

# HUMAN ACTION

*A Treatise on Economics*

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THIRD REVISED EDITION

Henry Regnery Company, Chicago

### 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 catalactic 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 paterfamilias 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 prevails an inexorable interconnectedness of physical and biological phenomena and that acting 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 suitability or unsuitability. With regard to the laws of the universe any doubt of their suitability 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 Borussiae*.

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 comes 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.<sup>1</sup>

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

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.

out for a special 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 decreasing 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 unhindered 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 unhindered 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 restricting 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 accord-

ing 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 from 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 deter-

mined the price. That all endeavors to construct nonmarket prices are vain has been shown.<sup>2</sup> 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 legions had easily defeated

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

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.<sup>3</sup> 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 food-stuffs 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 for the emperors to promulgate laws against the city-dweller who, "relecta civitate rus habitare maluerit."<sup>4</sup> 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 Führer 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 Iuris Civilis*, I. 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 catalactic 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 unhindered labor market a tendency for catalactic 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."<sup>5</sup> 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.<sup>6</sup> No one has ever succeeded in the effort

5. Cf. W. H. Beveridge, *Full Employment in a Free Society* (London, 1944), pp. 92 f.

6. Cf. Hunt, *The Theory of Collective Bargaining*, pp. 10-21.

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

It is important to remember also that 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."<sup>7</sup> The unions counted for Marx only as far as they attacked "the very system of wage slavery and present-day methods of production."<sup>8</sup> 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!*"<sup>9</sup> 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 the government or by violent union action, contend that they are fighting for the improvement of the conditions of the working masses. They do not permit

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.



anyone to question their dogma that 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 acknowledgment 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.<sup>10</sup> We have examined the purchasing power argument as advanced in favor of a policy of raising wage rates above the potential market rates.<sup>11</sup> 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.<sup>12</sup> 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-

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

11. Cf. above, pp. 301-303.

12. Cf. Ricardo, *Principles of Political Economy and Taxation*, chap. 1, sec. v. The term, "Ricardo effect" is used by Hayek, *Profits, Interest and Investment* (London, 1939), p. 8.

in-trade of popular 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 product. The employment of machinery itself does not *directly* result in a reduction of the number of hands employed in the production of the 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 labor-saving 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.<sup>13</sup> 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.<sup>14</sup> 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.<sup>15</sup>

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

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."

unions succeed in 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 fixed 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.<sup>16</sup> 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 be 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 Catalytic Aspects of Labor Unionism*

The only catalytic problem with regard to labor unions is the question of whether or not it is possible to raise by pressure and compulsion the wage 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

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 stragem in the thirties, cf. below, pp. 792-793.