

# HUMAN ACTION

*A Treatise on Economics*

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For the rest individuals are not molested by the police power. The law-abiding citizen is free from the interference of jailers and hangmen. What pressure is needed to impel an individual to contribute his share to the cooperative effort of production is exercised by the price structure of the market. This pressure is indirect. It puts on each individual's contribution a premium graduated according to the value which the consumers attach to this contribution. In rewarding the individual's effort according to its value, it leaves to everybody the choice between a more or less complete utilization of his own faculties and abilities. This method cannot, of course, eliminate the disadvantages of inherent personal inferiority. But it provides an incentive to everybody to exert his faculties and abilities to the utmost.

The only alternative to this financial pressure as exercised by the market is direct pressure and compulsion as exercised by the police power. The authorities must be entrusted with the task of determining the quantity and quality of work that each individual is bound to perform. As individuals are unequal with regard to their abilities, this requires an examination of their personalities on the part of the authorities. The individual becomes an inmate of a penitentiary, as it were, to whom a definite task is assigned. If he fails to achieve what the authorities have ordered him to do, he is liable to punishment.

It is important to realize in what the difference consists between direct pressure exercised for the prevention of crime and that exercised for the extortion of a definite performance. In the former case all that is required from the individual is to avoid a certain mode of conduct, precisely determined by law. As a rule it is easy to establish whether or not this interdiction has been observed. In the second case the individual is liable to accomplish a definite task; the law forces him toward an indefinite action, the determination of which is left to the decision of the executive power. The individual is bound to obey whatever the administration orders him to do. Whether or not the command issued by the executive power was adequate to his forces and faculties and whether or not he has complied with it to the best of his abilities is extremely difficult to establish. Every citizen is with regard to all aspects of his personality and with regard to all manifestations of his conduct subject to the decisions of the authorities. In the market economy in a trial before a penal court the prosecutor is obliged to produce sufficient evidence that the defendant is guilty. But in matters of the performance of compulsory work it devolves upon the defendant to prove that the task assigned to him was beyond his abilities or that he has done all that can be expected of him. The administrators combine in their persons the offices of the

legislator, the executor of the law, the public prosecutor, and the judge. The defendants are entirely at their mercy. This is what people have in mind when speaking of lack of freedom.

No system of the social division of labor can do without a method that makes individuals responsible for their contributions to the joint productive effort. If this responsibility is not brought about by the price structure of the market and the inequality of wealth and income if he gets, it must be enforced by the methods of direct compulsion as practiced by the police.

### 8. Entrepreneurial Profit and Loss

Profit, in a broader sense, is the gain derived from action; it is the increase in satisfaction (decrease in uneasiness) brought about; it is the difference between the higher value attached to the result obtained and the lower value attached to the sacrifices made for its attainment; it is, in other words, yield minus costs. To make profit invariably the aim sought by any action. If an action fails to attain the ends sought, yield either does not exceed costs or lags behind costs. In the latter case the outcome means a loss, a decrease in satisfaction.

Profit and loss in this original sense are psychic phenomena and as such not open to measurement and a mode of expression which could convey to other people precise information concerning their intensity. A man can tell a fellow man that *a* suits him better than *b*; but he cannot communicate to another man, except in vague and indistinct terms, how much the satisfaction derived from *a* exceeds that derived from *b*.

In the market economy all those things that are bought and sold against money are marked with money prices. In the monetary calculus profit appears as a surplus of money received over money expended and loss as a surplus of money expended over money received. Profit and loss can be expressed in definite amounts of money. It is possible to ascertain in terms of money how much an individual has profited or lost. However, this is not a statement about this individual's psychic profit or loss. It is a statement about a social phenomenon, about the individual's contribution to the societal effort as it is appraised by the other members of society. It does not tell us anything about the individual's increase or decrease in satisfaction or happiness. It merely reflects his fellow men's evaluation of his contribution to social co-operation. This evaluation is ultimately determined by the efforts of every member of society to attain the highest possible psychic profit. It is the resultant of the composite effect of all these people's sub-

jective and personal value judgments as manifested in their conduct on the market. But it must not be confused with these value judgments as such.

We cannot even think of a state of affairs in which people act without the intention of attaining psychic profit and in which their actions result neither in psychic profit nor in psychic loss.<sup>19</sup> In the imaginary construction of an evenly rotating economy there are neither money profits nor money losses. But every individual derives a psychic profit from his actions, or else he would not act at all. The farmer feeds and milks his cows and sells the milk because he values the things he can buy against the money thus earned more highly than the costs expended. The absence of money profits or losses in such an evenly rotating system is due to the fact that, if we disregard the differences brought about by the higher valuation of present goods as compared with future goods, the sum of the prices of all complementary factors needed for production precisely equals the price of the product.

In the changing world of reality differences between the sum of the prices of the complementary factors of production and the prices of the products emerge again and again. It is these differences that bring about money profits and money losses. As far as such changes affect the sellers of labor and those of the original nature-given factors of production and of the capitalists as moneylenders, we will deal with them later. At this point we are dealing with the promoters' entrepreneurial profit and loss. It is this problem that people have in mind when employing the terms profit and loss in mundane speech.

Like every acting man, the entrepreneur is always a speculator. He deals with the uncertain conditions of the future. His success or failure depends on the correctness of his anticipation of uncertain events. If he fails in his understanding of things to come, he is doomed. The only source from which an entrepreneur's profits stem is his ability to anticipate better than other people the future demand of the consumers. If everybody is correct in anticipating the future state of the market of a certain commodity, its price and the prices of the complementary factors of production concerned would already today be adjusted to this future state. Neither profit nor loss can emerge for those embarking upon this line of business.

The specific entrepreneurial function consists in determining the

19. If an action neither improves nor impairs the state of satisfaction, it still involves a psychic loss because of the uselessness of the expended psychic effort. The individual concerned would have been better off if he had merely enjoyed life.

employment of the factors of production. The entrepreneur is the man who dedicates them to special purposes. In doing so he is driven solely by the selfish interest in making profits and in acquiring wealth. But he cannot evade the law of the market. He can succeed only by best serving the consumers. His profit depends on the approval of his conduct by the consumers.

One must not confuse entrepreneurial profit and loss with other factors affecting the entrepreneur's proceeds.

The entrepreneur's technological ability does not affect the specific entrepreneurial profit or loss. As far as his own technological activities contribute to the returns earned and increase his net income, we are confronted with a compensation for work rendered. It is wages paid to the entrepreneur for his labor. Neither does the fact that not every process of production succeeds technologically in bringing about the product expected, influence the specific entrepreneurial profit or loss. Such failures are either avoidable or unavoidable. In the first case they are due to the technologically inefficient conduct of affairs. Then the losses resulting are to be debited to the entrepreneur's personal insufficiency, i.e., either to his lack of technological ability or to his lack of the ability to hire adequate helpers. In the second case the failures are due to the fact that the present state of technological knowledge prevents us from fully controlling the conditions on which success depends. This deficiency may be caused either by incomplete knowledge concerning the conditions of success or by ignorance of methods for controlling fully some of the known conditions. The price of the factors of production takes into account this unsatisfactory state of our knowledge and technological power. The price of arable land, for instance, takes into full account the fact that there are bad harvests, as it is determined by the anticipated average yield. The fact that the bursting of bottles reduces the output of champagne does not affect entrepreneurial profit and loss. It is merely one of the factors determining the cost of production and the price of champagne.<sup>20</sup>

Accidents affecting the process of production, the means of production, or the products while they are still in the hands of the entrepreneur are an item in the bill of production costs. Experience, which conveys to the businessman all other technological knowledge, pro-

20. Cf. Mangoldt, *Die Lehre vom Unternehmergewinn* (Leipzig, 1855), p. 82. The fact that out of 100 liters of plain wine one cannot produce 100 liters of champagne, but a smaller quantity, has the same significance as the fact that 100 kilograms of sugar beet do not yield 100 kilograms of sugar but a smaller quantity.

vides him also with information about the average reduction in the quantity of physical output which such accidents are likely to bring about. By opening contingency reserves, he converts their effects into regular costs of production. With regard to contingencies the expected incidence of which is too rare and too irregular to be dealt with in this way by individual firms of normal size, concerted action on the part of sufficiently large groups of firms takes care of the matter. The individual firms cooperate under the principle of insurance against damage caused by fire, flood, or other similar contingencies. Then an insurance premium is substituted for an appropriation to a contingency reserve. At any rate, the risks incurred by accidents do not introduce uncertainty into the conduct of the technological processes.<sup>21</sup> If an entrepreneur neglects to deal with them duly, he gives proof of his technical insufficiency. The losses thus incurred are to be debited to bad techniques applied, not to his entrepreneurial function.

The elimination of those entrepreneurs who fail to give to their enterprises the adequate degree of technological efficiency or whose technological ignorance vitiates their cost calculation is effected on the market in the same way in which those deficient in the performance of the specific entrepreneurial functions are eliminated. It may happen that an entrepreneur is so successful in his specific entrepreneurial function that he can compensate losses caused by his technological failure. It may also happen that an entrepreneur can counterbalance losses due to failure in his entrepreneurial function by the advantages derived from his technological superiority or from the differential rent yielded by the higher productivity of the factors of production he employs. But one must not confuse the various functions which are combined in the conduct of a business unit. The technologically more efficient entrepreneur earns higher wage rates or quasi-wage rates than the less efficient in the same way in which the more efficient worker earns more than the less efficient. The more efficient machine and the more fertile soil produce higher physical returns per unit of costs expended; they yield a differential rent when compared with the less efficient machine and the less fertile soil. The higher wage rates and the higher rent are, *ceteris paribus*, the corollary of higher physical output. But the specific entrepreneurial profits and losses are not produced by the quantity of physical output. They depend on the adjustment of output to the most urgent wants of the consumers. What produces them is the extent to which

21. Cf. Knight, *Risk, Uncertainty and Profit* (Boston, 1921), pp. 211-213.

the entrepreneur has succeeded or failed in anticipating the future—necessarily uncertain—state of the market.

The entrepreneur is also jeopardized by political dangers. Government policies, revolutions, and wars can damage or annihilate his enterprise. Such events do not affect him alone; they affect the market economy as such and all individuals, although not all of them to the same extent. For the individual entrepreneur they are data which he cannot alter. If he is efficient, he will anticipate them in time. But this is not always possible for him to adjust his operations in such a way as to avoid damage. If the dangers expected concern only a part of the territory which is accessible to his entrepreneurial activities, he can avoid operating in the menaced areas and can prefer countries in which the danger is less imminent. But if he cannot emigrate, he must stay where he is. If all entrepreneurs were fully convinced that the fatal victory of Bolshevism was impending, they would nevertheless not abandon their entrepreneurial activities. The expectation of imminent expropriation will impel the capitalists to consume their funds. The entrepreneurs will be forced to adjust their plans to the market situation created by such capital consumption and the threatened nationalization of their shops and plants. But they will not stop operating. If some entrepreneurs go out of business, others will take their place—newcomers or old entrepreneurs expanding the size of their enterprises. In the market economy there will always be entrepreneurs. Policies hostile to capitalism may deprive the consumers of the greater part of the benefits they would have reaped from unhindered entrepreneurial activities. But they cannot eliminate the entrepreneurs as such if they do not entirely destroy the market economy.

The ultimate source from which entrepreneurial profit and loss are derived is the uncertainty of the future constellation of demand and supply.

If all entrepreneurs were to anticipate correctly the future state of the market, there would be neither profits nor losses. The prices of all the factors of production would already today be fully adjusted to tomorrow's prices of the products. In buying the factors of production the entrepreneur would have to expend (with due allowance for the difference between the prices of present goods and future goods) no less an amount than the buyers will pay him later for the product. An entrepreneur can make a profit only if he anticipates future conditions more correctly than other entrepreneurs. Then he buys the complementary factors of production at prices the sum of

which, including allowance for the time difference, is smaller than the price at which he sells the product.

If we want to construct the image of changing economic conditions in which there are neither profits nor losses, we must resort to an unrealizable assumption: perfect foresight of all future events on the part of all individuals. If those primitive hunters and fishermen to whom it is customary to ascribe the first accumulation of produced factors of production had known in advance all the future vicissitudes of human affairs, and if they and all their descendants until the last day of judgment, equipped with the same omniscience, had appraised all factors of production accordingly, entrepreneurial profits and losses would never have emerged. Entrepreneurial profits and losses are created through the discrepancy between the expected prices and the prices later really fixed on the markets. It is possible to confiscate profits and to transfer them from the individuals to whom they have accrued to other people. But neither profits nor losses can ever disappear from a changing world not populated solely with omniscient people.

### 9. Entrepreneurial Profits and Losses in a Progressing Economy

In the imaginary construction of a stationary economy the total sum of all entrepreneurs' profits equals the total sum of all entrepreneurs' losses. What one entrepreneur profits is in the total economic system counterbalanced by another entrepreneur's loss. The surplus which all the consumers together expend for the acquisition of a certain commodity is counterbalanced by the reduction in their expenditure for the acquisition of other commodities.<sup>22</sup>

It is different in a progressing economy.

We call a progressing economy an economy in which the per capita quota of capital invested is increasing. In using this term we do not imply value judgments. We adopt neither the "materialistic" view that such a progression is good nor the "idealistic" view that it is bad or at least irrelevant from a "higher point of view." Of course, it is a well-known fact that the immense majority of people consider the consequences of progress in this sense as the most desirable state of affairs and yearn for conditions which can be realized only in a progressing economy.

In the stationary economy the entrepreneurs, in the pursuit of their

22. If we were to apply the faulty concept of a "national income" as used in popular speech, we would have to say that no part of national income goes into profits.

specific functions, cannot achieve anything other than to withdraw factors of production, provided that they are still convertible,<sup>23</sup> from one line of business in order to employ them in another line, or to direct the restoration of the equivalent of capital goods used up in the course of production processes toward the expansion of certain branches of industry at the expense of other branches. In the progressing economy the range of entrepreneurial activities includes, moreover, the determination of the employment of the additional capital goods accumulated by new savings. The injection of these additional capital goods is bound to increase the total sum of the income produced, i.e., of that supply of consumers' goods which can be consumed without diminishing the capital available and thereby without reducing the output of future production. The increase of income is effected either by an expansion of production without altering the technological methods of production or by an improvement in technological methods which would not have been feasible under the previous conditions of a less ample supply of capital goods.

It is out of this additional wealth that the surplus of the total sum of entrepreneurial profits over the total sum of entrepreneurial losses flows. But it can be easily demonstrated that this surplus can never exhaust the total increase in wealth brought about by economic progress. The laws of the market divide this additional wealth between the entrepreneurs and the suppliers of labor and those of certain material factors of production in such a way that the lion's share goes to the nonentrepreneurial groups.

First of all we must realize that entrepreneurial profits are not a lasting phenomenon but only temporary. There prevails an inherent tendency for profits and losses to disappear. The market is always moving toward the emergence of the final prices and the final state of rest. If new changes in the data were not to interrupt this movement and not to create the need for a new adjustment of production to the altered conditions, the prices of all complementary factors of production would—due allowance being made for time preference—finally equal the price of the product, and nothing would be left for profits or losses. In the long run every increase of productivity benefits exclusively the workers and some groups of the owners of land and of capital goods.

In the groups of the owners of capital goods there are benefited:

1. Those whose saving has increased the quantity of capital goods

23. The problem of the convertibility of capital goods is dealt with below, pp. 503-505.

available. They own this additional wealth, the outcome of their restraint in consuming.

2. The owners of those capital goods already previously existing which, thanks to the improvement in technological methods of production, are now better utilized than before. Such gains are, of course temporary only. They are bound to disappear as they cause a tendency toward an intensified production of the capital goods concerned. On the other hand, the increase in the quantity of capital goods available lowers the marginal productivity of these capital goods; it thus brings about a fall in the prices of the capital goods and thereby hurts the interests of all those capitalists who did not share at all or not sufficiently in the process of saving and the accumulation of the additional supply of capital goods.

In the group of the landowners all those are benefited for whom the new state of affairs results in a higher productivity of their farms, forests, fisheries, mines, and so on. On the other hand, all those are hurt whose property may become submarginal on account of the higher return yielded by the land owned by those benefited.

In the group of labor all derive a lasting gain from the increase in the marginal productivity of labor. But, on the other hand, in the short run some may suffer disadvantages. These are people who were specialized in the performance of work which becomes obsolete as a result of technological improvement and are fitted only for jobs in which—in spite of the general rise in wage rates—they earn less than before.

All these changes in the prices of the factors of production begin immediately with the initiation of the entrepreneurial actions designed to adjust the processes of production to the new state of affairs. In dealing with this problem as with the other problems of changes in the market data, we must guard ourselves against the popular fallacy of drawing a sharp line between short-run and long-run effects. What happens in the short run is precisely the first stages of the chain of successive transformations which tend to bring about the long-run effects. The long-run effect is in our case the disappearance of entrepreneurial profits and losses. The short-run effects are the preliminary stages of this process of elimination which finally, if not interrupted by a further change in the data, would result in the emergence of the evenly rotating economy.

It is necessary to comprehend that the very appearance of an excess in the total amount of entrepreneurial profits over the total amount of entrepreneurial losses depends upon the fact that this process of the elimination of entrepreneurial profit and loss begins at

the same time as the entrepreneurs begin to adjust the complex of production activities to the changed data. There is never in the whole sequence of events an instant in which the advantages derived from the increase in the amount of capital available and from technical improvements benefit the entrepreneurs only. If the wealth and the income of the other strata were to remain unaffected, these people could buy the additional products only by restricting their purchases of other products accordingly. Then the profits of one group of entrepreneurs would exactly equal the losses incurred by other groups.

What happens is this: The entrepreneurs embarking upon the utilization of the newly accumulated capital goods and the improved technological methods of production are in need of complementary factors of production. Their demand for these factors is a new additional demand which must raise their prices. Only as far as this rise in prices and wage rates occurs, are the consumers in a position to buy the new products without curtailing the purchase of other goods. Only so far can a surplus of the total sum of all entrepreneurial profits over all entrepreneurial losses come into existence.

The vehicle of economic progress is the accumulation of additional capital goods by means of saving and improvement in technological methods of production the execution of which is almost always conditioned by the availability of such new capital. The agents of progress are the promoting entrepreneurs intent upon profiting by means of adjusting the conduct of affairs to the best possible satisfaction of the consumers. In the performance of their projects for the realization of progress they are bound to share the benefits derived from progress with the workers and also with a part of the capitalists and landowners and to increase the portion allotted to these people step by step until their own share melts away entirely.

From this it becomes evident that it is absurd to speak of a "rate of profit" or a "normal rate of profit" or an "average rate of profit." Profit is not related to or dependent on the amount of capital employed by the entrepreneur. Capital does not "beget" profit. Profit and loss are entirely determined by the success or failure of the entrepreneur to adjust production to the demand of the consumers. There is nothing "normal" in profits and there can never be an "equilibrium" with regard to them. Profit and loss are, on the contrary, always a phenomenon of a deviation from "normalcy," of changes unforeseen by the majority, and of a "disequilibrium." They have no place in an imaginary world of normalcy and equilibrium. In a changing economy there prevails always an inherent tendency

for profits and losses to disappear. It is only the emergence of new changes which revives them again. Under stationary conditions the "average rate" of profits and losses is zero. An excess of the total amount of profits over that of losses is a proof of the fact that there is economic progress and an improvement in the standard of living of all strata of the population. The greater this excess is, the greater is the increment in general prosperity.

Many people are utterly unfit to deal with the phenomenon of entrepreneurial profit without indulging in envious resentment. In their eyes the source of profit is exploitation of the wage earners and the consumers, i.e., an unfair reduction in wage rates and a no less unfair increase in the prices of the products. By rights there should not be any profits at all.

Economics is indifferent with regard to such arbitrary value judgments. It is not interested in the problem of whether profits are to be approved or condemned from the point of view of an alleged natural law and of an alleged eternal and immutable code of morality about which personal intuition or divine revelation are supposed to convey precise information. Economics merely establishes the fact that entrepreneurial profits and losses are essential phenomena of the market economy. There cannot be a market economy without them. It is certainly possible for the police to confiscate all profits. But such a policy would by necessity convert the market economy into a senseless chaos. Man has, there is no doubt, the power to destroy many things, and he has made in the course of history ample use of this faculty. He could destroy the market economy too.

If those self-styled moralists were not blinded by their envy, they would not deal with profit without dealing simultaneously with its corollary, loss. They would not pass over in silence the fact that the preliminary conditions of economic improvement are an achievement of those whose saving accumulates the additional capital goods and of the inventors, and that the utilization of these conditions for the realization of economic improvement is effected by the entrepreneurs. The rest of the people do not contribute to progress, but they are benefited by the horn of plenty which other people's activities pour upon them.

What has been said about the progressing economy is *mutatis mutandis* to be applied to the conditions of a retrogressing economy, i.e., an economy in which the per capita quota of capital invested is decreasing. In such an economy there is an excess in the total sum of entrepreneurial losses over that of profits. People who cannot free themselves from the fallacy of thinking in concepts of collectives

and whole groups might raise the question of how in such a retrogressing economy there could be any entrepreneurial activity at all.

Why should anybody embark upon an enterprise if he knows in advance that mathematically his chances of earning profits are smaller than those of suffering losses? However, this mode of posing the problem is fallacious. Like everyone else, entrepreneurs do not act as members of a class, but as individuals. No entrepreneur bothers a whit about the fate of the totality of the entrepreneurs. It is irrelevant to the individual entrepreneur what happens to other people whom theories, according to a certain characteristic, assign to the same class they assign him. In the living, perpetually changing market society there are always profits to be earned by efficient entrepreneurs. The fact that in a retrogressing economy the total amount of losses exceeds the total amount of profits does not deter a man who has confidence in his own superior efficiency. A prospective entrepreneur does not consult the calculus of probability which is of no avail in the field of understanding. He trusts his own ability to understand future market conditions better than his less gifted fellow men.

The entrepreneurial function, the striving of entrepreneurs after profits, is the driving power in the market economy. Profit and loss are the devices by means of which the consumers exercise their supremacy on the market. The behavior of the consumers makes profits and losses appear and thereby shifts ownership of the means of production from the hands of the less efficient into those of the more efficient. It makes a man the more influential in the direction of business activities the better he succeeds in serving the consumers. In the absence of profit and loss the entrepreneurs would not know what the most urgent needs of the consumers are. If some entrepreneurs were to guess it, they would lack the means to adjust production accordingly.

Profit-seeking business is subject to the sovereignty of the consumers, while nonprofit institutions are sovereign unto themselves and not responsible to the public. Production for profit is necessarily production for use, as profits can only be earned by providing the consumers with those things they most urgently want to use.

The moralists' and sermonizers' critique of profits misses the point. It is not the fault of the entrepreneurs that the consumers—the people, the common man—prefer liquor to Bibles and detective stories to serious books, and that governments prefer guns to butter. The entrepreneur does not make greater profits in selling "bad" things than in selling "good" things. His profits are the greater the better he succeeds in providing the consumers with those things they ask for

most intensely. People do not drink intoxicating beverages in order to make the "alcohol capital" happy, and they do not go to war in order to increase the profits of the "merchants of death." The existence of the armaments industries is a consequence of the warlike spirit, not its cause.

It is not the business of the entrepreneurs to make people substitute sound ideologies for unsound. It rests with the philosophers to change people's ideas and ideals. The entrepreneur serves the consumers as they are today, however wicked and ignorant.

We may admire those who abstain from making gains they could reap in producing deadly weapons or hard liquor. However, their laudable conduct is a mere gesture without any practical effects. Even if all entrepreneurs and capitalists were to follow their example, wars and dipsomania would not disappear. As was the case in the pre-capitalistic ages, governments would produce the weapons in their own arsenals and drinkers would distill their own liquor.

#### *The Moral Condemnation of Profit*

Profit is earned by the adjustment of the utilization of the human and material factors of production to changes in conditions. It is those benefited by this adjustment who, scrambling for the products concerned and offering and paying for them prices that exceed the costs expended by the seller, generate the profits. Entrepreneurial profit is not a "reward" granted by the customer to the supplier who served him better than the sluggish routinists; it is the result of the eagerness of the buyers to outbid others who are equally anxious to acquire a share of the limited supply.

The dividends of corporations are popularly called profits. Actually they are interest on the capital invested plus that part of profits that is not ploughed back into the enterprise. If the enterprise does not operate successfully, either no dividends are paid or the dividends contain only interest on the whole or a part of the capital.

Socialists and interventionists call profit and interest *unearned income*, the result of depriving the workers of a considerable part of the fruits of their effort. As they see it, the products come into existence through toiling as such and nothing else, and should by rights benefit the toilers alone.

Yet bare labor produces very little if not aided by the employment of the outcome of previous saving and accumulation of capital. The products are the outgrowth of a cooperation of labor with tools and other capital goods directed by provident entrepreneurial design. The savers, whose saving accumulated and maintains the capital, and the entrepreneurs, who channel the capital into those employments in which it best serves the consumers, are no less indispensable for the

necessity of production than the toilers. It is nonsensical to impute the sole product to the purveyors of labor and to pass over in silence the contribution of the purveyors of capital and of entrepreneurial ideas. What brings forth usable goods is not physical effort as such, but physical effort aptly directed by the human mind toward a definite goal. The greater (with the advance of general well-being) the role of capital goods, and the more efficient their utilization in the cooperation of the factors of production, the more absurd becomes the romantic glorification of the mere performing of manual routine jobs. The marvelous economic improvements of the last two hundred years were an achievement of the capitalists who provided the capital goods required and of the elite of technologists and entrepreneurs. The masses of the manual workers were benefited by changes which they not only did not generate but which, more often than not, they tried to outshort.

#### *Some Observations on the Underconsumption Bogy and on the Purchasing Power Argument*

In speaking of underconsumption, people mean to describe a state of affairs in which a part of the goods produced cannot be consumed because the people who could consume them are by their poverty prevented from buying them. These goods remain unsold or can be shipped only at prices not covering the cost of production. Hence various disarrangements and disturbances arise, the total complex of which is called economic depression.

Now it happens again and again that entrepreneurs err in anticipating the future state of the market. Instead of producing those goods for which the demand of the consumers is most intense, they produce less urgently needed goods or things which cannot be sold at all. These inefficient entrepreneurs suffer losses while their more efficient competitors who anticipated the wishes of the consumers earn profits. The losses of the former group of entrepreneurs are not caused by a general abstention from buying on the part of the public; they are due to the fact that the public prefers to buy other goods.

If it were true, as the underconsumption myth implies, that the workers are too poor to buy the products because the entrepreneurs and the capitalists unfairly appropriate to themselves what by rights should go to the wage earners, the state of affairs would not be altered. The "exploiters" are not supposed to exploit from sheer wantonness. They want, it is insinuated, to increase at the expense of the "exploited" either their own consumption or their own investments. They do not withdraw their booty from the universe. They spend it either in buying luxuries for their own household or in buying producers' goods for the expansion of their enterprises. Of course, their demand is directed toward goods other than those the wage earners would have bought if the profits had been confiscated and distributed among them.



Entrepreneurial errors with regard to the state of the market of various classes of commodities as created by such "exploitation" are in no way different from any other entrepreneurial shortcomings. Entrepreneurial errors result in losses for the inefficient entrepreneurs which are counterbalanced by the profits of the efficient entrepreneurs. They make business bad for some groups of industries and good for other groups. They do not bring about a general depression of trade.

The underconsumption myth is baseless self-contradictory balderdash. Its reasoning crumbles away as soon as one begins to examine it. It is untenable even if one, for the sake of argument, accepts the "exploitation" doctrine as correct.

The purchasing power argument runs in a slightly different manner. It contends that a rise in wage rates is a prerequisite of the expansion of production. If wage rates do not rise, there is no use for business to increase the quantity and to improve the quality of the goods produced. For the additional products would find no buyers or only such buyers as restrict their purchases of other goods. What is needed first for the realization of economic progress is to make wage rates rise continually. Government or labor union pressure and communism aiming at the enforcement of higher wage rates are the main vehicles of progress.

As has been demonstrated above the emergence of an excess in the total sum of entrepreneurial profits over the total sum of entrepreneurial losses is inseparably bound up with the fact that a portion of the benefits derived from the increase in the quantity of capital goods available and from the improvement of technological procedures goes to the nonentrepreneurial groups. The rise in the prices of complementary factors of production, first among them wage rates, is neither a concession which the entrepreneurs willfully must make to the rest of the people nor a clever device of the entrepreneurs in order to make profits. It is an unavoidable and necessary phenomenon in the chain of successive events which the endeavors of the entrepreneurs to make profits by adjusting the supply of the consumers' goods to the new state of affairs are bound to bring about. The same process which results in an excess of entrepreneurial profits over losses causes, first—i.e., before such an excess appears—the emergence of a tendency toward a rise in wage rates and in the prices of many material factors of production. And it is again in the same process that would in the further course of events make this excess of profits over losses disappear, provided that no further changes, increasing the amount of capital goods available, were to occur. The excess of profits over losses is not a consequence of the rise in the prices of the factors of production. The two phenomena—the rise in the prices of the factors of production and the excess of profits over losses—are both steps in the process of adjustment of production to the increase in the quantity of capital goods and to the technological changes which the

entrepreneurial actions actuate. Only to the extent that the other strata of the population are enriched by this adjustment can an excess of profits over losses temporarily come into being.

The basic error of the purchasing power argument consists in misconstruing this causal relation. It turns things upside down when considering the rise in wage rates as the force bringing about economic improvement.

We will discuss at a later stage of this book the consequences of the attempts of the governments and of organized labor violence to enforce wage rates higher than those determined by a nonhampered market.<sup>24</sup> Here we must only add one more explanatory remark.

When speaking of profits and losses, prices and wage rates, what change in mind is always real profits and losses, real prices and real wage rates. It is the arbitrary interchange of money terms and real terms that has led many people astray. This problem too will be dealt with exhaustively in later chapters. Let us incidentally only mention the fact that a rise in real wage rates is compatible with a drop in nominal wage rates.

#### 10. Promoters, Managers, Technicians, and Bureaucrats

The entrepreneur hires the technicians, i.e., people who have the ability and the skill to perform definite kinds and quantities of work. The class of technicians includes the great inventors, the champions in the field of applied science, the constructors and designers as well as the performers of the most simple tasks. The entrepreneur joins their ranks as far as he himself takes part in the technical execution of his entrepreneurial plans. The technician contributes his own toil and labor toward definite goals. And the entrepreneur himself acts as a mandatory, as it were, of the consumers.

The entrepreneurs are not omnipresent. They cannot themselves attend to the manifold tasks which are incumbent upon them. Adjustment of production to the best possible supplying of the consumers with the goods they are asking for most urgently does not merely consist in determining the general plan for the utilization of resources. There is, of course, no doubt that this is the main function of the promoter and speculator. But besides the great adjustments, many small adjustments are necessary too. Each of them may seem trifling and of little bearing upon the total result. But the cumulative effect of shortcomings in many of these minor matters can be such as to frustrate entirely the success of a correct solution of the great problems. At any rate, it is certain that every failure to handle the smaller

<sup>24</sup> Cf. below, pp. 769-779.