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HUMANE  
ECONOMY

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The Social Framework  
of the Free Market

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*The timeless classic, with a new introduction by Samuel Gregg*

## CHAPTER III

### *The Conditions and Limits of the Market*

The questionable things of this world come to grief on their nature, the good ones on their own excesses. Conservative respect for the past and its preservation are indispensable conditions of a sound society, but to cling exclusively to tradition, history, and established customs is an exaggeration leading to intolerable rigidity. The liberal predilection for movement and progress is an equally indispensable counterweight, but if it sets no limits and recognizes nothing as lasting and worth preserving, it ends in disintegration and destruction. The rights of the community are no less imperative than those of the individual, but exaggeration of the rights of the community in the form of collectivism is just as dangerous as exaggerated individualism and its extreme form, anarchism. Ownership ends up in plutocracy, authority in bondage and despotism, democracy in arbitrariness and demagogy. Whatever political tendencies or currents we choose as examples, it will be found that they always sow the seed of their own destruction when they lose their sense of proportion and overstep their limits. In this field, suicide is the normal cause of death.

The market economy is no exception to the rule. Indeed, its advocates, in so far as they are at all intellectually fastidious, have always recognized that the sphere of the market, of competition, of the system where supply and demand move prices and thereby gov-

#### THE CONDITIONS AND LIMITS OF THE MARKET

ern production, may be regarded and defended only as part of a wider general order encompassing ethics, law, the natural conditions of life and happiness, the state, politics, and power. Society as a whole cannot be ruled by the laws of supply and demand, and the state is more than a sort of business company, as has been the conviction of the best conservative opinion since the time of Burke. Individuals who compete on the market and there pursue their own advantage stand all the more in need of the social and moral bonds of community, without which competition degenerates most grievously. As we have said before, the market economy is not everything. It must find its place in a higher order of things which is not ruled by supply and demand, free prices, and competition. It must be firmly contained within an all-embracing order of society in which the imperfections and harshness of economic freedom are corrected by law and in which man is not denied conditions of life appropriate to his nature. Man can wholly fulfill his nature only by freely becoming part of a community and having a sense of solidarity with it. Otherwise he leads a miserable existence and he knows it.

#### *Social Rationalism*

The truth is that a society may have a market economy and, at one and the same time, perilously unsound foundations and conditions, for which the market economy is not responsible but which its advocates have every reason to improve or wish to see improved so that the market economy will remain politically and socially feasible in the long run. There is no other way of fulfilling our wish to possess both a market economy and a sound society and a nation where people are, for the most part, happy.

Economists have their typical *déformation professionnelle*, their own occupational disease of the mind. Each of us speaks from personal experience when he admits that he does not find it easy to look beyond the circumscribed field of his own discipline and to acknowledge humbly that the sphere of the market, which it is his

#### A HUMANE ECONOMY

profession to explore, neither exhausts nor determines society as a whole. The market is only one section of society. It is a very important section, it is true, but still one whose existence is justifiable and possible only because it is part of a larger whole which concerns not economics but philosophy, history, and theology. We may be forgiven for misquoting Lichtenberg and saying: To know economics only is to know not even that. Man, in the words of the Gospel, does not live by bread alone. Let us beware of that caricature of an economist who, watching people cheerfully disporting themselves in their suburban allotments, thinks he has said everything there is to say when he observes that this is not a rational way of producing vegetables—forgetting that it may be an eminently rational way of producing happiness, which alone matters in the last resort. Adam Smith, whose fame rests not only on his *Wealth of Nations* but also on his *Theory of Moral Sentiments*, would have known better.

All of this has always been clear to us, and this is why we have never felt quite comfortable in the company of “liberals,” even when styled “neo-liberals.” But for everything there is season. We have been through years of untold misery and disorders which so many Western countries, including, in particular, Germany, brought upon themselves by their disregard of the most elementary principles of economic order. During these years there was a compelling need to put the accent on the “bread” of which the Gospel speaks and on the re-establishment of an economic order based on the market economy. To do this was imperative. Today, when the market economy has been revived up to a point and when even its partial re-establishment more than fulfills our expectations, it is equally imperative to think of the other and higher things here under discussion. That the hour is ripe for this is appreciated by all who are wise enough to sense the danger of stopping short at “bread.” It is a sign of the times that those who experience and voice these misgivings have become surprisingly numerous everywhere. They include a growing number of economists in several countries who,

#### THE CONDITIONS AND LIMITS OF THE MARKET

independently of each other, are stepping out of the ivory tower of their science to explore the open country "beyond supply and demand."<sup>1</sup> As far as this author is concerned, he is doing no more than returning to scientific work of a kind which he has considered paramount ever since he wrote his book on *The Social Crisis of Our Time*.

To the economist, the market economy, as seen from the restricting viewpoint of his own discipline, appears to be no more than one particular type of economic order, a kind of "economic technique" opposed to the socialist one. It is significant of this approach that the very name of the structural principle of this economic order has been borrowed from the language of technology: we speak of the "price mechanism." We move in a world of prices, markets, competition, wage rates, rates of interest, exchange rates, and other economic magnitudes. All of this is perfectly legitimate and fruitful as long as we keep in mind that we have narrowed our angle of vision and do not forget that the market economy is the economic order proper to a definite social structure and to a definite spiritual and moral setting. If we were to neglect the market economy's characteristic of being merely a part of a spiritual and social total order, we would become guilty of an aberration which may be described as social rationalism.

Social rationalism misleads us into imagining that the market economy is no more than an "economic technique" that is applicable in any kind of society and in any kind of spiritual and social climate. Thus the undeniable success of the revival of the market economy in many countries gave quite a few socialists the idea that the price mechanism was a device which an otherwise socialist economy could well use to its own benefit. In this concept of a "socialist market economy," which Tito seems to want to translate into practice, the market economy is thought of as part of a social system that is best described as an enormous apparatus of administration. In this sense, even the Communist economic system of Soviet Russia has always had a "market sector," although it is undoubtedly no

#### A HUMANE ECONOMY

more than a technical device and contrivance and not a living organism. How could a genuine market, an area of freedom, spontaneity, and unregimented order, thrive in a social system which is the exact opposite in all respects?

The same social rationalism is evident in the attitude of certain contemporary economists who, while not open partisans of socialism and sometimes speaking in the name of the market economy, work out the most elaborate projects for regulating the movements of the circular flow of the economy. They seem to be prepared to transform the economy into an enormous pumping engine with all sorts of ducts and valves and thermostats, and they not only seem confident that it will function according to the instructions for use but they also seem to be unaware of the question of whether such a machine is compatible with the atmosphere of the market, to which freedom is essential.

All of these protagonists of social rationalism—socialists and circular-flow technicians alike—have a common tendency to become so bemused by aggregate money and income flows that they overlook the fundamental significance of ownership. The market economy rests not on one pillar but on two. It presupposes not only the principle of free prices and competition but also the institution of private ownership, in the true sense of legally safeguarded freedom to dispose of one's own property, including freedom of testation.

To grasp the full significance of ownership to a free society, we must understand that ownership has a dual function. Ownership means, as in civil law, the delimitation of the individual sphere of decision and responsibility against that of other individuals. But ownership also means protection of the individual sphere from political power. It traces limits on the horizontal plane, and also vertically, and only this dual function can fully explain the significance of ownership as an indispensable condition of liberty. All earlier generations of social philosophers agreed on this point.

But ownership is not only a condition of the market economy, it

#### THE CONDITIONS AND LIMITS OF THE MARKET

is of the essence. This becomes evident from the following considerations. We start out from competition. We all realize its central importance for a free economy, but the concept is obscured by a confusing ambiguity. Communist governments, too, claim that they are using competition extensively and successfully. We have no reason to doubt that in the factories of Soviet Russia, the managers, and even the workers and employees, have ample opportunity for competitive performance. And in Yugoslavia, Tito made a whole system of the "decentralization" of public enterprises whereby the latter were divided up into independent and mutually competing units; he seems to regard this system, with some pride, as a sort of "socialist market economy." There can be no doubt that such an introduction of competition into a collectivist economic system may raise productivity. Is this not the same virtue which we have in mind when we ascribe the rapid recovery of the German economy chiefly to the re-establishment of competition?

There is obviously some confusion here, which calls for clarification. The confusion is due to neglect of the dual nature of competition and to the lumping together of things which should be kept strictly separate. Competition may have two meanings: it may be an institution for stimulating effort, or it may be a device for regulating and ordering the economic process. In the market economy, competition is both, and it constitutes, therefore, an unrivaled solution of the two cardinal problems of any economic system: the problem of continual inducement to maximum performance and the problem of a continual harmonious ordering and guidance of the economic process. The role of competition in the market economy is to be mainspring and regulator at one and the same time, and it is this dual function which is the secret of the competitive market economy and its inimitable performance.

If we now return to the question of whether a collectivist economic order can take advantage of competition and thus appropriate the secret of the market economy's success without impairing the collectivist nature of the economic order, we know that the

#### A HUMANE ECONOMY

answer depends upon which aspect of competition is meant. Competition as a stimulant is simply a psychological technique that is as applicable in a collectivist economy as in a market economy or, indeed, in any group, be it a school or a regiment or any other. We may even note that as far as the effects of competition on human destinies are concerned, it may, in collectivist systems, be hardened in a way that is unknown and impossible in the market economy. But the other function of competition, which is at least equally important for its economic effectiveness, the function of selection in the area of material means of production, meets with the greatest obstacles in collectivist systems. In relation to people, the carrot and the stick are ruthlessly applied, but it is quite another question whether in collectivist systems competition can accomplish so uncompromising, undeviating, and continual a selection of products and firms as takes place in the market economy.

Even on the unwarrantedly charitable assumption that collectivist public authorities resist the temptation to hush up investment errors and have the honest intention to carry out such a continual selection in accordance with the dictates of competition, they would lack the indispensable criterion. This brings us to the other function of competition: to serve as an instrument of the economic order as a whole and as a regulator of the economic process. Unlike the market economy, the collectivist economy is necessarily debarred from such use of competition because no collectivist system can create the necessary precondition without losing its own identity. This precondition is genuine economic independence of firms. Only on this condition is the formation of genuine scarcity prices for capital and consumer goods conceivable, but there can be no independence of firms without private ownership and related freedom of action.

Thus everything is interlocked: competition as a regulator of the economy presupposes free market prices; free market prices are impossible without genuine independence of economic units, and



#### THE CONDITIONS AND LIMITS OF THE MARKET

their independence stands and falls by private ownership and freedom of decision, unimpaired and undisturbed by government planning. No collectivist economy can possibly satisfy the last of these conditions without ceasing to be collectivist, and therefore it cannot enjoy the advantages of the regulatory and guiding functions of competition. To try to arrange such competition artificially would be as absurd for a collectivist system as it would be for me to want to play bridge with myself. It follows that "socialist competition" can, at best, stimulate (economically not necessarily rational) performance but cannot rule and guide the economic process. It is only half of what competition is in the market economy, and we may well ask whether this bisection does not reduce the effectiveness of even that half of competition which alone is accessible to collectivism, namely, the stimulating effect. Be that as it may, it remains a serious weakness in any collectivist economy that competition can, at best, fulfill only one of its functions, and even that less than optimally. And it is the incomparable strength of the market economy that it alone can take advantage of the dual nature of competition, which is genuine and fully effective only when it is whole. Just as unavoidable limitation to one aspect of competition gravely handicaps collectivism, so does the combination of both aspects of competition give the market economy a start which cannot be overtaken. This is the prerogative of the market economy, but this prerogative stands and falls by private ownership of the means of production.

The economic function of private ownership tends to be obstinately underestimated, and even more so is its moral and sociological significance for a free society. The reason is, no doubt, that the ethical universe in which ownership has its place is hard for social rationalism even to understand, let alone to find congenial. And since social rationalism is in ascendancy everywhere, it is not surprising that the institution of ownership has been badly shaken. Even discussions on questions concerning the management of firms

#### A HUMANE ECONOMY

are often conducted in terms which suggest that the owner has followed the consumer and the taxpayer into the limbo of "forgotten men." The true role of ownership can be appreciated only if we look upon it as representative of something far beyond what is visible and measurable. Ownership illustrates the fact that the market economy is a form of economic order belonging to a particular philosophy of life and to a particular social and moral universe. This we now have to define, and in so doing the word "bourgeois"\* imposes itself, however much mass public opinion (especially of the intellectual masses) may, after a century of deformation by Marxist propaganda, dislike this designation or find it ridiculous.

In all honesty, we have to admit that the market economy has a bourgeois foundation. This needs to be stressed all the more because the romantic and socialist reaction against everything bourgeois has, for generations past, been astonishingly successful in turning this concept into a parody of itself from which it is very difficult to get away. The market economy, and with it social and political freedom, can thrive only as a part and under the protection of a bourgeois system. This implies the existence of a society in which certain fundamentals are respected and color the whole network of social relationships: individual effort and responsibility, absolute norms and values, independence based on ownership, prudence and daring, calculating and saving, responsibility for planning one's own life, proper coherence with the community, family feeling, a sense of tradition and the succession of generations combined with an open-minded view of the present and the future, proper tension between individual and community, firm moral discipline, respect for the value of money, the courage to grapple on one's own with life and its uncertainties, a sense of the natural order of things, and a firm scale of values. Whoever turns up his nose at these things

\* The word "bourgeois" is here used to correspond to the German word *bürgerlich*, in a completely non-pejorative and non-political sense. As will be seen from the context, the word is used to designate a particular way of life and set of values.

#### THE CONDITIONS AND LIMITS OF THE MARKET

or suspects them of being “reactionary” may in all seriousness be asked what scale of values and what ideals he intends to defend against Communism without having to borrow from it.

To say that the market economy belongs to a basically bourgeois total order implies that it presupposes a society which is the opposite of proletarianized society, in the wide and pregnant sense which it is my continual endeavor to explain, and also the opposite of mass society as discussed in the preceding chapter. Independence, ownership, individual reserves, saving, the sense of responsibility, rational planning of one’s own life—all that is alien, if not repulsive, to proletarianized mass society. Yet precisely that is the condition of a society which cherishes its liberty. We have arrived at a point where we are simply forced to recognize that here is the true watershed between social philosophies and that every one of us must choose for himself, knowing that the choice is between irreconcilable alternatives and that the destiny of our society is at stake.

Once we have recognized this necessity of a fundamental choice, we must apply it in practice and draw the conclusions in all fields. It may come as a shock to many of us to realize how much we have already submitted to the habits of thought of an essentially unbourgeois world. This is true, not least, of economists, who like to think in terms of money flows and income flows and who are so fascinated by the mathematical elegance of fashionable macroeconomic models, by the problems of moving aggregates, by the seductions of grandiose projects for balanced growth, by the dynamizing effects of advertising or consumer credit, by the merits of “functional” public finance, or by the glamor of progress surrounding giant concerns—who are so fascinated by all this, I repeat—that they forget to consider the implications for the values and institutions of the bourgeois world, for or against which we have to decide. It is no accident that Keynes—and nobody is more responsible for this tendency among economists than he—has reaped fame and admiration for his equally banal and cynical observation that

#### A HUMANE ECONOMY

“in the long run, we are all dead.” And yet it should have been obvious that this remark is of the same decidedly unbourgeois spirit as the motto of the *ancien régime*: *Après nous le déluge*. It reveals an utterly unbourgeois unconcern for the future, which has become the mark of a certain style of modern economic policy and inveigles us into regarding it as a virtue to contract debts and as foolishness to save.

A most instructive example is the modern attitude toward an institution whose extraordinary development has caused it to become a much-discussed problem. I have in mind installment buying, or consumer credit. In its present form as a mass habit and in its extreme extent, it is certainly a conspicuous expression of an “unbourgeois” way of life. It is significant, however, that this view and the misgivings deriving from it are hardly listened to nowadays, let alone accepted. It is not, as we are often told, mere “bourgeois” prejudice but the lesson of millennial experience and consonant with man’s nature and dignity and with the conditions of a sound society to regard it as an essential part of a reasonable and responsible way of life not to live from hand to mouth, to restrain impatience, self-indulgence, and improvidence alike, to think of the morrow, not to live beyond one’s means, to provide for the vicissitudes of life, to try to balance income and expenditure, and to live one’s life as a consistent and coherent whole extending beyond death to one’s descendants rather than as a series of brief moments of enjoyment followed by the headaches of the morning after. To depart conspicuously from these precepts has always and everywhere been censured by sound societies as shiftless, spendthrift, and disreputable and has carried the odium of living as a parasite, of being incompetent and irresponsible. Even so happy-go-lucky a man as Horace was of one mind on this subject with Dickens’ Mr. Micawber: “Annual income twenty pounds, annual expenditure nineteen nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.”

#### THE CONDITIONS AND LIMITS OF THE MARKET

Installment buying as a mass habit practiced with increasing carelessness is contrary to the standards of the bourgeois world in which the market economy must be rooted, and jeopardizes it. It is, at the same time, an indicator of how much of the humus of the bourgeois existence and way of life has already been washed away by social erosion, as well as an infallible measure of proletarianization, not in the sense of the material standard of living but of a style of life and moral attitude. The representatives of this style of life and moral attitude have lost their roots and steadfastness; they no longer rest secure within themselves; they have, as it were, been removed from the social fabric of family and the succession of generations. They suffer, unconsciously, from inner non-fulfillment, their life as a whole is stunted, they lack the genuine and essentially non-material conditions of simple human happiness. Their existence is empty, and they try to fill this emptiness somehow. One way to escape this tantalizing emptiness is, as we have seen, intoxication with political and social ideologies, passions, and myths, and this is where Communism still finds its greatest opportunity. Another way is to chase after material gratifications, and the place of ideologies is then taken by motor scooters, television sets, by quickly acquired but unpaid-for dresses—in other words, by the flight into unabashed, immediate, and unrestrained enjoyment. To the extent that such enjoyment is balanced not only by corresponding work but also by a reasonable plan of life, saving and provision for the future, and by the non-material values of habits and attitudes transcending the moment's enjoyment, to that extent the emptiness, and with it the "unbourgeois" distress, is, in fact, overcome. But unless this is the case, enjoyment remains a deceptive method of filling the void and is no cure.<sup>2</sup>

The incomprehension, and even hostility, with which such reflections are usually met nowadays is one more proof of the predominance of social rationalism, with all its variants and offshoots, and of the implied threat to the foundations of the market economy. One of these offshoots is the ideal of earning a maximum amount

#### A HUMANE ECONOMY

of money in a minimum of working time and then finding an outlet in maximum consumption, facilitated by installment buying, of the standardized merchandise of modern mass production. *Homo sapiens consumens* loses sight of everything that goes to make up human happiness apart from money income and its transformation into goods. Two of the important factors that count in this context are how people work and how they spend their life outside work. Do people regard the whole of the working part of their life as a liability, or can they extract some satisfaction from it? And how do they live outside work, what do they do, what do they think, what part have they in natural, human existence? It is a false anthropology, one that lacks wisdom, misunderstands man, and distorts the concept of man, if it blinds us to the danger that material prosperity may cause the level of simple happiness not to rise but to fall because the two above-mentioned vital factors are in an unsatisfactory condition. Such anthropology also prevents us from recognizing the true nature of proletarianism and the true task of social policy.

It is, for instance, a superficial and purely materialist view of proletarianism to believe complacently that in the industrialized countries of the West the proletarians are becoming extinct like the dodo simply because of a shorter working week and higher wages, wider consumption, more effective legal protection of labor and more generous social services, and because of other achievements of current social policy. It is true that the proletariat, as understood by this kind of social rationalism, is receding. But there remains the question of whether, concurrently with this satisfactory development and perhaps because of it, ever wider classes are not engulfed in proletarianism as understood in a much more subtle sense, in the sense, that is, of a social humanism using other criteria which are really decisive for the happiness of man and the health of society. The criteria I have in mind are those which we know well already, the criteria beyond the market, beyond money incomes and their consumption. Only in the light of those criteria can we assess the tasks of genuine social policy, which I advocated fifteen years

#### THE CONDITIONS AND LIMITS OF THE MARKET

ago in my book on *The Social Crisis of Our Time* and for which Alexander Rüstow has recently coined the felicitous term of “vital policy.”

The circle of our argument closes. It is, again, private ownership which principally distinguishes a non-proletarian form of life from a proletarian one. Once this is recognized, the social rationalism of our time has really been left behind. We shall see in a later chapter how direct and short a road leads from here to the great problem of our era’s constant inflationary pressure, which has developed into a danger to the market economy plain for all to see.<sup>3</sup>

#### *The Spiritual and Moral Setting*

One of the oversimplifications by which social rationalism distorts the truth is that Communism is a weed particular to the marshes of poverty and capable of being eradicated by an improvement in the standard of living. This is a fatal misconception. Surely everyone must realize by now that the world war against Communism cannot be won with radio sets, refrigerators, and wide-screen films. It is not a contest for a better supply of goods—unfortunately for the free world, whose record in this field cannot be beaten. The truth is that it is a profound, all-encompassing conflict of two ethical systems in the widest sense, a struggle for the very conditions of man’s spiritual and moral existence. Not for one moment may the free world waver in its conviction that the real danger of Communism, more terrible than the hydrogen bomb, is its threat to wipe these conditions from the face of the earth. Anyone who rejects this ultimate, apocalyptic perspective must be very careful, lest, sooner or later, and perhaps for no worse reason than weakness or ignorance, he betray the greatest and highest values which mankind has ever had to defend. In comparison with this, everything else counts as nothing.

If we want to be steadfast in this struggle, it is high time to be-think ourselves of the ethical foundations of our own economic