets the state was an item of expenditure. Today the majority of the citizens look upon government as an agency dispensing benefits. The wage earners and the farmers expect to receive from the treasury more than they contribute to its revenues. The state is in their eyes a spender, not a taker. These popular tenets were rationalized and elevated to the rank of a quasi-economic doctrine by Lord Keynes and his disciples. Spending and unbalanced budgets are merely synonyms for capital consumption. If current expenditure, however beneficial it may be considered, is financed by taking away by inheritance taxes those parts of higher incomes which would have been employed for investment, or by borrowing, the government becomes a factor making for capital consumption. The fact that in present-day America there is probably [10] still a surplus of annual capital accumulation over annual capital consumption does not invalidate the statement that the total complex of the financial policies of the Federal Government, the States, and the municipalities tends toward capital consumption.

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

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

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

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

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

4. Insecurity

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

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

The concept of security is the wage earners' and small farmers' pendant to the concept of stability held by the capitalists.[11] In the same way in which capitalists want to enjoy permanently an income which is not subject to the vicissitudes of changing human conditions, wage earners and small farmers

11.Cf. above, pp. 225-227.

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

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

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

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

5. Social Justice

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

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

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

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

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

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

12.If you seek his monument, look around.

XXXVI. THE CRISIS OF INTERVENTIONISM

1. The Harvest of Interventionism

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

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

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

2. The Exhaustion of the Reserve Fund

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

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

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

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

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

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

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

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

1. In the United States the surtax rate under the 1942 Act was 52 per cent on the taxable income bracket $22,000-26,000. If the surtax had stopped at this level, the loss of revenue on 1942 income would have been about $249 million or 2.8 per cent of the total individual income tax for that year. In the same year the total net incomes in the income classes of $10,000 and above was $8,912 million. Complete confiscation of these incomes would not have produced as much revenue as was obtained in this year from all taxable incomes, namely, $9,046 million. Cf. *A Tax Program for a Solvent America*, Committee on Postwar Tax Policy (New York, 1945), pp. 116-117, 120.

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

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

3. The End of Interventionism

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

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

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

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

Marching ever further along the path of interventionism, all those countries that have not adopted full socialism of the Russian pattern are more and