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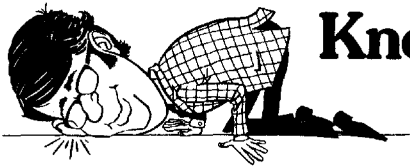
Gary North

Exploitation and Knowledge



THE PROFIT MOTIVE: Everyone knows that the free market economic system operates in terms of the profit motive. The trouble is, hardly anyone understands where profits come from. This includes businessmen who make them. This failure to understand the source of profits has given a real advantage to the critics of the market. When the supposed defenders of the market argue that the hope for profit is the motivating force of capitalism, yet they cannot state clearly where profits come from, they have left themselves intellectually defenseless.

The critics claim that profits come from the ability of the stronger, richer, and more ruthless members of the society to exploit their weaker neighbors. The word "exploitation" has been a favorite one in socialist circles. Marx made the word a weapon against capitalism. The workers are exploited by the capitalists, Marx said, because the capitalists can extract surplus value from laborers. The laborer has to work, say, three hours in order to have enough money to buy minimum food and shelter, but the capitalist keeps him on the job many hours longer. Thus, the capitalist "exploits" extra money from his workers.

The theory was absolutely wrong, and it was demolished by the Austrian economist, Eugen von Böhm-Bawerk, before Marx died.[1] Workers

© Gary North, 1982. Gary North, Ph.D., is President of the Institute for Christian Economics. The ICE publishes a newsletter, *Biblical Economics Today*. A free six-month trial subscription is available by writing to Subscription Office, ICE, P. O. Box 8000, Tyler, Texas 75711.

[1] *The Exploitation Theory of Socialism-Communism* by Eugen von Böhm-Bawerk. An extract from *Capital and Interest*. Third revised edition 1975, 176 pp. paperback. Libertarian Press, P. O. Box 218, South Holland, Illinois 60473.

are paid the value of their output, or very close to it. When they are not paid according to the value of their output, other profit-seeking employers start offering them more, since they want the "surplus value" for themselves. The market price of the formerly "exploited" labor services climbs, since no capitalist wants to allow his competitors the advantage of hiring underpriced labor services. Capitalists may well be greedy; this is the best assurance for workers that they are being paid what they are worth.

The Ignorance Factor

It might be argued that laborers really do not know what their labor services are worth on the free market. Therefore, they refuse to take a chance and threaten to quit. They are afraid of losing their jobs, and they are not aware of the better opportunities available to them elsewhere.

This is quite true; *accurate information is not a free good.* It is, perhaps more than any other scare economic resource, the most valuable of assets. If men are unaware of an opportunity, then they cannot take advantage of it. But all men do not need to be informed of the existence of higher wages, or better working conditions, or jobs that offer more days of paid vacation per year. A few workers are sufficient to alert all the others. "Say, did you hear that XYZ Widgets have raised their pay scale 25 per cent?" That story, if true, is all that is needed to alert workers. The information comes to a few. They start quitting. Others wonder why their old friends are leaving the job. Nothing spreads faster than information about opportunities. Rumors are efficient means of spreading information; in fact, the problem facing the listener is to sort out false from true information. But there is an economic incentive for laborers to check out rumors of major employment opportunities.

Consider a particular worker. For the sake of the argument, let us assume that he is indeed "exploited." His employer knows that he is worth, say, \$10 per hour. But we will not call them dollars, since inflation tends to make dollar-denominated arguments look silly after a few years, or at least very old-fashioned. So we will not pay him in dollars. We will pay him in a hypothetical currency units, shekels. (A shekel in ancient Israel was a unit of weight, which made it easier for people to know what units they were dealing with: shekels of silver, shekels of gold, etc.) The employer is paying him only eight shekels per hour, and the company is pocketing the extra two shekels. Or maybe the company is only pocketing one shekel, but is charging less for the product, and is thereby underbidding the competition, and increasing its share of the market. Whatever the case happens to be, the laborer is not receiving the value of his output.

What Can He Do?

What can he do to better himself? He can start investing. He starts putting time and effort into a "new company," himself. He starts investing in a search for information. He looks in the classified ad columns of his newspaper to see what other corporations are paying for labor services like his. He starts calling old friends on the phone, asking them what conditions are like at ABC Widgets, Inc. He starts calling the personnel offices of rival companies. Sooner or later, if he is really being exploited, he may find proof of the exploitation: some firm that is offering more than eight shekels per hour for labor services like his.

This investment involves sacrifice. When he searches for better information concerning the market he is participating in, he is an investor. He is a kind of capitalist. More important, he becomes an entrepreneur. He *thinks* there is a better opportunity around. He *hopes* he can find it by investing time and effort into his search. He *expects* to better himself if he discovers higher pay, or better working conditions, being offered by another company. He *wants* to take advantage of any such offer. But the key fact is this: *initially, he does not know for certain.*

If he knew for sure, he would not have to spend time searching. He would simply take the better offer. There is ignorance involved. He may not be exploited after all. Perhaps his employer is paying him a market wage. In fact, perhaps the market is about to drop; his employer may be paying him too much, by mistake. Also, even if a better offer is ready and waiting, he may not find it in time. He may never find it at all. There is no way for him to be sure just what the market is offering to people who sell services comparable to his. And even if he finds a better deal, he may not be able to convince the prospective employer that he, as a skilled worker, actually possesses the qualifications. After all, the prospective employer really is not certain just who this prospective employee is, or what he can do on the job. *The ignorance factor is inescapable.*

The worker who begins a search to better his position is, in fact, an *entrepreneur.* He is making a forecast: with work, and time, and telephone calls, he thinks he can find a better opportunity. He cannot be certain, but he thinks so. He faces an *uncertain future.* He is not omniscient. No person is omniscient. Nevertheless, he "senses" that there are better opportunities available. He is willing to invest time in the search. He skips Saturday afternoon television in order to find a better opportunity. He skips bowling with the boys. He skips an afternoon of fishing. In other words, *he invests a scarce resource*—leisure—by *forfeiting* it. He tries to get a return on his investment: money, or working conditions, or a job that offers possibilities of advancement, that will be more valuable to him in the *future* than the leisure time activities are valuable to him in the present.

Is He Exploited?

Is the worker really exploited? How has his present employer exploited him? Only by not giving him a gift, namely, the precious gift of accurate knowledge. He has not come to the worker and said to him, "Look, Charlie, I'm paying you eight shekels an hour, but ABC Widgets is paying at least ten per hour. I've known that for a long time. I feel guilty for not telling you. Now, if you want to call the personnel department at ABC Widgets, go ahead. See if you can get a job lined up there. If you do, come to me and tell me. Then I'll be forced to give you a raise. Fair enough? Have a nice day." How can we distinguish "exploitation" from a mere refusal to give away information that is economically detrimental to the income of the one who is giving it? (And how could we distinguish the *gift of information* from possible *stupidity* on the part of the company's management?)

Furthermore, how can we distinguish the worker who goes shopping for a better job from a capitalist? And if he finds the job, and refuses to run to all his fellow workers to tell them about the job down at ABC Widgets that pays 25 per cent more, how can we distinguish him from an exploiter of labor himself? After all, he has information that would help his buddies. He wants to take advantage of the information to increase his income. But that is precisely what his present employer is doing to him: taking advantage of better information. If there is only one job available at ten shekels per hour, and he takes advantage of it, has he become a selfish exploiter of his fellow man? If he forfeits the raise, despite his investment of time and effort in searching for a better deal for himself, has he acted rationally? Is rational action—taking advantage of the opportunity a man searches for—inevitably immoral, selfish, and exploitative?

Employer-Entrepreneur vs. Worker-Entrepreneur

How can we distinguish the worker from the employer? What is different about an employer-entrepreneur, who takes advantage of his access to information by refusing to give that information away, from a worker-entrepreneur, who takes advantage of his access to information by refusing to give that information away? The employer-entrepreneur spent years in establishing his business, and his profits stem from using accurate information wisely. He has *invested in information-gathering,* and it has finally paid off. He is beating his competition, since ABC Widgets does not know that there are workers available—or at least one worker available—who will work for slightly over eight shekels per hour. He is profiting at the expense of the competition: the other Widget company. He is also profiting from the worker's lack of knowledge. But if the worker finds out, and other workers do not find out, then the worker is also profiting at the expense of the other workers (his competition) and his present employer, who now will have to pay him more, or do without his services. What is the difference?

The people who proclaim that capitalism exploits workers are really proclaiming something very, very different: capitalism allows people to take advantage of better information, at least until the competition finds out and starts taking advantage of it themselves. What the opponents of capitalism are really proclaiming is that men have a moral and legal obligation to *give away* the world's most valuable scarce economic resource: accurate, profitable knowledge. The critics expect men to give away a resource as if it were a free good, when we all know it is anything but a free good. It takes an *investment in an uncertain future* to gain ownership of this asset. Yet the critics want us to believe that it is exploitative to use it once we have discovered it. *The critics want to kill the private markets for information.*

Hidden Treasure

Some of the finest economic wisdom in history can be found in Jesus' parables. He aimed His parables at the average listener. He knew that they were not trained theologians. They would not respond to detailed theological analysis. So he went to them with parables, and several were "pocketbook parables." (Others were agricultural parables: seeds, growth, sowing, reaping.) His parable of the buried treasure was based on His understanding of the market's process of searching for information and using it to one's advantage: *Again, the kingdom of heaven is like unto treasure hid in a field; the which when a man hath found, he hideth, and for joy thereof goeth and selleth all that he hath, and buyeth that field* (Matthew 13:44).

Consider what the man in the parable was doing. He stumbles across an important piece of information. There is a valuable treasure hidden in a field. He is not sure just who it was who hid it, but it is there. He presumes that the person who hid it was not the present owner of the field. He is not certain of this at first, but he is willing to take a major step. He hides the treasure again, and goes out and sells everything that he owns. I suppose he did some preliminary investigating, just to see if the present owner will sell it. But the present owner may change his mind. Or he may have known about the treasure all the time, and he is luring the speculator into a disastrous decision. The discoverer cannot be certain. But he takes a chance. He sells everything, and goes to the owner with his money. He buys the field. Now he owns the treasure. He took advantage of special information: his knowledge of the existence of a treasure in a particular field. He took a risk when he sold everything that he owned to come up with the purchase price. Then he went back to the owner, thereby alerting the owner to a possible opportunity—the possibility that something valuable is connected to the field. Maybe it would be unwise to sell it after all. But finally he decides to sell. The entrepreneur—the man with the information and some venture capital—has closed the deal. He has attained his goal.

The Socialist View

The modern socialist would be outraged at this parable. The entrepreneur, who was striving to better his position, was clearly immoral. First, the land he was on should have been owned by the people, through the State. Second, he had no business being on the land, without proper papers having been filed with the State in advance. Third, he should never have hidden the treasure again. It was the State's. Fourth, if it was not the property of the State, then he should have notified the private owner of the property. Fifth, failing this, he was immoral to make the offer to buy the property. He was stealing from the poor man who owned the property. Sixth, should he attempt to sell the treasure, the State ought to tax him at a minimum rate of 80 per cent. Seventh, if he refuses to sell, the State should impose a property tax, or a direct capital tax, to force him to sell.

What the socialist-redistributionist objects to is *the lack of mankind's omniscience*. The economy should operate as smoothly, as efficiently, and as profit-free as an economy in which all participants had equally good knowledge—perfect knowledge—as all other participants. Knowledge, in a "decent" social order, is a universally available free good, equally available to all, and equally acted upon by all. It is only the existence of private property, and personal greed, and a willingness to exploit the poor, that has created our world of scarcity, profits, and losses. Knowledge about the future should be regarded as a free good. Profits are therefore evil, not to mention unnecessary, in a sound economy. This has been the argument—the real, underlying, implicit argument—of all those who equate profits and exploitation. Men are not God; they are not omniscient. This angers the socialists, and they strike out in wrath against the market order which seeks to encourage men to search for better information so that they can profit from its application in economic affairs. The socialists prefer to stop the search for information concerning the uncertain future, rather than to allow private citizens to profit personally from the use of knowledge in society.

The Transfer of Knowledge

Accurate knowledge of the future is a valuable asset. How can society profit from its discovery and application? Not everyone wants to take the time and trouble to search out the future. No one can take the time and trouble to search out *all* the possible bits of information concerning an uncertain future that might be useful to him or his family. So we allow others to do the work, bear the risk of action, and sell us the results at a price we are willing and able to pay. We consumers become the users, and therefore the beneficiaries, of the entrepreneur's willingness and ability to peer into the future, take steps to meet the demand of the uncertain future, and deliver the finished product—consumer good, consumer service, or spiritual insight—at a price we are willing to pay. Why should we care what price he paid, or what risks he bore, when we pay the price? Sure, if we knew what he paid, we might guess that he is willing to take less than what he is asking, but why should we care from a *moral* standpoint what he paid versus what he is asking us to pay?

Besides, the existence of his profit on any transaction encourages other entrepreneurs to search out similar opportunities to present to us in the future. Let us consider our old friend, the entrepreneur-worker. He accepts the job with ABC Widgets. The other workers throw a farewell party for him. The conversation inevitably gets around to the reason why he is leaving. "Hey, Charlie, why are you leaving XYZ Widgets? Haven't we had great times together? What are you trying to do, get on their bowling team or something?" And Charlie may be willing to say, now that he knows he has *his* job, and there are others just like it available. Now he can look like a smart cookie in front of his friends. "I'm leaving because I'm going to make 25 per cent more each week, that's why. Why should I stay here at XYZ Widgets and work for less than I'm worth?" That bit of information will make itself felt in the labor market of XYZ Widgets very, very fast. The management at XYZ Widgets will have to do some explaining, and perhaps make some wage adjustments for the workers, as the effects of that new knowledge are felt. *The spread of information is rapid because the pay-off for those who have it is immediate, and personally beneficial for those who act in terms of it.*

A Chance to Profit from the Use of Better Knowledge

If knowledge is a scarce economic resource, and if it is a good thing for members of society to act in terms of accurate information, then it is certainly a wise policy to allow citizens to profit from the use of better knowledge. That way, there is an economic incentive for others to enter the "knowledge market" and take advantage of whatever knowledge is available. The spread of accurate knowledge is increased because of the profit potential offered to acting individuals. If better knowledge is a valuable asset, then its sale in the market should be encouraged.

Inaccurate knowledge should be dropped rapidly. How do we best stop the transfer of inaccurate knowledge? *Make it expensive to act in terms of inaccurate knowledge.* This is why we need opportunities to make losses as well as profits. Make the use of inaccurate knowledge expensive to those who use it, and you will discourage its transfer through the whole society. This is perhaps more important than encouraging the production or discovery of new, accurate knowledge. There are always more good ideas available than capital to finance them. But the continued use of bad ideas—loss-producing ideas—inhibits the build-up of capital. It is always very risky to launch a new project, since there are so many variables. But dropping a bad idea is an immediate benefit to society, for it increases the capital base—the information base—by removing a major source of capital consumption. The existence of *losses* testifies to the existence of *inappropriate plans* in an economy. Without negative feedback—the loss portion of the profit-and-loss sheet—society has no effective way to eliminate bad ideas. If men see the danger of establishing censorship boards to reduce the spread of knowledge, they had better cling to the free market's mechanism of eliminating resource-absorbing, erroneous information.

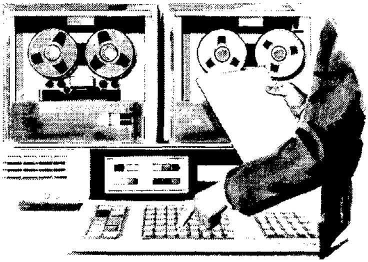
Conclusion

The word "exploitation" should be understood by those people who are likely to be the victims of true exploitation. Exploitation in a market order means the personally beneficial use of accurate economic information. Socialist programs to reduce exploitation are, in the final analysis, programs to make it unprofitable for forecasters to launch risky ventures based on their predictions concerning the uncertain future. These socialist programs are also based on a false view of knowledge: that it is a free good that is available to all, if only private ownership were abolished. By abolishing "exploitation"—the profitable use of knowledge—the socialists will inevitably *reduce the flow of accurate knowledge* of economic conditions. The public will have more inaccurate knowledge in its capital structure, and therefore more losses, with fewer profits to compensate for the losses. Men will not be the beneficiaries of uncertainty-bearing forecasters. The State becomes the active suppressor of the spread of accurate knowledge. If this is not exploitation, what is?

What we need is a means of reducing "exploitation"—the profitability of suppressing knowledge. The exploitation of another man's ignorance cannot long continue in a society in which there is freedom of expression, *if* this freedom is accompanied by the freedom to act on the information provided by the freedom of expression. It means that each man's "exploitation" of the resource of knowledge is always threatened by his competitors' "exploitation" of that same knowledge, as well as the "exploited" person's use of the knowledge. Knowledge is like any other asset: it is not a free good. Those who want it must pay for it.

The socialist brings a moral critique of profits: "Capitalists would try to reduce exploitation by making opportunities for exploitation available to all. They tell us that the spread of the legal right of exploiting others leads to a reduction of exploitation. Who can believe such nonsense? Exploitation should be made illegal. The best way to stop exploitation is to make it costly to be an exploiter." But this assumes always that knowledge is a free good. But it is a scarce good. So the best way to produce better knowledge—that is, the best way to *reduce the zones of ignorance* in a society by *increasing the flow of accurate knowledge*—is to get everyone who wants to be in the "discovery business" the right to get involved. The best way to obtain better knowledge is to make it profitable for people to increase the production of knowledge. By giving all men the right to sell all that they have and buy the fields of the world—if the sellers have the right to turn down the offer (i.e., have the right to keep "buying" their fields, day by day)—the hidden treasures of life will see the light of day. There is no treasure more precious than knowledge of the truth. That is why the kingdom of heaven is like a field in which a treasure is hidden. Give all men an incentive to search out the treasures of life. If we want more treasures, we had better encourage men to go out and look for them.

Russell Shannon



And Now for Some GOOD Economic News!

THIS PAST SUMMER, the economic news was good. Congress and the Reagan Administration agreed on an unprecedented package of budget cuts and tax incentives designed to curb inflation and boost the economy. The Dow Jones average rose above 1000. The much-taunted "supply-side" economics had arrived, and the stock market, seeing it, found it good.

Then came the fall. Prospects of huge budget deficits and persistent double-digit inflation kept interest rates high and interest in stock purchases low. The construction industry continued to flounder, and savings and loan associations hovered on the brink of catastrophe.

What's worse, alarming signs suggested extensive government controls and subsidies could be restored. The Reagan Administration's agreement to limit Japanese auto imports served as a frightening precedent for other industries to seek similar trade restraints. Farm groups, having lent their support for Reagan's tax and budget adjustments, pressed for further federal financial aid.[1] In short, the outlook became so bleak that "supply-side" economics now seemed likely to become just another version of what Carlyle called the "dismal science."

Yet a pleasant prospect glows beneath the gloom. Harking back to the refreshing optimism expressed by Adam Smith, the founder of modern economics, it relies upon the dramatic possibilities for expanding output via the advantages of specialization, innovation, and free trade.

Smith showed what the division

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of labor did just to the production of pins. One pin-maker, working alone, said Smith, "could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty." But specialization changed all that. Now one man, as Smith described it, "draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head."

Altogether, Smith said, the process of making pins had been broken up into "about eighteen distinct operations." But with what marvellous results! Each person, Smith reported, ended up making not just 20 but the equivalent of about 4,800 pins in a day.[2] What a fabulous increase in productivity! What a strong argument for maintaining free and open markets in which to sell this prodigious output!

About a century after Adam Smith wrote, the moving assembly line further enhanced the production process. Usually we associate the name of Henry Ford and automobiles with that feat. In fact, Gustavus Swift was more instrumental and the product was meat.

As quoted by the historian Daniel J. Boorstin, Upton Sinclair described the new assembly line for processing in his novel *The Jungle:* "The carcass hog was strung up by machinery and sent upon another trolley ride." It then passed between two lines of men, "each doing a certain single thing to the carcass as it came to him. One scraped the outside of a leg; another scraped the inside of the same leg. One with a swift stroke cut the throat," and so on.[3]

Swift imaginatively combined the assembly-line dismembering of hogs with distribution of the finished product via refrigerated railroad cars. So sharply did Swift cut costs and so vastly did he increase production that he was able to market meat not only throughout the U.S. but in Europe and the Orient as well.[4]

Now another century has elapsed since Adam Smith wrote, and we find ourselves face to face with the prospect of a further momentous upsurge in productivity launched by the computer. Gene Bylinsky gave a glimpse of the amazing future that it promises in the October 5 issue of *Fortune* magazine.

Specifically, the innovation Bylinsky describes is called CAD/CAM (Computer Aided Design/Computer Aided Manufacturing). Bylinsky uses for an example the tubes which Northrup needs for its aircraft. Prior to the new computer process, "it took Northrup six weeks from release of engineering drawing to bent tube in hand." But the use of CAD/CAM collapsed the time from six weeks to 18 minutes! Similarly, Pratt & Whitney report that CAD/CAM allows a 50 to one reduction in labor, and GM now "turns out car-body components such as fenders in half the time it took with manual techniques."[5]

Of course, there are those who will despair at these fabulous prospects. What, they ask in dismay, will people do for jobs if computers mercilessly replace all those diligent workers?

One who does not share such a gloomy view is Alvin Toffler. Writing in his recent book, *The Third Wave,* Toffler notes: "Between 1963 and 1973 Japan had the highest rate of investment in new technology, as a percentage of value added, of any country in a seven-nation study. It also had the highest growth in employment. Britain, whose investment in machinery was the lowest, showed the greatest *loss* of jobs."[6]

Now the labor unions are upset with President Reagan for his treatment of the air traffic controllers. Many people look with dismay at the perceived dismantling of government social programs by an Administration bent on balancing its budget.

But there is a vital question which must be squarely faced: Can labor unions, or social programs, or trade restrictions possibly provide for the health and welfare of American workers and consumers even a small fraction of what the innovations in technology, ranging from pin making, to meat dressing, to computer designing, have demonstrably achieved? Expressed another way, can the promises of shallow socialism and meager mercantilism ever hope to match the powerful impact of creative capitalism? The impressive evidence of the past two centuries surely suggests that the answer is "no."

—FOOTNOTES—

[1]"The Ripples of a Farm Recession," *Business Week,* September 28, 1981, 27.

[2]Adam Smith, An *Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1973; originally published in 1776), 4, 5.

[3]Daniel J. Boorstin, *The Americans: The Democratic Experience* (New York: Vintage Books, Random House, 1974), 319.

[4]*Ibid.,* pp. 318–20.

[5]Gene Bylinsky, "A New Industrial Revolution Is on the Way," *Fortune,* October 5, 1981, 106–14.

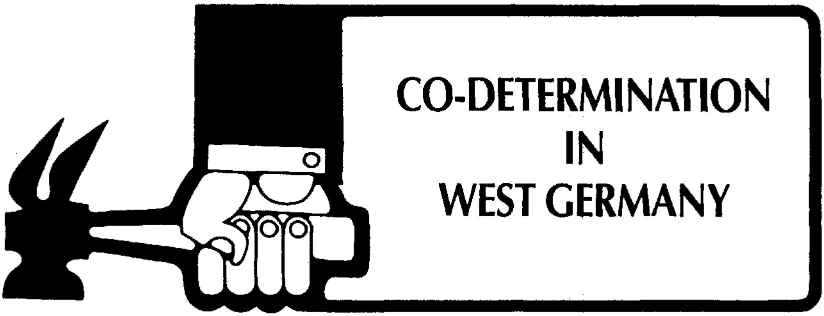
[6]Alvin Toffler, *The Third Wave* (New York: Bantam Books, 1981), 192.

IDEAS ON LIBERTY

Alfred North Whitehead

WITHOUT a society in which life and property are to some extent secure, existence can continue only at the lowest levels—you cannot have a good life for those you love, nor can you devote your energies to life on a higher level.

Hans F. Sennholz



CO-DETERMINATION IN WEST GERMANY

MOST AMERICANS are aware that labor unions are enjoying legal privileges and immunities, that their members and officials are free to commit wrongs to person and property, to deprive individuals of the right to earn a livelihood, to break contracts and trespass upon other people's property, to restrain industry, trade and commerce. All these immunities and privileges were granted by law, embellished by courts and agencies, under the political pressure and power which labor unions possess in contemporary society.

Many unions and their numerous spokesmen in education and the news media are clamoring for more legislation. They are demanding a "democratization of the economy," "equal rights" for employees, a genuine "social partnership" for employers and workers, "equal power for capital and labor." Many point at West Germany where labor unions are enjoying unprecedented power through equal representation on corporate boards of directors.

In no other country of the West do union officials exert as much influence on economic decision-making as in West Germany. Their influence rests on legislation that goes back to 1947 when the Allied occupation powers introduced equal representation in the steel industry. In 1951 the German Bundestag yielding to union pressure made it applicable also to coal mining. In 1956 it applied and expanded the concept to holding companies in the coal and steel industries. In 1952 and 1972 it incorporated co-determination in the Enterprise Organization Acts, and in 1976 it passed the Co-Determi-

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nation Act. Depending on the nature of the industry, its structure and size, and the legal organization of the enterprise, the laws are applicable to most privately owned businesses.[1]

The Coal and Steel Co-Determination Act of 1951 provides for equal representation on the boards of directors. That is, the number of union officials or shop stewards elected to the board of directors by employees must equal the number of board members elected by stockholders. Moreover, both groups of directors must agree on and elect a "neutral member" who is expected to break any potential deadlock in decision-making. The law also created the position of a full-time "labor director" serving on the executive committee who cannot be removed except by majority decision of the labor directors.

The Enterprise Organization Acts of 1952 and 1972 stipulated that the board of directors of all corporations consist of one-third employee-directors. The same was ordered for all other business organizations with limited liability and to cooperatives with more than 500 employees. The law also directed the creation of workers' councils or committees in all such enterprises with five or more employees. The committees were endowed with far-reaching co-determination rights in social, personal and economic matters. But the law was not to apply to so-called "purpose enterprises" pursuing objectives in politics, labor unions, religion, education, science, art, and similar pursuits. Moreover, the law does not cover enterprises of the federal, state and local governments and other public corporations.

Contractual Co-Determination through Collective Bargaining

The Co-Determination Act of 1976 is applicable only to corporations with more than 2000 employees. The boards of directors of such enterprises must consist of an equal number of directors elected by stockholders and by employees. The stockholders may elect the chairman of the board who in case of deadlock may cast the decisive vote.

In addition to these legal provisions imposing co-determination on German commerce and industry there is contractual co-determination resulting from collective bargaining. As a condition for cooperation with management on such issues as reorganization or production adjustments, or to settle a costly strike, many companies not covered by law were forced to introduce the kind of co-determination imposed on the coal and steel industries, that is, parity representation by labor. To the

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[1]Cf. Walter Hamm, *Erfahrungen mit der Mitbestimmung in der Bundesrepublik Deutschland,* Schweizerischer Handels- und Industrie-Verein, #25, Sept. 1981.

unions this is the only co-determination worthy of the name. The Co-Determination Act of 1976 is rejected as unsatisfactory because it grants the decisive vote to the chairman of the board who is elected by the owners.

Altogether, 600,000 employees of the coal and steel industries have parity co-determination rights. One million workers possess the rights granted by the Enterprise Organization Acts, and more than four million employees in some 500 large corporations are covered by the Co-Determination Act. All in all, one-fourth of all West German employees are grantees of co-determination rights. But this does not mean that these millions of workers actually view their rights as urgent or important, or that they are co-determination conscious. Every public opinion poll seems to confirm that the masses of workers are unconcerned and uninterested, which leads many labor leaders to voice their disappointment. It seems that the interest in labor co-determination is limited primarily to union officials.

Three Types of Co-Determination

It cannot be surprising that the laws created voting blocs consisting of owner-directors and labor-directors. Each bloc meets well in advance of a board meeting in order to arrive at a consensus that will be presented and defended in unison at the meeting. Nevertheless, in the coal and steel industries subject to full parity legislation there is no serious confrontation. Both blocs are fully aware that they may be outvoted by the "neutral director." It leads them to make every effort through lengthy and painstaking consultations and negotiations to arrive at some compromise. Many decisions are finally made by unanimous vote.

The situation is quite different in the corporations subject to the Co-Determination Act. There is little bargaining and maneuvering for compromises as the chairman of the board can be expected to cast his decisive vote with his colleagues, the stockholder-directors, in opposition to the bloc of labor-directors. Moreover, some corporations managed to reduce the tasks and functions of their boards to the legally permissible minimum, which has led to significant changes in the corporate structure. Union officials obviously are distressed and perturbed by the power of the chairman and the reduction in board functions, which they interpret as flagrant examples of anti-labor and anti-union behavior. Of course, the boards organized under the Enterprise Organization Acts of 1952 and 1972, on which the owner-directors outvote the one-third labor-directors without much ado, are the favorite objects of union scorn and contempt.

A New Breed of Directors

Co-determination in the true parity sense exists only in the coal and steel industries. The law imposing the co-determination effected far-reaching changes in the composition of the boards of directors, in the behavior of board members, and in company policies, which in turn affect not only the employees but also the public at large.

To the labor union agents on a board, the election of new stockholder-members is of utmost importance. As it is most difficult to be elected without the consenting votes of the labor-directors, only candidates with proven willingness to "cooperate" can be expected to be elected to the board. Surely, the chairman of the board usually selects and recommends the candidates. But he must be ever mindful that they must be acceptable to the labor-directors. The selection therefore concentrates on "friendly" candidates whose board behavior can be surmised in advance.

In every board meeting and with every vote the owner-director may jeopardize his professional future. If he aspires to be elected to the boards of other companies he faces the risk that the union agents on the board may be in contact with other agents on other boards and bar his election. The union may even black-list him, which would signal the end of his career.

Surely, the capabilities and talents on the boards of directors in the coal and steel industries have changed materially. Young owner-directors work diligently to curry the favors of labor-directors in order to enhance their professional careers. The labor-directors are expected to be uncompromisingly loyal to their unions, and owner-directors are expected to be cooperative with the labor-directors. At any rate, the former must at least be depended upon to be very silent and sympathetic to the actions of labor-directors. It cannot be surprising, therefore, that any and all insider criticism of parity co-determination has been muzzled and the freedom of speech, at least for owner-directors, abridged. A new breed of directors is crowding the boards jealously guarding the interests of employees as interpreted by the labor-directors. Employee benefits are always paramount—even if they should be very costly, inflict losses, or even jeopardize the future of the company. In final analysis, massive government subsidies can be expected to cover the losses of an ailing coal and steel industry.

The law sought to avoid paralyzing situations in which both blocs are deadlocked and are unable to make management decisions by creating the position of a "neutral member." As such situations occur rather frequently, excessive demands are made on one person who usually has little or no professional knowledge. He is expected to resolve difficult issues on which the two director blocs cannot agree, which leads him to make very few resolute decisions. He may simply abstain from voting or alternate his vote between the owner-directors and the labor-directors in order to retain the good will of both sides. After all, he, too, would like to be re-elected.

Co-determination has seriously impeded the decision-making ability of the board. There is little demand for expert knowledge of the enterprise or even the industry. A member must be loyal to the labor team and, as owner-director, be sympathetic to the other team. The boards which in bygone days used to guide the affairs of their enterprises now are spending considerable time and energy on the discussion and solution of labor union problems. If enterprise questions are to be resolved, their solution invariably is made dependent upon the satisfaction of employee demands. Transaction costs are greatly increased, investment returns are reduced, and the profitability of the enterprise is sacrificed anew to union objectives. And all such effects are the bitter fruit of many months or even years of feverish deliberations and negotiations.

At times, heterogeneous composition of the owner-bloc compounds the co-determination problems. Twenty-five per cent of the stock of the well-known Krupp enterprises in Bochum, for instance, is owned by the government of Iran. In June of 1981 the Iranian representative on the board single-handedly prevented a needed reorganization because "Islamic principles elevate the fate of man above economic issues." Offsetting the vote of the neutral director, the one Iranian vote succeeded in paralyzing the board.

A similar heterogeneity of the owner bloc can be anticipated as a result of certain union demands. In recent rounds of bargaining the unions insisted on profit sharing that would transfer company profits or preferably company shares to an employee fund managed by the labor union. Workers are to become owners of stock that is managed by the union, which in turn entitles its agents to be elected to the board as owner-directors.

Bargains Without Bargaining

Co-determination has changed the nature of collective bargaining. The notion that both sides meet at the bargaining table in order to come to amicable agreements on employment conditions cannot hold true if both sides are represented by or are loyal to a labor union. There are no two sides if the members of the executive board who are to represent the interests of the company can be appointed only with union support.

When difficult decisions must be made by the board, such as a reduction of output or the closing of a plant, a temporary impasse can be expected which, in the end, will be resolved at the expense of owners. The severance pay to employees, even though they may readily find employment elsewhere or draw generous unemployment compensation, may reach 40,000 DM (some $17,600) per person. If the company cannot bear such expense, the board is expected to petition and pressure the government for more subsidies, for protection from cheap foreign competition, or for government guarantees of sales at higher prices. During the 1950s and 1960s when coal mining was laboring under the competitive pressures of cheap oil imports, it became the most subsidized West German industry. During the 1970s also the steel industry needed extensive government aid and support.

Public discussion of co-determination in Germany usually is limited to the confrontation between owners and employees, to the pros and cons of parity power between owner-management and labor unions. Little is said about the economic, social and political effects of co-determination, or about its moral and ideological aspects. And little mention is made of countless consumers whose economic well-being depends on the industries, and millions of taxpayers who are called upon to subsidize the companies.

Parity co-determination has not brought peace to the labor markets. A long and ugly strike shut down the steel industry from November 1978 to January 1979. The key issue was the union demand for a 35-hour work week. The strike was settled with a compromise that retained the 40-hour work week, but granted increased holidays and vacations to employees.

Co-Determination is Expropriation

Co-determination brings into question the very foundation of the private property order. It grants equal rights of property to individuals who did not provide it. If labor unions or their agents have equal rights of management they are equal partners in ownership. No new rights are created; existing property rights are merely redistributed, that is, seized by political force from the owners and given to labor unions.

An inevitable consequence of such a seizure is the immediate closure of all new sources of equity capital. No one can be expected to invest or reinvest his savings in an enterprise in which someone else has parity rights to his investments. No one is likely to risk his capital in economic production if he bears all the risk and someone else has equal rights not only to the returns but to the capital itself. Any industry with parity co-determination, therefore, loses its access to the equity market and is relegated to the credit market or to the public treasury.

The ever-rising operating costs not only depress the returns on the capital invested, but sooner or later lead to losses which in turn cause the industry to constrict. Despite the militant union opposition to production curtailments, to shut-downs of plants and facilities, the number of jobs tends to shrink continually and output declines. The industry loses its ability to adjust to changing market constellations and to compete effectively with foreign enterprises working without the co-determination handicap. If it were not for new government intervention in order to effect the rescue of co-determination industries, such as government support prices, import restrictions or generous subsidies, the co-determination industries would self-destruct, giving way to foreign competition.

Unseen Consequences

In the short run the employees of a company with parity co-determination may enjoy the benefits they reap from union work rules, from less work and higher pay, from management limitations and costly fringe benefits. They may savor the consumption of investors' capital and the returns that otherwise go to them. But when the industry begins to stagnate or even constricts, which is unavoidable after a while, the co-determination benefits give way to co-determination losses. As plants and mines shut down permanently, unemployment rises, especially among young workers. Moreover, it becomes increasingly difficult to find and tap new sources of benefits. When, as a last resort, the public treasury becomes the primary source, a national economic "crisis" or "emergency" needs to be declared to come to the rescue of the co-determination industries.

The "emergency" proves to be severe and tenacious. It just won't go away; but it can be alleviated temporarily through bigger and bigger subsidies. To listen to the moaning of the co-determination directors is most interesting and amusing: "The Arabs are causing the energy crisis." "The U.S. dollar is too weak." "It is too strong." "We are running out of cheap energy"—and so on. The blame invariably is laid on some extraneous factor, preferably abroad.

The public is paying a co-determination price in the form of higher goods prices, which signal lower levels of living. When the public treasury must finally be tapped to sustain the industry and pay the benefits, the public pays again through higher taxes or, in the case of debt monetization, through more inflation. And finally, the people in neighboring countries trading with the co-determination country are adversely affected as trade and commerce are shrinking and trade barriers are rising. Everyone loses because the co-determination industry no longer functions efficiently and is consuming or misusing economic resources.

Eroding the Market Order

The private-property competitive order depends on the unhampered choices and decisions of countless individuals seeking to satisfy their wants and desires. Entrepreneurs as managers or investors guide the production process which is a continuous process of adjustment of economic resources to the whims and wishes of consumers. Successful adjustment generates profits, inefficient operation inflicts losses.

Labor-directors who are not guided by profit and loss and are unaffected by the consequences of their actions, are hampering or thwarting the adjustment process. Intentionally or instinctively they are sabotaging the market process in order to preserve or expand their own economic power and ultimately to replace the market order with a political command system, that is, with socialism.

It is a fact verifiable in words and deeds that many labor-directors favor a command system in which they themselves would man the central controls. Their ideological bent raises the question whether their board decisions, aiming to thwart market adjustments and to turn profits to losses, may not be designed to prove the "failure" of the market order and to promote the command order.

West German labor unions are playing an ominous game. They are ruthlessly employing political power to gain economic power, which in turn is paving the way for a political command order. It must not be forgotten that parity co-determination came into existence by sheer labor union intimidation. On April 10, 1951, the *Bundestag* cast its final vote against it. But Carlo Schmid, the speaker of the House, refusing to announce the outcome of the vote, called the leadership into special session in order to inform it anew of the seriousness of the situation. With the union posted for a general strike he made the *Bundestag* vote again until it agreed to co-determination. The "democratization" of industry thus was born by antidemocratic means.

The German miracle of economic recovery after World War II never touched the coal and steel industries. On the contrary, they militated against it and vitiated it until the miracle gave way to stagnation and decline. The ideology and policy that gave rise to co-determination, and other government intervention in the private-property competitive order, must answer for the decline.

Frank Chodorov

The Humanity of Trade

WHEREVER two boys swap tops for marbles, that is the market place. The simple barter is in terms of human happiness no different from a trade transaction involving banking operations, insurance, ships, railroads, wholesale and retail establishments; for in any case the effect and purpose of trade is to make up a lack of satisfactions. The boy with a pocketful of marbles is handicapped in the enjoyment of life by his lack of tops, while the other is similarly discomfited by his need for marbles; both have a better time of it after the swap, while their respective surpluses before the swap are nuisances. In like manner, the Detroit worker who has helped to pile up a heap of automobiles in the warehouse is none the better off for his efforts until the product has been shipped to Brazil in exchange for his morning cup of coffee. Trade is nothing but the release of what one has in abundance in order to obtain some other thing he wants. It is as pertinent for the buyer to say "thank you" as for the seller.

The market place is not necessarily a specific site, although every trade must take place somewhere. It is more exactly a system of channeling goods or services from one worker to another, from fabricator to consumer, from where a superfluity exists to where there is a need. It is a method devised by man in his pursuit of happiness to diffuse satisfactions, and operating only by the human instinct of value. Its function is not only to transfer ownership from one person to another, but also to direct the current of human exertion; for the price-indicator on the chart of the market place registers the desires of people, and the intensity of these desires, so that other people (looking to their own profit) may know how best to employ themselves.

Living without trade may be possible, but it would hardly be living; at best it would be mere existence. Until the market place appears, men are reduced to getting by with what they can find in nature in the way of food and raiment; nothing more. But the will to live is not merely a craving for existence; it is rather an urge to reach out in all directions for a fuller enjoyment of life, and it is by trade that this inner drive achieves some measure of fulfillment. The greater the volume and fluidity of market place transactions the higher the wage-level of Society; and, insofar as things and services make for happiness, the higher the wage-level the greater the fund of happiness.

Policing the Market

The importance of the market place to the enjoyment of life is illustrated by a custom recorded by Franz Oppenheimer in *The State*. In ancient times, on days designated as holy, the market place and its approaches were held inviolable even by professional robbers; in fact, stepping out of character, these robbers acted as policemen for the trade routes, seeing to it that merchants and caravans were not molested. Why? Because they had accumulated a superfluity of loot of one kind, more than they could consume, and the easiest way of transmuting it into other satisfactions was through trade. Too much of anything is too much.

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This article, reprinted from the July 1956 issue, is especially pertinent in light of the trade wars plaguing the world today.

The market place serves not only to diffuse the abundances that human specialization makes possible, but it is also a distributor of the munificences of nature. For, in her inscrutable way, nature has spread the raw materials by which humans live over the face of the globe; and unless some way were devised for distributing these raw materials, they would serve no human purpose. Thus, through the conduit of trade the fish of the sea reach the miner's table and fuel from the inland mine or well reaches the boiler of the fishing boat; tropical fruits are made available to northerners, whose iron mines, in the shape of tools, make production easier in the tropics. It is by trade that the far-flung warehouses of nature are made accessible to all the peoples of the world and life on this planet becomes that much more enjoyable.

We think of trade as the barter of tangible things simply because that is obvious. But a correlative of the exchange of things is the exchange of ideas, of the knowledge and cultural accumulations of the parties to the transaction. In fact, embodied in the goods is the intelligence of the producers; the excellent woolens imported from England carry evidence of thought that has been given to the art of weaving, and Japanese silks arouse curiosity as to the ideas that went into their fabrication. We acquire knowledge of people through the goods we get from them. Aside from that correlative of trade, there is the fact that trading involves human contacts; and when humans meet, either physically or by means of communication, ideas are exchanged. "Visiting" is the oil that lubricates every market place operation.

It was only after Cuba and the Philippines were drawn into our trading orbit that interest in the Spanish language and customs was enlivened, and the interest increased in proportion to the volume of our trade with South America. As a consequence, Americans of the present generation are as familiar with Spanish dancing and music as their forefathers, under the influence of commercial contacts with Europe, were at home with the French minuet and the Viennese waltz. When ships started coming from Japan, they brought with them stories of an interesting people, stories that enriched our literature, broadened our art concepts, and added to our operatic repertoire.

It is not only that trading in itself necessitates some understanding of the customs of the people one trades with, but that the cargoes have a way of arousing curiosity as to their source, and ships laden with goods are followed with others carrying explorers of ideas; the open port is a magnet for the curious. So, the tendency of trade is to break down the narrowness of provincialism, to liquidate the mistrust of ignorance. Society, then, in its most comprehensive sense, includes all who for the improvement of their several circumstances engage in trade with one another; its ideational character tends toward a blend of the heterogeneous cultures of the traders. The market place unifies Society.

The Trading Community

The concentration of population determines the character of Society only because continguity facilitates exchange. But contiguity is a relative matter, depending on the means for making contacts; the neutralization of time and space by mechanical means makes the whole world contiguous. The isolationism that breeds an ingrown culture, and a mistrust of outside cultures, melts away as faster ships, faster trains, and faster planes bring goods and ideas from the great beyond. The perimeter of Society is not fixed by political frontiers but by the radius of its commercial contacts. All people who trade with one another are by that very act brought into community.

The point is emphasized by the strategy of war. The first objective of a general staff is to destroy the market place mechanisms of the enemy; the destruction of his army is only incidental to that purpose. The army could well enough be left intact if his internal means of communication were destroyed, his ports of entry immobilized, so that specialized production, which depends on trade, could no longer be carried on; the people, reduced to primitive existence, thus lose the will to war and sue for peace. That is the general pattern of all wars. The more highly integrated the economy the stronger will be the nation in war, simply because of its ability to produce an abundance of both military implements and economic goods; on the other hand, if its ability to produce is destroyed, if the flow of goods is interrupted, the more susceptible to defeat it is, because its people, unaccustomed as they are to primitive conditions, are the more easily discouraged. There is no point to the argument as to whether "guns" or "butter" are more important in the prosecution of war.

Intervention Is War

It follows that any interference with the operation of the market place, however done, is analogous to an act of war. A tariff is such an act. When we are "protected" against Argentine beef, the effect (as intended) is to make beef harder to get, and that is exactly what an invading army would do. Since the duty does not diminish our desire for beef, we are compelled by the diminished supply to put out more labor to satisfy that desire; our range of possibilities is foreshortened, for we are faced with the choice of getting along with less beef or abstaining from the enjoyment of some other good. The absence of a plenitude of meat from the market place lowers the purchasing power of our labor. We are poorer, even as is a nation whose ports have been blockaded.

Moreover, since every buyer is a seller, and vice versa, the prohibition against their beef makes it difficult for Argentineans to buy our automobiles and this expression of our skills is constricted. The effect of a tariff is to drive a potential buyer out of the market place. The argument that "protection" provides jobs is patently fallacious. It is the consumer who gives the worker a job, and the consumer who is prevented from consuming might as well be dead, as far as providing productive employment.

Incidentally, is it jobs we want, or is it beef? Our instinct is to get the most out of life with the least expenditure of labor. We labor only because we want; the opportunity to produce is not a boon, it is a necessity. Neither the domestic nor the foreign producer "dumps" anything into our laps. There is a price on everything we want and the price is always the weariness of toil. Whatever causes us to put out more toil to acquire a given amount or kind of satisfactions is undesirable, for it conflicts with our natural urge for a more abundant life. Such is a tariff, an embargo, an import quota or the modern device of raising the price of foreign goods by arbitrarily lowering the value of our money. Any restriction of trade, internal or external, does violence to a man's primordial drive to improve his circumstances.

The Seeds of Conflict

Just as trade brings people together, tending to minimize cultural differences, and makes for mutual understanding, so do impediments to trade have the opposite effect. If the customer is always "right," it is easy to assume that there is something wrong with the non-buyer. The faults of those who refuse to do business with us are accentuated not only by our loss but also by the sting of personal affront. Should the boy with the tops refuse to trade with the boy who has marbles, they can no longer play together; and this desocialization can easily stir up an argument over the relative demerits of their dogs or parents. Just so, for all our protestations of good neighborliness, the Argentinean has his doubts about our intentions when we bolt our commercial doors against him; compelled to look elsewhere for more substantial friendship, he is inclined to think less of our national character and culture.

The by-product of trade isolationism is the feeling that the "outsider" is a "different kind" of person, and therefore inferior, with whom social contact is at least undesirable if not dangerous. To what extent this segregation of people by trade restrictions is the cause of war is a moot question, but there can be no doubt that such restrictions are irritants that can give other causes for war more plausibility; it makes no sense to attack a good customer, one who buys as much of our products as he can use and pays his bills regularly. Perhaps the removal of trade restrictions throughout the world would do more for the cause of universal peace than can any political union of peoples separated by trade barriers; indeed, can there be a viable political union while these barriers exist? And, if freedom of trade were the universal practice, would a political union be necessary?

Testing the Logic

Let us test the claims of "protectionists" with an experiment in logic. If a people prosper by the amount of foreign goods they are not permitted to have, then a complete embargo, rather than a restriction, would do them the most good. Continuing that line of reasoning, would it not be better all around if each community were hermetically sealed off from its neighbor, like Philadelphia from New York? Better still, would not every household have more on its table if it were compelled to live on its own production? Silly as this *reductio ad absurdum* is, it is no sillier than the "protectionist" argument that a nation is enriched by the amount of foreign goods it keeps out of its market, or the "balance of trade" argument that a nation prospers by the excess of its exports over imports.

Yet, if we detach ourselves mentally from entrenched myths, we see that acts of internal isolationism such as described in our syllogism are not infrequent. A notorious instance of this is the French *octroi,* a tax levied on products entering one district from another. Under cover of "quarantine" regulations, Florida and California have mutually excluded citrus fruits grown in the other state. Labor unions are violent advocates of opulence-through-scarcity, as when they restrict, by direct violence or by laws they have had enacted, the importation of materials made outside their jurisdiction. A tax on trucks entering one state from another is of a piece with this line of reasoning. Thus, the "protectionist" theory of fence-building is internalized, and in the light of these facts our *reductio ad absurdum* is not so farfetched. The market place, of course, scoffs at such scarcity-making measures, for it yields no more than it receives; if its offerings are made scarce by trade restrictions, that which remains becomes harder to get, calls for an expenditure of more labor to acquire. The wage-level of Society is lowered.

The Labor Theory of Value—and Prosperity

The myth of "protectionism" rests on the notion that the be-all and end-all of human life is laboring, not consumption—and certainly not leisure. If that were so, then the slaves who built pyramids were most ideally situated; they worked much and received little. Likewise, the Russians chained to "five year plans" have achieved heaven on earth, and so did the workers who, during the depression, were put to moving dirt from one side of the road to the other. Extending this notion that exertion for the sake of exertion is the way to prosperity, then a people would be most prosperous if they all labored on projects with no reference to their individual sense of value. What is euphemistically called "war production" is a case in point; there is in fact no such thing, since the purpose of production is consumption; and it is not on record that any worker built a battleship because he wanted it and proved his craving by willingly giving up anything in exchange for it. Keeping in mind the exaltation of laboring, would not a people be most uplifted if all of them were set to building battleships, nothing else, in return for the necessaries that would enable them to keep building battleships? They certainly would not be unemployed.

Yet, if we base our thinking on the natural urge of the individual to better his circumstances and widen his horizon, operating always under the natural law of parsimony (the most for the least effort), we are compelled to the conclusion that effort which does not add to the abundance of the market place is useless effort. Society thrives on trade simply because trade makes specialization possible, specialization increases output, and increased output reduces the cost in toil for the satisfactions men live by. That being so, the market place is a most humane institution.

IDEAS ON LIBERTY

Trade and Productivity

THE RULE to remember is that what hurts consumers hurts business, and what hurts business hurts proficiency. After all, what is proficiency? Simply the power to produce. The power to produce is best determined by free trade, and not by bureaucratic decree. The power to produce is a corollary of the power to trade. Thus the more trade the more production, and the more production the more trade.

Protection, on the other hand, is aimed at the power to trade. In this, the protectionist government does indeed aid *some* industries, but only at the expense of *all* industry. Under protection, all domestic industry is deprived of markets at home and abroad. All domestic industry is hurt by the higher costs of labor and materials. Thus by restricting the power to trade and locking in inefficiency, the protectionist government restricts the power to produce.

This means, in turn, that consumers will have less, for production constitutes the sole means of consumption. The power to produce, after all, is the power to consume.

WILLIAM H. PETERSON, "Barriers to World Commerce"

Brian Summers

They Solve Tomorrow's Problems

MY NEIGHBOR JOE is a friendly chap with a sharp eye on current affairs. Thus, one Saturday morning after I had mowed the lawn, I strolled over to get his considered views on the state of the world.

"This country faces a lot of problems," he told me as he slid under his car to change the oil. "Everything seems to be falling apart. Last night I was an hour late getting home because the subway broke down. I don't know why they can't maintain those trains any better."

"You seem to be doing a pretty good job maintaining your car," I observed.

"Sure," he said. "I have to keep this car in good condition. I want to sell it next year."

"Too bad we can't sell the subways."

"What?" he asked, poking his head from under the chassis.

"Suppose you held a share in a privately owned subway. Wouldn't you want the managers to maintain the value of your share by keeping the trains in good working order?"

"Sure. If they didn't, I would sell my stock."

"Of course. And as people sold their shares, the price of the company's stock would fall. This could lead to a stockholder revolt or corporate takeover. Either way, management would

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Mr. Summers is a member of the staff of The Foundation for Economic Education.

be compelled to fix the trains. As a general rule, when things are privately owned, people try to maintain their value by anticipating future maintenance problems."

"What about the apartments across town?" he asked as he reached for an oil filter. "Why don't the owners maintain them?"

"Rent controls have destroyed the incentive," I answered. "The owners know that controls will keep them from getting higher rents, even if they make extensive repairs. Furthermore, they can't get full market value if they try to sell. Who wants to buy a rent controlled apartment building, even if it is in perfect condition?"

"A free market may encourage people to maintain their own property," Joe allowed, "but this country faces some bigger problems. We are running low on natural resources. Each year, for instance, loggers cut down more trees."

"Yes," I agreed, "but each year forest product companies plant more trees. They try to maintain the value of their land, the same as you try to maintain the value of your car. Here again, private ownership is the key to heading off tomorrow's problems."

"What about the energy shortage?" he asked as he opened a can of oil. "Private owners don't go around planting more oil."

"Yes, but with price controls being lifted, they do go around looking for more oil. And you and I may be helping in the search."

"How is that?"

"When we save our money, we make more capital available for private investment. The money you put into your bank may help provide the loan capital oil companies need to lease equipment."

"I never thought of it that way. I am just trying to make some investments to provide for my retirement."

"Sure. But by trying to provide for your own future, you help solve tomorrow's problems."

"Come again?"

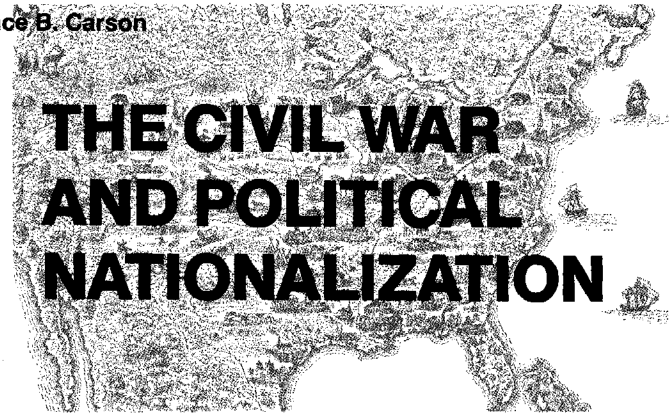
"Well, consider your mutual fund. The fund's managers try to anticipate tomorrow's problems, and try to invest in the corporations most likely to profit by solving these problems. For instance, some of your money may be furnishing equity capital for an oil exploration firm."

"You make it sound as if free enterprise will solve all our problems."

"No, people will have problems under any social system. But we should examine the incentives inherent in each system. Some incentives tend to create problems; others will solve them."

"This is all very new to me," Joe said as he closed the hood. "I'll have to think about it."

Clarence B. Carson



THE CIVIL WAR AND POLITICAL NATIONALIZATION

THE CIVIL WAR was a watershed in American economic history. During the war, and the Reconstruction of the South which followed, the stage was set for major economic developments. The political nationalization which occurred provided the framework for large-scale economic development. A nation-wide rail transportation network was soon formed. Interstate commerce grew rapidly, and some businesses became nationwide in scope. Foreign investment and domestic accumulation provided the capital for large industries.

It would be a mistake, however, to attribute these developments to the warfare itself. At least, that is not my meaning. Warfare is destructive of capital, of materials, and of manpower. It has been shown, too, that the most immediate impact of the Civil War was a decline in the growth of production of consumer goods, and that it took several years before the rate of growth that had been going on before the war was achieved again. Certainly, the devastation and political disruptions within the South were anything but conducive to economic development.

Rather, my point has to do with the control and disposition of political power. The secession of the South brought a new political party, the Republican party, to power. The victory of the North and the policies followed during Reconstruction consolidated the Republican party in power for several decades. Involved in this development was a basic shift of political power from the South to the Northeast and Midwest. Most

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important, it meant a change in the ends for which the power of the United States government was to be used.

The Gilded Age

An understanding of the shift in the role of government in the economy is critical to the interpretation of the period which historians have long called the Gilded Age. But by whatever name it may be called, the period from 1870 to 1910, or thereabouts, left a distinctive mark on America. It was the age of the great entrepreneurs, of John D. Rockefeller, Jay Gould, Philip Armour, Leland Stanford, Andrew Carnegie, James J. Hill, Jim Fiske, Collis P. Huntington, Cornelius Vanderbilt, J. P. Morgan, and many others. It was an age of spectacular economic developments: of great rail systems thrust across the plains, over the mountains, and to the Pacific, of the emergence of large industrial corporations, of the growth of large cities as manufacturing and commercial centers, and of the opening up of millions of acres of land to farming and ranching.

These dramatic developments provided the substance, such as existed, for a number of myths, some of which have been given generic names, such as the Robber Barons myth, the Horatio Alger myth, and so on. Probably, the most persistent myth is the one that the economic thrust in the latter part of the nineteenth century was simply a result of freedom. This position was forcefully stated by Vernon L. Parrington in these words:

> It was an abundant harvest of those freedoms that America had long been struggling to achieve, and it was making ready the ground for later harvests that would be less to its liking. Freedom had become individualism, and individualism had become the inalienable right to pre-empt, to exploit, to squander. . . . From the sober restraints of aristocracy, the old inhibitions of Puritanism, the niggardliness of an exacting domestic economy, it swung far back in reaction, and with the discovery of limitless opportunities for exploitation it allowed itself to get drunk. Figures of earth, they followed after their own dreams. Some were builders with grandiose plans in their pockets; others were wreckers with no plans at all. It was an *anarchistic* world of strong, capable men, selfish, unenlightened, amoral—an excellent example of what human nature will do with *undisciplined freedom.*[1]

The other side of the coin of this myth of unlimited economic freedom was that it provided a justification for government regulation, restriction, and control of the economy. Freedom must be curbed, obviously, if it produces such results as Parrington and other mythmakers describe. Freedom is nothing short of a destructive menace by their interpretation.

There is a profound misunderstanding of the free market and free enterprise entangled in this myth. What some, at least, of the mythmakers are leaving out of account is that government was intervening in the economy during these years, and doing so to a significant and sometimes determinate extent. There are two distinct types of government intervention. One is when government grants favors to some kinds of economic development, promotes some industries, grants class privileges, and aids and abets in the establishment of monopolies. The other type is government regulation and restriction of economic undertakings.

Both types of intervention are interferences with the market. Each produces its own kinds of distortions, favors some and disadvantages others. That some businessmen, for example, may seek and get government privileges should not be taken to mean that such things are in accord with freedom. That much of the intervention between 1860 and 1900 was of the first type means as surely that there was intervention and distortion as it would if the second type had prevailed.

Curbing Intervention

The main political thrust of the first half of the nineteenth century was to get the United States government out of involvement with or intervention in the economy. There were two main elements behind this thrust. One was that many of the intellectual and political leaders favored a free market in principle. The other was that the South (or slave states, as they became known, including not only those states which would eventually be a part of the Confederacy but also Maryland, Delaware, Kentucky, and Missouri) both generally opposed intervention by the United States government in the economy and favored a free market. The South was the major exporting region during this era, favored the development of international trade, and looked toward Europe both as a market for its goods and as a source of imports.

And, the South dominated national politics from 1800 to 1860, or, at least, Southerners did. Southerners served in the Presidency for approximately 41 years from 1801 to 1861. There were only two Chief Justices of the Supreme Court from 1801 to 1864, John Marshall of Virginia and Roger Taney of Maryland. Southerners served as Speaker of the House of Representatives for approximately 49 years between 1801–1861.

Southern Dominance

How or why the South should have been so dominant politically is not readily apparent. From the outset, the South had a minority. If disfranchised blacks had not been counted in the census, their minority status would have been even more pronounced. It was the prominence of the South in one political party that enabled Southerners to exercise their dominant political role. The Jeffersonian Republican party and the Jacksonian Democratic party, which succeeded it, were in control of the government for all but a few years from 1801 to 1861. While both these parties, if they be considered distinct from one another, had a national following, their greatest strength was in the South. So it was that Southerners maintained their leverage over the government during these years.

So it was, too, that the opposition to using the power of the general government to develop a nationally integrated economy triumphed during the era before the Civil War. Both the Jeffersonians and Jacksonians were basically states' rights parties. Both generally opposed government intervention and favored free trade and free markets. Jefferson's party had been born out of opposition to what might be called the economic nationalism of Hamilton's policies. Jackson's party was shaped in opposition to the National Republicans and Whigs, at least in part, in opposition to Henry Clay's "American System" and John Quincy Adams' nationalist ideas.

The critical economic issues from 1800 down to about 1845 were the protective tariff, a national banking system, and internal improvements (roads and canals mainly, to that date). These were joined from about 1845 onward by immigration, slavery expansion, and railroad promotion for internal improvement. Generally, the Jeffersonians and Jacksonians opposed a protective tariff, a national bank, federal appropriations for internal improvements, and, in the years before the Civil War, favored the expansion of slavery. The opposition to the national bank and federally aided internal improvement reached its peak during Jackson's presidency, and is symbolized by his veto of the Maysville Road Bill and the Bill for rechartering of the Second United States Bank. Jackson got caught in political crossfires on the tariff question, but his followers generally opposed the protective tariff as well.

Seeds of Conflict

Those who would use the power of the United States government to develop a national economy were generally thwarted up to the Civil War, and undoubtedly they were more than a little frustrated. Some historians have maintained that the frustration mounted in the years just before the war. Charles A. Beard held that it was Northern capitalists ranged against Southern slaveholders that precipitated the conflict. The desire for a protective tariff did apparently spread after the depression which began in 1857. There is no doubt that the necessity for expanding slavery if the South was to regain its parity in the Senate became more pressing after 1850. That slaveholders (actual and potential) suffered from a capital (or credit) crunch attributable mainly to the rising cost of slaves can be, and has been, documented *ad nauseam*. That made them competitors, at the least, with Northern industrialists for capital.

But it is neither my purpose to make an economic interpretation of a portion of United States history nor to explain the coming of the Civil War. Rather, I wish to show the change in direction that took place by way of political centralization or nationalization during and after the war. To do that at all effectively, it needs to be done against the background of what had happened before the war.

Sectional Interests

The main features of pre-Civil War America were: widespread economic freedom, decreasing intervention in the economy by the national government, and developing sectionalism, regionalism, and localism. The sectionalism was not a consequence of economic freedom, but of slavery, which is its opposite. The regionalism and localism were, however, at least according to its critics, a product of non-involvement by the United States. One thing is clear: while the Constitution removed or forbade the erection of political obstacles to a common market in the United States, the general government did very little to overcome the natural obstacles to a nation-wide market. A case can be made that building roads, canals, and railroads is not the business of government, and that position had vigorous advocates during these years. Also, it should be noted that much building of transportation routes and linking of regions was done during this period, both by private investors and with the aid of state governments. But for virtually the whole period they were links from the inland to seaports, not connections between inland areas.

Aside from the difficulties of transportation, one of the greatest obstacles to a national market during much of this period was the absence of a generally agreed upon and acceptable currency. To put it more precisely, a good many different kinds and varieties of money, or would be money, vied to become the currency. The Constitution seemed to bend the United States toward a gold and silver coin currency. That ran into trouble early on, however, because of Hamilton's effort to establish bimetallism. He set a ratio of 15 to 1 between silver and gold. This undervalued gold and overvalued silver. In consequence, only silver was presented to the mint for coining. But that ran into difficulties, too, because the American dollar was slightly lighter than the Spanish silver dollar. It tended to leave this country to be exchanged for the Spanish dollar. The mint had little to employ it, so the ever frugal Jefferson had it closed in 1806.[2] Thereafter, until the 1830s, Americans relied mainly on foreign coins for minted money.

Government Control of Banking

Meanwhile, banks took up the slack by issuing paper money which was sometimes redeemable in specie. The First United States Bank was chartered in 1791 and lasted until 1811. The Second United States Bank was chartered in 1816 and expired in 1836. During their tenure, these banks usually supplied a common currency for the United States, one limited in its quantity by law and redeemable ordinarily in specie. Further, they held in check the issues of paper money by state banks by discounting their paper money. Thus, the United States Banks provided a standard of measurement of the value of all circulating media of exchange in the country. With the demise of the second bank there was no longer any generally acceptable measure of the worth of state bank issues.

Before its demise, however, a new mint had been established by the United States, and a 16 to 1 ratio between gold and silver promulgated. This overvalued gold and undervalued silver. In consequence, gold was brought in for minting.[3] Whether the United States then had a gold standard may be debatable, but it is certain that thereafter silver dollars, following Gresham's Law, did not remain long in circulation. After the gold discoveries of the late 1840s, even the subsidiary silver coins had to be debased to keep them in circulation.

Market Possibilities

If governments had withdrawn entirely from the monetary field, except for specifying in what forms they would accept payment of taxes and for land, it is quite possible that a common currency would have developed in the United States. Private mints could have supplied the coins, and the troublesome question of a fixed ratio between precious metals could have been settled by having none. The weight in ounces of what metal could have been engraved on all coins. Merchants could have set their prices, and adjusted them from time to time, in terms of ounces of gold, silver, copper, or what have you. Paper money might even have circulated with a guarantee of redeemability certified by 100 per cent reserve in specie backing it. (A major difficulty with this scenario is that there would be little profit, if any, for the mints and none, so far as I can see, for the issuers of paper money. Counterfeiting and fraud might not be prohibitive difficulties, but they would remain as problems nonetheless.)

There was a movement, of sorts, against banks and against their issuance of paper money which mounted in the 1830s and probably reached a peak in the 1840s.[4] It got underway with Jackson's veto of the bill to recharter the Second Bank of the United States. Animosity mounted following Jackson's issuance of the Specie Circular, requiring the payment for government lands in specie. There were numerous bank failures as banks were pressed to redeem their paper money in specie. President Martin Van Buren proposed an Independent Treasury, which was eventually passed into law in the 1840s. This meant that money received and held by the United States would not go into the banking system (or lack of system) at all, and could not, therefore, be used by banks as a reserve against their paper money. Several states in the West adopted constitutional provisions prohibiting their legislatures to charter banks. Others adopted strenuous limitations upon banking.

Even so, governments remained entangled in the monetary situation. The federal government was minting gold coins and had set a ratio between gold and silver. Most states continued to charter banks which could and did issue paper money. Those states that did not were usually flooded with paper money from surrounding states. The paper money was not legal tender, of course, but it did pass as currency, or at least some of it did. It is probably true that good money will drive bad money out of circulation, in the absence of tender laws, but while it is doing so the paper continues to pass as currency. Moreover, during the 1840s and 1850s, as well as earlier, there were usually plenty of new banks to put out some more. Besides, some of the paper was not bad money, and it was not readily apparent which was which in many cases.

In Massachusetts, the currency was stabilized by a consortium of bankers. In New York, the state enforced a reserve system that worked tolerably well. Elsewhere, there was usually chaos. A contemporary described the situation this way:

> In the West, the people have suffered for years from the issues of almost every state in the Union, much of which is so irredeemable, so insecure and so unpopular as to be known by opprobrious names... There the frequently worthless issues of the State of Maine, the shinplasters of Michigan, the wildcats of Georgia, of Canada and Pennsylvania, the red dogs of Indiana and Nebraska, the miserably engraved notes of North Carolina, Kentucky, Missouri and Vir-

ginia and the not-to-be-forgotten stump-tails of Illinois and Wisconsin are mixed indiscriminately with the par currency of New York and Boston. . . .[5]

For Lack of a Common Currency

The main point that I would make is that there was considerable difficulty in having a common market without a common currency, that trade between manufacturing centers, such as there were, and the hinterlands, for example, was made unusually difficult by the variety of currencies and the absence of up-to-date discount rates. (Discount rates were published, but some of them were apt to be obsolete by the time they were printed.) In consequence of this, as well as other obstacles, most production of manufactured articles was for local markets up to the Civil War. As one historian says, "Most firms sold only in certain natural geographic regions, shipping only limited distances and depending upon consumer satisfaction and local advertising for the spread of their wares."[6]

With one or two exceptions, the federal government's posture was neutral toward economic development. A good example of this neutrality is what happened following the Panic of 1837. Many states had become deeply involved in road, canal, and some railroad building in the 1830s. Large issues of bonds had been sold, especially to foreign investors, particularly the English. When hard times hit, many of the states defaulted on the payment of the debts. Efforts to get the federal government to bail them out, to assume the loans or enforce payment, were of no avail. In consequence, foreign sources of capital almost dried up for Americans. Not even the securities of the United States could find subscribers in the 1840s. "You may tell your government," said one of the Rothschilds, "that you have seen the man who is at the head of the finances of Europe, and that he has told you that they cannot borrow a dollar, not a dollar."[7]

States did offer the means for the consolidation of capital from investors by way of the limited liability corporation. In the early 1800s, however, corporate charters could only be obtained by special acts of legislatures. Such charters were difficult to obtain, were conducive to bribery, and were tainted because they were special privileges. To overcome these objections, a movement began in the 1830s for states to pass general acts for incorporation. By 1860, the following states had passed such acts: Connecticut, Maryland, New Jersey, New York, Pennsylvania, Indiana, Massachusetts, and Virginia.[8]

There was a difficulty with state incorporation, however. It was not clear what rights a corporation chartered in one state would enjoy in others, if it chose to operate there. Would its property be secure there? Might it not be subject to disabling taxation, regulation, or other punitive measures? Whether the United States government had the authority to protect foreign (i.e., out of state) corporations, or whether it would if it could, were open questions.

A Pro-Slavery Trend

The political trends of the 1840s and 1850s were not very reassuring. This brings us to the major exception to the neutrality of the federal government toward economic development, its position regarding slavery. It is possible to argue that prior to the 1840s the government was neutral toward slavery, except for prohibiting the importation of slaves. But in the last decade or so before the war, the Southern leverage over the government was being used to expand and protect slavery.

The annexation of Texas and the territorial acquisitions from Mexico following the Mexican War were viewed at the time as moves to expand territory open to slavery. A Fugitive Slave Act was passed in the wake of the Compromise of 1850 which put the government in the business of capturing runaway slaves and returning them to their owners. The Kansas-Nebraska Act opened up Kansas to slavery, if the voters wanted it. The revelations of the Ostend Manifesto brought out into the open proposals for annexing Cuba as a potential slave state. The Dred Scott decision held that Congress had no power to determine where slaves could be taken in the United States.

The trend was to circumscribe the powers of the federal government and augment those of the states. Southern leaders were becoming less and less willing to compromise, and they were bending the United States Constitution in the direction that they would write into fundamental law in the Confederate Constitution.

A Republican Party

The modern Republican party was brought into being to counter these trends and directions. It ran its first presidential candidate in 1856. The platform called for the repeal of the Missouri Compromise, the admission of Kansas as a free state, the stamping out of slavery in the unorganized territories, federal aid to build a Pacific railroad, and a federal program for internal improvements. The appeal of the new party was clearly demonstrated, for it carried several Northeastern and Midwestern states.[9]

The Democratic party broke up in 1860. The Northern Democrats nominated Stephen A. Douglas, the Southern Democrats, John C. Breckinridge, and a new party, the Constitutional Union, was devised for those who wanted neither. It nominated John Bell of Tennessee as its candidate. With the disruption of the Democratic party went almost certainly the Southern dominance of national politics. The Republicans seized the opportunity, nominated Abraham Lincoln for President, and adopted a platform which had no discernible appeal in the South.

While the Republican platform did not come out in favor of the abolition of slavery, did not even condemn the Fugitive Slave Act or slavery in the District of Columbia, it did reaffirm its opposition to slavery expansion in the territories. It denied that Congress had the authority "to give legal assistance to slavery in the territories," viewed with horror the illegal reopening of the slave trade, and once again demanded the admission of Kansas to the union as a free state. In contrast to the platform of 1856, it came out in favor of a protective tariff, declaring that duties should be adjusted so as "to encourage the development of the industrial interests of the whole country."[10] It opposed any change in the naturalization laws, i. e., favored a liberal immigration policy, and came out for a new homestead law which would make government land available virtually free. Or, as one contemporary newspaper expressed it, the platform offered protection for industry, "economy in the conduct of the government, homesteads for settlers on the public domain, retrenchment and accountability in the public expenditures, appropriation for rivers and harbors, the admission of Kansas, and a radical reform in the government."[11]

As soon as it became certain that Lincoln had been elected, Southern states began to secede to form a Confederacy. When all who would had seceded, control over the United States government was fully in the hands of the Republican party. The control was consolidated during Reconstruction, mainly by Congressional dictation of the terms of readmission to the Union of Southern states. Not until 1884 was a Democrat elected to the presidency, and he was the only one to serve (if Andrew Johnson be excepted) from 1861 to 1913. One or the other houses of Congress was from time to time Democratic, but in general Republicans dominated the government from the Civil War to the eve of World War I.

The South Dispossessed

Not only was the South dispossessed of most of its political power by secession, war, and reconstruction but also of much of its wealth and the basis of its economy. The abolition of slavery resulted in a loss of capital (in slaves) reckoned at something on the order of $400 million. The Fourteenth Amendment prohibited both the United States governments and those of any states from compensating owners for any loss of property in slaves. Moreover, neither were permitted to assume or pay any debts contracted for the prosecution of the war by the Confederacy. The Confederate money was then worthless as were all bonds and securities sold by the Confederacy or states that were in rebellion. On top of this, many of the larger cities were burned or destroyed, railroads destroyed, plantations plundered, and so on. Whatever power and fortune there had been in the South to defend the powers of the states or thwart centralizing and nationalizing tendencies was, as Margaret Mitchell well said, *Gone With the Wind.*

With the South as an obstacle to centralization removed, with a war to fight and a South to remake, a large scale nationalization of power took place. The most far-reaching step toward nationalization was made in Section 1 of the Fourteenth Amendment, which said, in part: "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the law." In theory, at least, this gave Congress and the federal courts oversight over all state acts and legislation, for there was little they could do that would not involve in one way or another, privileges and immunities or life, liberty, and property. When the courts later ruled that a corporation was a "person" in the sense intended by the amendment, they also enjoyed this protection from state governments.

Protectionism

But well before the Fourteenth Amendment had been either proposed or ratified the government had adopted considerable legislation with a nationalizing tendency. The Republicans in power moved with a right good will to use the government to promote economic development along lines congenial to them. While there is hyperbole in his summation, there is truth too in Wilbur Cash's harsh assessment of Northern aims, when he said: "The Civil War and Reconstruction represent in their primary aspect an attempt on the part of the Yankee to achieve by force what he had failed to achieve by political means: first, a free hand in the nation for the thievish aims of the tariff gang, and secondly, and far more fundamentally, the satisfaction of the instinctive urge of men in the mass to put down whatever differs from themselves. . . ."[12]

Whether the aims were thievish or not, the Southern representatives were hardly out of Congress before the movement was afoot to adopt a fullfledged protective tariff. It came to fruition in the Tariff Act of July 14, 1862, which "increased the rates on articles of non-American production, gave protective increases in the case of many articles which could not be produced at home, and greatly reduced the free list."[13] Tariffs reached a wartime peak after the passage of the Tariff Act of 1864. The average of duties on imports was 47 per cent and some rose as high as 100 per cent.[14]

Nor was Congress any slower in getting around to authorizing the building of a railroad to the Pacific. Federal corporations to be named the Union Pacific and Central Pacific were authorized to build and operate the roads. Large inducements were offered to the builders of the road, first in 1862, but these were supplemented by another act in 1864. Among the inducements were the full use of the power of the federal government to obtain rights of way: the extinguishment of any Indian titles to land along the route; the availability of armed forces to drive off any trespassing Indians; the power of eminent domain would be exercised to acquire land. In addition large land grants were made, and millions of dollars in bonds.[15] With such privileges in hand, financiers were able to raise much capital for the undertaking.

State bank notes were finally banished once and for all after the passage of the National Bank Act of 1864. This act authorized the formation of national banks, granted them the power to issue bank notes, made them depositories of federal funds, and required them to purchase United States bonds to the extent of one-third of their capital. When banks did not rush to become national banks, Congress levied a 10 per cent tax on state bank notes, and those banks which remained state banks stopped issuing paper money.

Financial Concentration

It should be noted that reserves against both bank notes and deposits had to be kept in specified "reserve cities." So it was that much of the reserves of national banks came to be held in New York City banks.[16] It is worth pointing out, too, that after the war bank note issues were concentrated in the Northeast. They were supposed to be distributed on the basis of population, or at least along those lines. It did not happen that way: New England and the Middle Atlantic states got the lion's share, and the South hardly any at all. As one historian pointed out, "The little state of Connecticut had more national bank circulation than Michigan, Wisconsin, Iowa, Minnesota, Kansas, Missouri, Kentucky and Tennessee."[17]

Much of the liquid wealth in the

country was bound up with, tied to, and dependent on the national government in the course of the war and its aftermath. This came about mainly by way of the financing of the war. The National Bank Act was, in part, a device for financing a part of the cost of the war initially. The requirement that banks buy bonds served that purpose, and the bank notes augmented the money supply. Taxes were more widely levied during the war than had ever been the case under the Constitution. An income tax was even imposed. Mainly, though, the war was financed by the selling of bonds and the issue of Greenbacks. The Greenbacks were not quite fiat money, for they did carry a promise of eventual redemption, though no time was specified. They were made legal tender both for the payment of government obligations, except interest on bonds, and for taxes to the United States. The largest portion of the cost of the war was paid for by the sale of bonds.

Another way to look at it is that a great concentration of wealth, hence, of potential capital, took place during the war. The instrument for this concentration was the federal government. The concentration was accomplished in two ways during the course of the war: by taxation and by promises to pay in the future. The national bank notes, the Greenbacks, and government bonds were promises to pay, or debt, and the concentration took place by way of the wealth they drew into the treasury at the time.

Government Distorts the Economy

This concentration had two major impacts on the accumulation and concentration of private capital. In the first place, it was paid out by the government for goods and services, for ships, for munitions, for army and navy supplies, for salaries and bonuses, and such like. Government contracts for supplies brought profits, and, when they were saved, future capital for industrialists. For example, in meat packing, one historian says: "It was no accident that the men who obtained Civil War government contracts—Jacob Dold, Philip D. Armour, Nelson Morris—were to emerge by 1865 . . . as the packers of modern-day capitalist enterprise."[18]

The other major impact occurred as the debts were paid and the currency redeemed. Unlike what has happened since World War II, the government did not long continue most of its inflationary war practices. It moved toward retirement of the bonded indebtedness as the bonds matured. Eventually it redeemed, or offered to redeem, the Greenbacks in specie. National bank notes in circulation were reduced or retired as the government reduced its debt. Since the bonds had floated in the market and the Greenbacks depreciated after they were issued, it was possible to trade in these for profit. Since interest on the bonds was always payable in specie, exceedingly good returns were possible by buying them at discount and collecting interest in premium money. There were widespread accusations, too, in the decades after the war that government bonds had been bought with 50-cent dollars and paid back with 100-cent dollars. There was some substance to the charge, but my point is that handsome private accumulations of capital could be had at the expense of taxpayers generally in this situation.

Since it is easy to misinterpret these events, and since it has been done often enough, let me restate the broad point I am making and summarize what has been presented so as to bring it as directly as possible to bear on that point. The conception I am working with is that when government intervenes in the economy it produces distortions and may have determinative impact on the direction of economic development. Further, my broad point is that a sectional party, the Republican party, came to power at the time of the Civil War, that it centralized power in the national government, and used that power to intervene in the economy so as to promote a nationally integrated economy, especially by the promotion of capital concentration, manufacturing, and the development of transportation. The developments which followed in the latter part of the nineteenth century were shot through with the impact of government intervention.

The Destruction of Wealth

The most drastic intervention, of course, was the destruction of a large portion of the wealth of the South. The emancipation of the slaves—surely, a desirable outcome—was accomplished in the most disruptive and vindictive manner conceivable, and the canceling of all debts left many Southerners in financial ruin. The protective tariffs were the most direct sort of intervention, aimed at discouraging foreign trade and promoting domestic manufactures and goods. The government commenced a policy of large grants for the promotion of transportation. The interventions in the money supply were multiple: fostering national banks, giving precedence to their bank notes, stopping redemption in specie during the war, issuing Greenbacks, and gaining national control of the money supply. It was this surreptitious financing of the war rather than the later redemptions that was the intervention and the source of the ills.

It was these and other interventions that contributed so heavily to the ills most historians have identified in the latter part of the nineteenth century: the greatly accelerated, hasty and shoddy railroad building, the lopsided thrust to industrialization, the financial shenanigans, the surge of farmers into Western lands that could not support them, and the booms and busts that followed upon expansions and reductions of the money supply. Economic freedom does no more than provide opportunities; government intervention thrusts economic development along political lines that are dangerous to the well-being of the populace.

—FOOTNOTES—

[1]Vernon L. Parrington, *The Beginnings of Critical Realism in America:* 1860–1920 (New York: Harcourt, Brace and World, 1930), p. 17. Emphasis added.

[2]Clarence H. Cramer, *American Enterprise: Free and Not So Free* (Boston: Little, Brown and Co., 1972), p. 145.

[3]*Ibid.*, p. 159.

[4]See Bray Hammond, "Banking in the Early West: Monopoly, Prohibition, and Laissez Faire" in Thomas C. Cochran and Thomas B. Brewer, *Views of American Economic Growth,* vol. I (New York: McGraw-Hill, 1966), pp. 171–88.

[5]Quoted in Louis M. Hacker, *The Triumph of American Capitalism* (New York: Columbia University Press, 1947), pp. 333–34.

[6]Thomas C. Cochran, "Business Organization and the Development of an Industrial Discipline" in Cochran and Brewer, *op. cit.*, p. 227.

[7]Thomas C. Cochran and William Miller, *The Age of Enterprise* (New York: Harper & Row, 1961), pp. 48–49.

[8]Cochran, "Business Organization," *op. cit.*, p. 218.

[9]Hacker, *op. cit.*, pp. 315–16.

[10]Quoted in James F. Rhodes, *History of the United States,* vol. II (New York: Harper & Brothers, 1893), p. 464.

[11]Quoted in Hacker, *op. cit.*, p. 338.

[12]Wilbur J. Cash, *The Mind of the South* (Garden City, N. Y.: Doubleday Anchor Books, 1954), p. 113.

[13]J. G. Randall and David Donald, *The Civil War and Reconstruction* (Boston: D. C. Heath, 1961, 2nd ed.), p. 287.

[14]*Ibid.*

[15]*Ibid.*, pp. 288–89.

[16]*Ibid.*, p. 351.

[17]Quoted in *ibid.*, p. 352.

[18]Hacker, *op. cit.*, pp. 256–57.

IDEAS ON LIBERTY

Causes of War

REFERENCE to the just and unjust causes of war can be particularly valuable when we try to expose the fallacy in what is perhaps the "liberals'" most persuasive contention: that the programs of the welfare state aim to help those who are really in need of great help. They usually do not deny that the "social gains" they are seeking are attainable only if the money of some is forcibly seized and granted to others. They do deny that any impropriety is involved in the process; on the contrary, they proudly announce, the welfare state merely enforces the undoubted axiom that one man's need has precedence over another man's luxury.

CRAIG HOWELL, "Aggression Is Always Wrong"

John Montgomery

ADAM SMITH'S ECONOMICS OF FREEDOM

THE REPUTATION of Adam Smith's *The Wealth of Nations* has survived its bicentennial, which is not always the case with anniversaries of weighty scientific or literary works. But Smith's portrayal of the free-market economy remains the centerpiece of economic theory, often challenged but never replaced. And, even after the passage of more than two centuries, it clearly speaks to the economic dilemma of today.

To start with one misconception, economics did not begin with the great 18th-century Scotsman, Adam Smith. Economic thought can be traced back through St. Thomas Aquinas all the way to Aristotle. Nor was Smith the first economist. In his time there was a group of theorists in France which anticipated some of his ideas. They are now known as the Physiocrats, except that they called themselves *economistes*. In England at the time many pamphlets, tracts and books on economic questions were being written by businessmen, bankers and scholars of various sorts. The dominant point of view then, Mercantilism, thought of economics as strategy in the competition among trading nations. This first epoch of the "science" of economics did not begin with Adam Smith; it culminated in him.

What Smith did in the watershed year of 1776 was to come out with a great tome of a thousand pages with the abridged title of *The Wealth of Nations*. In time it was to become a blockbuster in economics and it has been called one of the world's truly great books. What Smith did in the book was to survey all the scattered ideas and writings about economics before him and then assemble them into a coherent whole which, for the first time, compelled the recognition that economics was and deserved to be a single, special field. In Adam Smith political economy, as it was

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known then, was the beginning of modern economic thought.

The complete title of his book was *An Inquiry into the Nature and Causes of the Wealth of Nations,* and that well describes his point of departure. Economic debate in the 18th century focused on the source of national wealth. Was it agriculture, labor or commerce? The answer suggested by the quickening of business activity in England at the time was commerce.

Not Just Precious Metals, But All Items of Commerce

The Mercantilists held that wealth was gold and silver, mostly acquired in foreign trade. But Smith saw it differently: Wealth was the nation's production of the "necessaries, comforts and conveniences of life" or, as he also put it, the "annual produce of the land and the labor of the people." This is what is now called GNP, gross national product. As for the source of this wealth, Smith started with what economists would call a "labor theory of value." For Smith and his followers, and for all Marxists to this day, human labor was the ultimate source of wealth.

Smith pointed out the great increase in human productivity yielded by what he called the "division of labor," that is, the growing practice of splitting up the job of making something into separate tasks assigned to different workers. In effect, he was describing an early stage in the development of mass production and, to illustrate it, he chose the pin factory of his time.

He asserted that ". . . a workman not educated to this business . . . nor acquainted with the machinery employed in it . . . could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty. But in the way in which this business is now carried on . . . One man draws out the wire, another straights it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on, is a peculiar business, to whiten the pins is another; it is even a trade in itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations, which, in some manufactories, are all performed by distinct hands, though in others the same man will sometimes perform two or three of them. I have seen a small manufactory of this kind where ten men only were employed, and where some of them consequently performed two or three distinct operations. But though they were very poor, and therefore but indifferently accommodated with the necessary machinery, they could, when they exerted themselves, make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of a middling size. These ten persons, therefore, could make among them upwards of forty-eight thousand pins in a day."

Thus, Smith made his point about the productivity realized by means of the division of labor—and in a small shop employing ten men at the very beginning of the Industrial Revolution.

Smith went on to describe how the division of labor operated not just in a shop or factory but also in a whole national economy made up of diverse, specializing firms and industries in the different localities and regions, taking advantage of local differences in climate, soil, location, natural resources, the characteristics of the local population: all of those things which can make possible more efficient and lower-cost production of particular goods than can be accomplished elsewhere. And, similarly, Smith described an international division of labor in the production of commodities for foreign trade among the diverse nations and regions of the world.

Economic Growth

From that starting point, Smith went on to describe the system of production of goods in a national economy and outlined what he conceived of as the forces which led to the "progress of opulence," or what today would be called economic growth. He saw the production of material wealth, that is, of goods, as requiring three things: the division of labor, the widening and extension of markets for the goods produced, and increasing "stock," his term for production equipment, machinery and working capital.

In Smith's scheme, it was the accumulation of capital which led to the progress of opulence from an agricultural economy to manufacturing to commerce. The resulting increased output of food and other goods necessary to life permitted the survival of a larger population which, in turn, meant further extension of markets, a larger and more skilled labor force, and further accumulation of capital. In this way he saw the economy spiraling to higher and higher levels of development, raising the whole social order with it. It was an optimistic, almost buoyant view which was largely justified by the times he lived in but was not to survive its author by very long.

It was Adam Smith's description of how a market economy worked which was the starting point of a complex theoretical system which would become the new "science of economics." His theory of markets would be elaborated and refined by economists throughout the 19th century, and it has remained center stage in the 20th century, at least in the negative sense of growing disagreement and retreat from it after the debacle of theory in the Great Depression. But the theory of markets is too central a part of economics to be quickly set aside, and much of modern economic debate has amounted to repeated attempts to dislodge it in favor of corrective or alternative formulations.

Market Pricing

In effect, Smith conceived of the economy of a nation as one vast whole with immense internal complexity but with interaction and interdependence of internal forces which were self-adjusting and self-regulating. In Smith's scheme the market was not a place but the totality of exchanges—that is, of buying and selling—of the products of all the different occupations and industries in the national economy. At the center of this were prices, constantly changing in accordance with the laws of supply and demand and, in turn, balancing supply and demand not just for goods but for the resources, both human and material, needed to produce them.

As for those resources—land, labor and capital, needed in varying proportions to produce each good—their prices, mediated by supply and demand, directed them to those places and those employments where they would produce the most for the economy and the population as a whole. Of course, money spent by one person is money received by another. So, in Smith's system, those prices were also income: rent for the landlords, wages for laborers, and profits for the capitalists and businessmen. These people, making up the three great classes of the population of Great Britain in his time, divided up the total income generated by the national economy, which amounted to the prices paid for all of the goods and commodities produced—that is, for all the "necessaries, comforts and conveniences" of the people, the sovereign consumers for whom the system operated.

The Role of the Businessman

In Smith's market theory people were not only the beneficiaries but the moving parts of the system: householders, workers, farmers, land owners, manufacturers, merchants and traders, all of them rational economic men (and they were almost solely male at that time) who were free to pursue their own gain, the best return for their own contributions to the economic life of their communities and the country. To Smith, the key to the success of the system was the capitalist businessmen, whom he referred to as "under takers," in the sense that they were the ones who undertook business ventures. For it was the "undertakers" who coordinated the movements and combinations of all the other participants in the economy for their best possible employments under existing conditions.

Smith mistrusted businessmen. In one of the best known passages in his book, he wrote: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." But he gave them credit for being the savers who accumulated capital for new business ventures, without which there would be no economic growth. He wrote that in contrast to the workers, who were forced to spend all they earned on the necessaries, and the idle rich, who squandered their incomes on the comforts and conveniences, the capitalist businessmen put off immediate spending for consumption to some extent and set aside part of their profits for investment in future undertakings, with no guarantee that the capital they risked might not be lost in an unsuccessful venture.

Mobility and Competition

Smith set forth two linked and indispensable conditions to be met if the economic system he described were to work: There must be free movement for all in the system so that each man might seek the best opportunity for his labor or resources. And there must be free competition among all, for the buyer's shilling, for markets, for labor and for jobs. There must be no monopolies or combinations in restraint of trade or limiting entry into new fields, and no government-granted privileges for a favored few. Smith railed at the dense thicket of government regulations and restrictions of his time, which he saw as preventing the fluid and free movement of men and capital throughout the economy that was necessary for prosperity and growth.

Smith sensed an order in the economic universe, not imposed from above but somehow the outcome of the almost infinite number of transactions in the exchange economy. It has been said that the nature of this order was the "mystery" he set out to solve in his book. Instead of government direction of the economy as the source of that order, Smith came up with his famous metaphor of the "invisible hand." It was, he wrote, as though there were an invisible hand directing the efforts of everyone—even though each man was pursuing his own gain—in a way that promoted the interests of society as a whole.

As a man of his time, Smith was a deist, and it was the hand of Providence he meant. It was not that he thought the invisible hand was tugging on puppet strings to guide the economic behavior of each individual. To Smith, the invisible hand was a metaphor for the workings of the market economy in the setting of the institutions of political and economic freedom. It was Providence, he thought, that had endowed mankind with the capacities and propensities which made possible such a society and such a system. Today, what Smith called the invisible hand might be thought of in cybernetic terms as "feedback loops"—for example, as market prices being regulated by negative feedback.

Smith knew, of course, that his ideal of the invisible hand operating in a completely free, purely competitive market economy was never a very realistic picture of an economy in the real world. But he contended that the more nearly the ideal was realized, the better the economy would work. And it was that ideal which was the unifying concept he applied to the wilderness of economic phenomena to reveal an underlying order.

A Self-Regulating Arrangement

By now the idea of the self-regulating economy is a familiar one, whether accepted or not. And many of the elements contained in the idea had been described before Smith put them all together. But how did he come up with the whole "vision" and where did he get it from? In effect, it was already at hand, in the climate of opinion and generally held ideas of that time—although in a different context.

In Smith's time the burgeoning commercial society of England was beginning to generate the Industrial Revolution, that great outburst of inventions which meant the end of the old system of hand-crafted production and ushered in the modern age of mass production in factories equipped with power-driven machinery. England was harnessing water power and steam. Soon to come were the giant textile mills in the north of England where uprooted country people, and their children, tended looms which disgorged immense quantities of cotton cloth for new world markets. In its "satanic mills," capitalism was to produce enormous quantities of goods and amass hitherto unattainable wealth—as well as great fortunes for a few.

It was this great national wealth which, in effect, bought and paid for the British Empire, financing the Royal Navy, the troops and the colonial administrations which would rule one-third of the world. But there was a vital question posed by capitalism, although the word was not yet then in currency. How was this incredible machine to be controlled? It was showing signs of becoming a juggernaut.

Smith had been professor of "moral philosophy" at Glasgow University in Scotland. Economics or, rather, political economy as it was known at the time, was still a branch of moral philosophy, which corresponded to the social sciences of today. Besides moral philosophy there was natural philosophy, the physical sciences.

The "Age of Enlightenment"

Eighteenth-century philosophers, in the "Age of Enlightenment," believed they were beginning to make sense of the world in the light of scientific thought, which had erupted in the century that preceded them. In the 17th century Isaac Newton's theoretical physics with its concept of the physical universe as a mechanical system and its theory of the "natural laws" of the movements of the heavenly bodies had seemed to show a harmony in nature, a cosmos with all its parts reliably performing their appropriate functions in the over-all smooth working of the whole.

Inspired by that concept, the men of the Enlightenment believed there were also natural laws governing man's behavior. The social and moral sciences of that time were finding in the world of man the possibility of a similar, harmonious human-social cosmos, a world of free individuals pursuing the satisfaction of their natural desires and in so doing acting in ways that would fit into an orderly system of natural social processes.

But, outside of the libraries and studies of the scholars of that time, there was change, ferment and disorder all around. The iron constraints of medieval society had long since given way, and the Protestant Reformation had rejected the absolute authority over the individual of God's church. The people were beginning to ask questions about their lot; there was a growing clamor for personal liberties and a chance to get in on the new opportunities to make money. The social philosophers of the 17th century were forced to confront some less than theoretical questions: How does social order emerge from the potential chaos of an individualistic society? Is there a natural social order? What should be the role of government?

By Adam Smith's time in the 18th century these questions had brought an answer: a theory of liberal democracy which was believed to rest on natural law like the laws of the physical world. The theory harked back to the philosopher John Locke in the previous century and, along with many others, was advanced in Smith's time by his close friend and fellow Scottish philosopher, David Hume.

According to the theory, each individual was a part of nature and therefore was endowed with "natural" rights: to life, liberty and property. Further, he was endowed with God-given capacities and propensities which would flower in a society that served the best interests of all. To realize that society, a political system of the rule of law rather than of a few powerful men was required. The laws would provide even-handed justice, personal freedoms, minimal government, private property, the sanctity of private contracts, economic freedoms, and free trade, both domestic and foreign. In the kind of society made possible by such laws, free men would both compete with and cooperate with each other, exercising their rights to pursue their own visions and, at the same time, respecting the rights of others.

Classical Liberalism

This doctrine of classical liberalism was patterned after Newton's concept of the physical universe as a mechanical system embodying "natural laws"; the doctrine amounted to a similar vision, that of a human-social system also embodying natural laws. And, in much the same way, what Smith did in his theory of a liberal economy was to pattern it, too, after Newton's system, using quasi-gravitational mechanics to explain the workings of a self-regulating market economy. What made it possible for Smith to do this was his encyclopedic knowledge of economic history and his authoritative mastery of the economic life of his own time, which he described in realistic and convincing detail.

Classical liberalism provided the vision for political and social reforms in England for two centuries. By the 20th century that time had largely passed in England and in the rest of Europe where intellectuals and social reformers were convinced by Marx's dissection of capitalism and excited by the utopian spell of socialism. But the Founding Fathers of this country were very much men of the Enlightenment and it was the ideas of classical liberalism as expressed in the Declaration of Independence and the Constitution that gave shape to the American republic and have been the foundation of our liberties ever since.

On publication, Adam Smith's great tome was well received by his fellow scholars both in Britain and abroad. But government, understandably, was in no hurry to take its advice, with one notable exception: The younger Pitt, to become George the Third's prime minister, was deeply influenced by the book as a student and would be the first English statesman to be converted to the doctrine of free trade.

Smith's death in 1790 attracted little notice. But the influence of his book continued to grow. By the time another 20 years had passed, his readers had become his followers and successors, and had established him as the father of classical economics. His book routed the Mercantilist ideas that had prevailed in his lifetime and for a while virtually blotted out the memory of those who had come before him.

William Henry Chamberlin

Some Mistakes of Marx

"The evil that men do lives after them." This maxim applies with singular force to the work of Karl Marx. The life of this apostle of socialism, communism, and class war was spent, for the most part, in obscure and sometimes squalid poverty. Marx was unable to make even a humble living as a writer and journalist; he had no other trade or profession. He would probably have had to go on poor relief, in his time less generous in England than it is now, if it had not been for handouts from his disciple and collaborator, Friedrich Engels, who enjoyed the advantage of having a successful capitalist father.

Marx's record of political achievement at the time of his death seemed quite sterile. Because, in a moment of bravado, he renounced Prussian citizenship, he was unable to go to Germany or take any intimate part in the German socialist movement. He played no role in English politics.

To put it mildly, Marx was not a mellow or lovable character. His habits of excommunicating from the socialist movement everyone who disagreed with him kept his circle of friends very limited.

There is an abundance of historical evidence for Max Eastman's caustic profile of Marx in *Reflections on the Failure of Socialism:*

> If he ever performed a generous act, it is not to be found in the record. He was a totally undisciplined, vain, slovenly, and egotistical spoiled child. He was ready at the drop of a hat with spiteful hate. He could be devious, disloyal, snobbish, anti-Semitic, anti-Negro. He was by habit a sponge, an intriguer, a tyrannical bigot who would rather wreck his party than see it succeed under another leader.

But if there were few mourners, literally or figuratively, at the grave of Marx the man, the idea of Marxism, the vision of a world in which the proletariat, oppressed by capitalism, was to become the architect of new millennial order, marched from success to success.

Before World War I Marx was revered as the founding father of the socialist parties which had sprung up in most European countries. Because a Russian genius of revolutionary action, Vladimir Ilyitch Lenin, swallowed Marx's ideas whole without conscious reservation, Marxism became the creed of the new communist regime in Russia.

William Henry Chamberlin (1897–1969) was a frequent contributor to *The Freeman.* Author of the *Russian Revolution* and numerous other books and articles on world affairs, he was uniquely qualified to discuss Marxian errors by having lived and traveled where such mistakes are obvious.

It is especially timely to review what Chamberlin reported more than twenty-five years ago to be some of the mistakes of Marx. This article is reprinted from the May 1956 *Freeman.*

This regime, which has never wavered in its belief that someday its power will encompass the entire world, represents a revolt against all the values of Western civilization, against religion and the moral law, against civil and personal liberties, against the right to own property, which is one of the first and most indispensable of human liberties. After World War II communism, the offspring of Marxist teaching, extended its dominion over China, over the countries of Eastern Europe, so that today [1956] it has been imposed as a dogmatic faith on more than one third of the population of the world.

And the influence of Marx is by no means restricted to nations under communist rule. The appeal of Marxian ideas to European socialists, to the half-baked intellectuals of newly emancipated countries in Asia has been considerable. And, although the number of persons who can honestly claim to have read through with comprehension the dry and abstruse *Capital* must be small, the simplified version of Marxist theory presented in *The Communist Manifesto* and elsewhere possesses strong psychological appeal.

Marx Sets the Proletariat Against the Bourgeoisie

Marx professed to know all the answers, to offer a complete explanation of human activity on the basis of historic materialism. In the Marxian scheme there is a hero, the proletariat, a villain, the bourgeoisie; and the hero is represented as a certain ultimate winner. There is a vision of revolutionary victory that will transform the conditions of human existence and usher in a millennium, of the nature of which, to be sure, Marx offers few and vague hints. To trusting minds which accept Marx's premises and assumptions without question there comes an intoxicating sense of being in step with history, of professing a creed that is based on infallible science.

But it is just this myth of infallibility that is the Achilles' Heel of Marx as a thinker, of Marxism as a system. An examination of the works of Marx and his collaborator Engels reveals ten big mistakes, of which some are so fundamental that they completely discredit, as a preview of the future, the whole superstructure of faith in capitalist misery and doom, and socialist prosperity and triumph, which Marx laboriously reared on a foundation of Hegelian metaphysics and minute research in government reports on the seamy sides of early British capitalism. These mistakes are as follows:

(1) *The doom of capitalism is assured because under its operation the rich will become richer and fewer; the poor will become poorer and more numerous.* To quote one of the more striking rhetorical passages in *Capital:*

> While there is a progressive diminution in the number of the capitalist magnates, there occurs a corresponding increase in the mass of poverty, oppression, enslavement, degeneration and exploitation. But at the same time there is a steady intensification of the wrath of the working class—a class which grows ever more numerous and is disciplined, unified and organized by the very mechanism of the capitalist method of production. Capitalist monopoly becomes a fetter upon the method of production which has flourished with it and under it. The centralization of the means of production and the socialization of labor reach a point where they prove incompatible with their capitalist husk. This bursts asunder. The knell of capitalist private property sounds. The expropriators are expropriated.

These are resounding words, but utterly empty words, in view of the fact that social and economic development in capitalist countries has proceeded along a precisely opposite direction from the one predicted by Marx. What was in Marx's time a social pyramid has become more like a cube. The capitalist system has brought to the working class not increasing "oppression, enslavement, degeneration and exploitation," but an increasing share of new inventions and comforts that did not even exist for the wealthy a hundred years ago: automobiles, radios, television sets, washing machines, as well as money in the bank, stocks, and bonds.

(2) *Socialism can only come about when capitalism has exhausted its possibilities of development.* Or, as Marx puts it in his *Critique of Political Economy:*

> No form of society declines before it has developed all the forces of production in accordance with its own stage of development.

But, of the three countries which,

according to Marx, were ripest for the transition to socialism, as most industrially developed, the United States is still, by and large, the freest economically.

The larger free part of Germany, after the terrific shock of the war, has achieved a remarkable recovery by shedding Nazi and Allied controls and resorting to old-fashioned individualistic incentives. Great Britain has settled for a kind of socialistic New Deal, without violence or outright expropriation and well short of Marx's "dictatorship of the proletariat."

On the other hand, the countries where violent revolutions were carried out in the name of Marx, the Soviet Union and China, were, on Marx's own theory, completely unripe for socialism. Capitalism was in a fairly early stage of development in Russia. Much of China lived in precapitalist conditions. Experience has shown that, in precise contradiction of Marxist dogma, capitalism is harder to overthrow as it strikes deeper roots and shows what it can accomplish. A plausible case can be made out for the proposition that, although political and economic change would have come to Russia, there would have been no communist revolution if World War I had been avoided and Stolypin's policy of breaking up the old peasant communes and giving the peasant more sense of individual property had developed long enough to yield results.

(3) *The "dictatorship of the proletariat" is a just and feasible form of government.* This is based on two false assumptions: that the "proletariat," or industrial working class, has some kind of divine right to rule and that governing power can be directly exercised by this group of the population. Both are wrong. Marx never clearly explained why the proletariat, for which he foresaw increasing poverty and degradation, would be qualified to rule. And Soviet experience and Red Chinese experience offer the clearest proofs that dictatorships of the proletariat, in theory, become ruthless dictatorship over the proletariat, in practice. Absolute power in communist states is exercised not by workers in factories, but by bureaucrats, of whom some have never done any manual work; others have long ceased to do any.

(4) *Under socialism the state will "wither away."* This grows out of Marx's belief that the state is an instrument for the suppression of one class by another. In the classless society of socialism, therefore, there will be no need for the state.

Events have played havoc with this theory. Nowhere is the state more powerful, more arbitrary, more of a universal policeman, snooper, and interventionist than in the Soviet Union. Yet it is here that the new regime has abolished private property in means of production, thereby, according to Marx, inaugurating a classless society. One is left to choose between two alternative conclusions. Either the Marxist theory of the state as an instrument of class rule is a humbug or the kind of class rule that prevails in the Soviet Union must be uncommonly crude and ruthless.

(5) *Capitalism (in the nineteenth century) has exhausted its productive possibilities.* This flat statement is made by Marx's *alter ego,* Engels, in his *Anti-Dühring,* written before the internal-combustion engine, X-rays, aviation, synthetic chemistry, and a host of other enormously important additions to the productive process, brought into existence by the stimulus of capitalism.

(6) *All ideas, all forms of intellectual and artistic expression are a mere reflection of the material interests of the class in power.* This conception is expressed repeatedly in Marx's writings, notably in *German Ideology,* where he writes: "The class which has the dominant *material* power in society is at the same time the dominant *spiritual* power. . . . The dominant ideas are nothing but the ideal expression of material conditions." One of the few wisecracks associated with the name of Marx is that the Church of England would rather give up all its Thirty-Nine Articles of Faith than one thirty-ninth of its possessions.

The historical record shows that this interpretation of human conduct is crudely one-sided and inaccurate. Men die far more often for ideas than for material interests. The communist victory in Russia was not due to the fact that material conditions for the masses became better after the Bolshevik Revolution. This was emphatically not the case. What did happen was that the organized, disciplined, communist minority acquired an iron grip on the masses by its double weapon of propaganda and terror, kept passions of class hatred and class envy at the boiling point, whipped laggards into line by ruthless regimentation, and thereby preserved their regime through years of civil war and famine. Sometimes the materialistic interpretation of history becomes sheer absurdity, as in the case of a Moscow musical announcer, whom I once heard offer the following bit:

> We will now hear Glinka's overture, "Ruslan and Ludmilla." This is a cheerful, buoyant piece of work, because when it was written Russian trade capitalism was expanding and conquering markets in the Near East.

It would seem that, in order to carry any semblance of plausibility, this should have been accompanied by proof that Glinka owned stock in the expanding companies—a highly improbable contingency, if one considers the economic status of Russian musicians.

(7) *Production depends on class antagonism.* To quote Marx, in *The Poverty of Philosophy:*

> From the very moment in which civilization begins, production begins to be based on the antagonism of orders, of states, of classes, and finally on the antagonism between capital and labor. No antagonism, no progress. This is the law which civilization has followed down to our own day.

Like many of Marx's "laws," this is a mere unsupported assertion of a pedantic dogma. No proof is adduced. The greatest human constructive achievements, the cathedrals of the Middle Ages, the great dams and skyscrapers of modern times, are the fruit of cooperation, not of antagonism.

(8) *Nationalism is a negligible force.* Marx and Engels lived in an age of rising national consciousness. Conflicting nationalism was the strongest force that let loose World War I. Yet in all their writings the attitude toward nationalism is one of contemptuous deprecation. As Isaiah Berlin, a fairly sympathetic biographer, writes (*Karl Marx,* p. 188):

> He consistently underestimated the force of rising nationalism; his hatred of all separatism, as of all institutions founded on some purely traditional or emotional basis, blinded him to their actual influence.

(9) *War is a product of capitalism.* This idea has found some acceptance outside the ranks of the Marxist faithful. The temptation to seek an oversimplified scapegoat for war is strong. But while, theoretically, such Marxian motives as struggle for trade, colonies and commercial spheres of influence, might lead to war, there is no serious historical evidence that any major conflict was ever touched off by such considerations. There were differences of economic interest between the industrializing North and the mainly agricultural South before the Civil War. But these could easily have been compromised. What made the fratricidal conflict "irrepressible," in Seward's phrase, were the two big political and moral issues: secession and slavery.

World War I was purely political in origin. There was the clash between Slav nationalism and Austro-Hungarian desire to hold together a multinational empire. A system of tight and almost automatic alliances turned what might have been an Austrian punitive expedition against Serbia into a general war.

World War II was the handiwork

not of any magnates of capitalism, but of a plebeian dictator, Adolf Hitler, pursuing aspirations of conquest and military glory that far antedate the modern capitalist system. The three countries that were best prepared for war were the communist dictatorship in the Soviet Union, the Nazi dictatorship in Germany, the authoritarian military regime in Japan. Capitalism makes for free trade, free markets, limited governmental power, and peace. And the principal war threat today comes from the expansionist urge of communist imperialism.

(10) *The worker is cheated because the employer, instead of paying him the full value of his work, holds out on him profit, interest, and rent.* Or, as Marx himself states his theory of "surplus value" (*Capital,* Modern Library edition, p. 585):

> All surplus value, whatever particular form (profit, interest, or rent) it may subsequently crystalize into, is in substance the materialization of unpaid labor. The secret of the self-expansion of capital resolves itself into having the disposal of a definite quantity of other people's unpaid labor.

It requires little reflection or research to realize that "surplus value," like many other Marxian catch phrases, is a myth. How, under any economic system—capitalist, fascist, socialist, communist—could industry expand and provide more goods and more jobs for more people if capital were not withheld from immediate payment to finance future construction? Perhaps the best refutation of Marx's rabble-rousing myth that surplus value is a peculiar dirty trick of capitalists, practiced against workers, is that the extraction of what might be called surplus value is practiced on a gigantic scale in the Soviet Union through the medium of a sales or turnover tax that often exceeds 100 per cent.

A Classic Failure

It is amazing that, with such a demonstrable record of failure to understand either the world in which he was living or the direction in which that world was going, Marx should be hailed as an unerring prophet. The truth is that there is nothing remotely scientific about Marx's socialism. He started with a set of dogmatic a priori assumptions and then scratched around in the British Museum for facts that would seem to bear out these assumptions. Like the Emperor in the fairy tale, Marxism, for all its ponderous appearances, really has no clothes on when examined in light of realities, in Marx's time and in our own. His supposedly infallible system of interpreting history and life is riddled with mistakes, of which the foregoing ten are only the most obvious and the most glaring.

Enterprise Zones

THE IDEA of establishing Enterprise Zones, small free trade enclaves with special tax concessions, in the slum areas of our decaying central cities, was brought to America by a British economist, Stuart M. Butler, who works for the Heritage Foundation in Washington, D.C. In a generous foreword to his book on the subject, *Enterprise Zones: Greenlining the Inner Cities* (Universe Books, 381 Park Ave. South, New York, NY 10016, 175 pp., $12.95), Mr. Butler credits the concept to the collaborative thinking of Professor Peter Hall, a former President of the socialist Fabian Society, and Sir Geoffrey Howe, a Conservative Member of Parliament.

For a Fabian "planner" to take part in advocating the creation of miniature Hong Kongs and Singapores in British cities that are more or less dominated by interventionist trade unions may seem passing strange. The British Trades Union Congress doesn't like Professor Hall's defection at all—it has predicted that "rogue employers" would capitalize on special tax concessions in Glasgow, Liverpool, Manchester and the Isle of Dogs docking area in London to reproduce Hong Kong's "horrors." But Hall is willing to take a calculated risk: "unorthodox ideas," he says, are sometimes called for. As for Sir Geoffrey Howe, the Conservative, he doesn't regard the Enterprise Zone idea as any risk at all.

Stuart Butler, while he remains fearful that the British will mess up a good idea, thinks the Enterprise Zone is just the thing for America. He has a thorough grasp of what has happened to change demographic patterns in this country. Our northeastern and Great Lakes cities have suffered as industries and people have moved to the Sun Belt. Skilled and educated people, in search of more pleasant life styles, have emigrated to the suburbs. Port areas and railheads, while still important, cannot compete with interstate highways as a locale for new businesses. Fate has singled out special cities for special blows—Buffalo was by-passed by the opening of the St. Lawrence Seaway, and Detroit is suffering from being a one-industry town that has lost much of its automobile market to the Japanese.

Urban Blight

Our political efforts to halt urban decay have been markedly unsuccessful. The zoning that eliminates small shops from public housing areas has deprived city blocks of the variety needed to keep them alive. As Jane Jacobs has pointed out, crime doesn't flourish in mixed neighborhoods, where there are always watchful people on the streets and porches. But when "planning" segregates shopping and residential areas, the mugger and the rapist flourish. And when rent control is piled on top of everything, the whole housing picture deteriorates. Landlords can't afford to improve slum properties, and new builders are discouraged.

To end the blight, Mr. Butler suggests that municipal, state and federal governments get together to allow islands of free competition to grow in such places as New York City's South Bronx. A general package of federal tax and regulatory concessions (suspension of the minimum wage, modifications of Social Security and the like) would be offered provided the city agreed on matching concessions of its own. The tax concessions would combine with the plentiful existence of old buildings to lure small enterprises to semi-abandoned areas. There would be employment for local people, and the welfare rolls would shrink.

On paper, the Enterprise Zone theory sounds good. In England, bigger companies have shown more interest in it than small innovative firms. The danger is that a big established company would be interested in shifting its location to an Enterprise Zone just to get away from taxes it has been paying elsewhere. This would not result in any net increase in employment. Mr. Butler doesn't think this sort of thing would necessarily happen in America, where there are plenty of inexpensive "make-do" old buildings still standing in slums where new ideas could be hatched without raising capital for construction costs. New businesses need old edifices, says Mr. Butler. Tax incentives could be geared to favor new small companies over mature companies that would merely be trying to relocate.

Jack Kemp Espouses

Congressman Jack Kemp was quick to catch on to the Enterprise Zone idea. Significantly, he comes from the Buffalo region of New York State, which has lost its importance as a grain terminal now that ships sail past it to the Atlantic by way of the St. Lawrence Seaway. Kemp is a Republican, but he found no difficulty in getting a Democrat, Congressman Robert Garcia of the Bronx, to join him in introducing an Enterprise Zone bill that has had the favorable attention of the White House.

The Kemp support of the Enterprise Zone concept is attended with a bit of irony. For Kemp, more than anyone else in Congress, is committed to the idea that the whole United States should be one large Enterprise Zone. Kemp has thought of the 5-10-10 Kemp-Roth tax cuts as a mere beginning. If the annual income tax of thousands of businessmen could be made sufficiently low to leave them with something tangible to put into expanding their companies, the Enterprise Zone would not be able to compete with the rest of the country in job-making.

It could be, of course, that Jack Kemp, as an old professional quarterback, knows the value of having alternative game plans. His advocacy of a return to the gold standard indicates that he doesn't believe tax cuts in themselves will solve our problems. The Enterprise Zone, with Kemp, could be a stop-gap proposition.

The trouble is that it is the sort of idea that Congress, with more pressing problems on its mind (not to mention the imminence of coming elections), can find very little time to debate. The big picture seemingly calls for an eternity spent on fighting over budget cuts and the need for displaying "compassion." The talk is always of orphans and indigent old ladies who might suffer if a tax rate is changed and an "entitlement" cut. There is no attempt to look at things in dynamic terms. If Congress could hurry up and enact the legislation needed to create an Enterprise Zone in the South Bronx, Newark or Detroit, the need to worry about "safety nets" and "entitlements" could diminish.

Maybe the Enterprise Zone idea would come to little anyway. But it would be good to test the virtues which Stuart Butler claims for it. If it were to succeed even in one little area, it would stand as an example for the whole country. The whole nation would be that much closer to becoming one big Hong Kong.