

# Marxism Unmasked:



From Delusion to Destruction



LUDWIG VON MISES

# Marxism Unmasked:

From Delusion to Destruction

BY LUDWIG VON MISES



With an Introduction by Richard M. Ebeling

*Lecture Transcriptions by Bettina Bien Greaves*

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The lectures by Ludwig von Mises contained in *Marxism Unmasked* were delivered at the San Francisco Public Library, June 23–July 3, 1952, under the sponsorship of *The Freeman* magazine. They were taken down, word for word, in shorthand and transcribed by Mrs. Bettina Bien Greaves. She has very kindly made these lectures available to the Foundation for Economic Education for publication. Mrs. Greaves worked as a senior staff member at FEE for practically 50 years, only retiring in 1999. Along with her late husband, Percy L. Greaves, Jr., she was a long-time friend and associate of Ludwig von Mises. Indeed, there are few people in the world today who are as conversant with Mises's ideas and writings as she.

The publication of these lectures has been made possible through the kind and generous continuing support of Mr. Sheldon Rose of Farmington Hills, Michigan, and the Richard E. Fox Foundation of Pittsburgh, Pennsylvania. Special thanks are due to Mr. Michael Pivarnik, Executive Director of the Fox Foundation, for his dedicated interest in the ideas of the Austrian School of Economics and Ludwig von Mises in particular.

Mrs. Beth Hoffman, managing editor of FEE's monthly magazine, *The Freeman*, has once again overseen the entire preparation of the manuscript. Her eye for detail in all things is reflected in the fine final product.

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## INTRODUCTION

by Richard M. Ebeling

AUSTRIAN ECONOMIST LUDWIG VON MISES delivered these nine lectures, which we have titled *Marxism Unmasked*, from June 23 to July 3, 1952, in San Francisco at a seminar sponsored by *The Freeman*. A history teacher who received a scholarship to attend the program later wrote to the magazine to say:

The lectures themselves I found provocative, stimulating and highly rewarding. As a classic exposition of the virtues of individualism and the evils of socialism, buttressed with an impressive array of scholarship, they were unmatched. . . . I am not trying to say that I became converted completely to the set of ideas that Dr. Mises and the *Freeman* represent. But I do say that any student or teacher of the social sciences who fails to think deeply on these ideas is negligent and ill-informed, if not worse. This feeling the seminar did leave me with. Certainly I personally appreciate some of these ideas far more than I did a month ago.<sup>1</sup>

It is worth recalling the state of the world in 1952 when Ludwig von Mises gave these lectures. Everywhere around the globe Soviet socialism seemed to be on the march. World War II had left all of Eastern Europe in the grip of the Soviet Union. In 1949, mainland China had fallen under the control of Mao Zedong's communist armies. In June of 1950 the Korean War had broken out, and in 1952 American armies under the UN flag were in a bloody stalemate along the 38th parallel against the forces of North Korea and Communist China. The French were immersed in a

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<sup>1</sup> Letter from Robert Miller, "From a History Teacher," *The Freeman* (August 11, 1952), pp. 752, 782.

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seemingly endless colonial conflict in Indochina against Ho Chi Minh's communist guerrilla army.

In the West, large numbers of intellectuals were persuaded that "history" was inescapably on the side of socialism, under the leadership Comrade Stalin in the Kremlin. Communist parties in France and Italy had large memberships, and followed every ideological twist and turn made by Moscow. Even many of those who rejected the brutality of Soviet-style socialism still believed that economic planning was inevitable. A prominent political scientist at the University of Chicago even declared in 1950 that "Planning is coming. Of this there can be no doubt. The only question is whether it will be the democratic planning of a free society, or totalitarian in character."<sup>2</sup>

In both Europe and the United States it was presumed that capitalism, when left unregulated, could only lead to exploitation, misery, and social injustice. Governments on both sides of the Atlantic were introducing ever more stringent interventionist and welfare statist policies meant to ameliorate the supposed cruelty of the market economy. And because of the "emergency" of the Korean War, the U.S. government had further burdened the American people with a comprehensive system of wage and price controls that hampered almost every aspect of economic activity.<sup>3</sup>

The primary source and impetus for the global bias toward socialism were the writings of Karl Marx (1818–1883). He claimed to have discovered the invariant "laws" of human historical development that would lead to the demise of capitalism and the triumph of socialism, followed by a final transition to a blissful, post-scarcity communist world. During the intermediary socialist stage leading to communism, Marx declared, there would be a "revolutionary dictatorship of the proletariat." It would prevent remnants of the old capitalist ruling class from trying to return to power

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2 Charles E. Marriam, "The Place of Planning," in Seymour E. Harris, ed., *Saving American Capitalism* (New York: Alfred A. Knopf, 1950), p. 161.

3 On the importance of a free-market pricing system even during a time of war emergency, see Ludwig von Mises, *Human Action: A Treatise on Economics* (New York: Foundation for Economic Education, 4th revised ed., 1996), pp. 825–28; also, F. A. Hayek, "Prices versus Rationing" and "The Economy of Capital" [1939] in Bruce Caldwell, ed., *The Collected Works of F. A. Hayek*, Vol. X: *Socialism and War* (Chicago: University of Chicago Press, 1997), pp. 151–60.

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and would “reeducate” the workers into a “higher consciousness” free from the residues of the prior bourgeois mentality.<sup>4</sup>

What makes this entire process inescapable and irreversible, Marx insisted, is that the physical means of production follow technological transformations in a series of historical stages that are beyond man’s control. Each of these stages of transformation requires a particular set of human institutional relationships for the full blossoming of that technology’s potential. What men, in their limited and subjective views of the world, take to be the invariant foundations of human life—morality, family, property, religious faith, customs and traditions, and so on—are merely the temporary elements of a societal “superstructure” serving the ends of the objective material forces of production during each of these historical epochs. Therefore, even man’s “consciousness” about himself and the world around him is a product of his particular place and role in this process of historical evolution.<sup>5</sup>

Every man’s “class” position in society, according to Marx, is determined by his relationship to the ownership of the means of production. Those who own the means of production in capitalist society must, by historical necessity, “exploit” the others who offer their labor services to them for hire. The capitalist class lives off the labor of the working class by expropriating as “profit” a part of what the laborers in their employ have produced. Hence, these two social classes are in irreconcilable conflict with each other for the material rewards of human labor. This conflict reaches its climax with the violent overthrow of the exploiters by the proletariat, who experience an increasing economic misery during the final death throes of the capitalist system.<sup>6</sup>

In the new socialist order that replaces capitalism, the means of production will be nationalized and centrally planned for the economic betterment of the vast majority of humanity, and no longer will be used only for the profit-oriented benefit of the capitalist property owners. Economic planning will generate material prosperity far exceeding anything experienced under capitalism; technological advances and rising

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4 See Karl Marx, “Critique of the Gotha Program” [1875], in Robert C. Tucker, ed., *The Marx-Engels Reader* (New York: W.W. Norton, 1972), pp. 382–98.

5 Karl Marx, “A Contribution to the Critique of Political Economy” [1859], in *ibid.*, pp. 4–5.

6 Karl Marx and Frederick Engels, “Manifesto of the Communist Party” [1848] in *ibid.*, pp. 331–62.

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production will not only eliminate poverty but also push society to a level of material abundance at which all physical wants and worries will be a thing of the past. This final stage of communism will create a paradise on earth for all mankind.<sup>7</sup>

### *Ludwig von Mises as Critic of Socialism*

There were many critics of socialism and Marxism in the nineteenth and early twentieth centuries. One of the most outstanding was the French economist Paul Leroy-Beaulieu, who in 1885 penned an extremely insightful and devastating analysis of collectivism, addressing its dangers to both personal liberty and economic prosperity.<sup>8</sup> In 1896 one of Ludwig von Mises's own professors at the University of Vienna, the internationally renowned Austrian economist Eugen von Böhm-Bawerk, published the most damaging critique of Marx's labor theory of value and the accompanying idea of exploitation of labor under capitalism.<sup>9</sup> There were even highly effective anti-utopian novels that depicted the disastrous effects to be expected if a socialist regime were to come to power and impose central planning on society.<sup>10</sup>

But none of these writers was as penetrating in demonstrating the inherent unworkability of a system of socialist central planning as Ludwig von Mises. During World War I and its immediate aftermath there was an enthusiastic confidence that the age of government planning had finally arrived. The wartime price and wage controls and production planning boards imposed in virtually all the belligerent nations were considered by many the precursors of continued peacetime planning. Following the

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7 On the appeal of paternalism, planning, and paradise on earth over the centuries, see Alexander Gray, *The Socialist Tradition: Moses to Lenin* [1946] (New York: Harper & Row, 1968); and Igor Shafarevich, *The Socialist Phenomenon* [1975] (New York: Harper & Row, 1980).

8 Paul Leroy-Beaulieu, *Collectivism* [1885] (London: John Murray, 1908); on Leroy-Beaulieu and other early critics of socialist economic planning, see Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom* (Northampton, Mass.: Edward Elgar, 2003), Chapter 4: "Economic Calculation Under Socialism: Ludwig von Mises and His Predecessors," pp. 101–35.

9 Eugen von Böhm-Bawerk, "Karl Marx and the Close of His System" [1896] in *Shorter Classics of Eugen von Böhm-Bawerk* (South Holland, Ill.: Libertarian Press, 1962), pp. 201–302; see also H.W. B. Joseph, *The Labor Theory of Value in Karl Marx* (London: Oxford University Press, 1923).

10 Eugene Richter, *Pictures of the Socialistic Future* [1893] (London: Swan Sonnenschein, 1907).

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Bolshevik Revolution in Russia in 1917, Lenin's Marxist regime imposed "war communism" in 1918, heralding it not only as an emergency device to fight the anti-communist White armies during the three-year civil war in Russia, but also as the great leap into the fully planned society. And following the end of the war in November 1918, new Social Democratic Party governments in Germany and Austria declared that the time for "socialization" and economic planning had finally arrived.<sup>11</sup>

In 1919, at a meeting of the Austrian Economic Society, Mises delivered a paper on "Economic Calculation in the Socialist Commonwealth," which was published in a leading German-language journal in 1920.<sup>12</sup> He incorporated this article as the centerpiece in a comprehensive treatise on collectivism that he published two years later in 1922, titled *Socialism: An Economic and Sociological Analysis* in its English translation.<sup>13</sup>

Mises observed that most of the earlier critics of socialism had rightly pointed out that a system of comprehensive government planning of economic affairs would create the worst tyranny ever experienced in human history. With all production, employment, and distribution of output completely under the monopoly control of the State, the fate and fortune of every individual would be at the mercy of the political authority. In addition, these earlier opponents of socialism had cogently argued that with the end of private property and freedom of enterprise, individuals would lose much of the self-interested motivation for industry, innovation, and work effort that exists in a market economy.

But, Mises said, what had not been thoroughly examined and challenged was whether a socialist economic system was even workable in practice. In other words, would the socialist central planners be able to rationally and efficiently manage the everyday affairs of economic life?

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11 On the failure of these first attempts at nationalization and planning in Russia, Germany, and Austria, see Arthur Shadwell, *The Breakdown of Socialism* (London: Ernest Benn, 1926), pp. 23–131.

12 Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth" [1920] in F. A. Hayek, ed., *Collectivist Economic Planning: Critical Studies on the Problem of Socialism* (London: George Routledge, 1935), pp. 87–130; reprinted in Israel M. Kirzner, ed., *Classics in Austrian Economics: A Sampling in the History of a Tradition*, Vol. III (London: William Pickering, 1994), pp. 3–30.

13 Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (Indianapolis: Liberty Classics [1922; English trans., 1936, revised ed., 1953], 1981); Mises later restated and refined his critique of socialist central planning in *Human Action: A Treatise on Economics* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education [1949; revised eds., 1963, 1966] 1996), pp. 200–31, 689–715.

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His answer was no. In the market economy production is guided by the expected consumer demand of the buying public. Businessmen and entrepreneurs, in the quest to earn profits and avoid losses, must direct the resources at their disposal in a way that minimizes their costs of production relative to the expected revenues from supplying goods and services that consumers want to purchase.

Money prices for both finished consumer goods and the means of production facilitate the process. The prices for consumer goods tell entrepreneurs what consumers want. The prices for the means of production—land, labor, and capital—tell them the costs of producing those goods with different types of resources and raw materials in different combinations. The entrepreneur’s task is to select that resource “mix” that minimizes the expense of bringing goods to market in the quantities and qualities demanded by consumers.

The price attached to any one of those resources (whether it be land, labor, or capital) reflects its value in alternative uses, as represented by the competing bids to purchase or hire it by rival entrepreneurs who also seek to employ it for some production purpose in the market. Unless the expected price for the finished good is able to cover the costs necessary to employ a variety of resources to produce it, it is uneconomical—wasteful—to devote those resources for its manufacture. As Mises later explained in his book on *Bureaucracy*, “To the entrepreneur of capitalist society a factor of production through its price sends out a warning: Don’t touch me, I am earmarked for the satisfaction of another, more urgent need” of the consuming public.<sup>14</sup>

This means that the price system of a competitive free market tends to assure that the scarce resources of society are allocated and used in a way that best reflects the wants and desires of all of us in our roles as consumers. Since one of the inescapable elements of the world in which we live is constant change, every shift in consumer demand and every modification in the availability and uses of those scarce resources are reflected in changes in the market structure of relative prices. Such changes in the structure of market prices provide new information to both producers and consumers that they may have to adjust their buying, selling, and production decisions, given the new circumstances.

Mises’s challenge to the socialists was to argue that this “rationality” of the market, which constantly coordinated selling prices with cost-prices,

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14 Ludwig von Mises, *Bureaucracy* (New Haven: Yale University Press, 1944), p. 29.

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and supply with demand, would be totally absent under a system of central planning. Prices emerge out of the buying and selling of the market participants. But buying and selling are only possible with the institution of private property, under which goods and resources are owned, used, and transferred through voluntary exchange at the discretion of the owners.

Furthermore, under capitalism the complex network of market transactions is made possible through the use of a commonly accepted medium of exchange—money. With all goods and resources bought and sold in the market through a medium of exchange, their respective exchange values are all expressed in terms of the same common denominator: their money prices. This common denominator of money prices enables the process of “economic calculation,” i.e., the comparing of relative costs with selling prices.

The primary goal of practically all socialists in the nineteenth century and most of the twentieth century was the abolition of private property, market competition, and money prices. In their place, the State would nationalize the means of production, and as the “trustee” of the interests of the “working class” would centrally plan all of society’s economic activities. The central planning agency would determine what got produced, how and where it was produced, and then distribute the resulting output to the members of the new “workers’ paradise.”

Mises showed that the end of private property would mean the end to economic rationality. Without private ownership of the means of production—and no competitive market upon which rival entrepreneurs could bid for those resources based on their profit-motivated estimates of their respective values in producing goods desired by the consuming public—there would be no way to know real and actual opportunity costs among the potential alternative uses for which they might be applied. How, therefore, would the central planners know whether or not they were misusing and wasting the resources of society in their production decisions? As Mises summarized the dilemma, “It is not an advantage to be ignorant of whether or not what one is doing is a suitable means of attaining the ends sought. A socialist management would be like a man forced to spend his life blindfolded.”<sup>15</sup>

Even if a socialist system were not controlled by brutal dictators but instead by human “angels” who only wanted to do “good” for humanity,

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15 Ibid., p. 30.

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and even if the incentives for work and industry were not reduced or eliminated through the abolition of private property, Mises was able to demonstrate that the very institutional structure of a socialist regime made it impossible for it to produce a material “heaven on earth” for mankind superior to the productive and innovative efficiency of a functioning free-market economy.<sup>16</sup> It is what enabled Mises to declare in the early 1930s, when the appeal of socialist planning around the world was reaching its zenith, that, “From the standpoint of both politics and history, this proof is certainly the most important discovery made by economic theory. . . . It alone will enable future historians to understand how it came about that the victory of the socialist movement did not lead to the creation of the socialist order of society.”<sup>17</sup>

### *Mises’s San Francisco Lectures*

Mises believed that any comprehensive critique of socialism had to deal with more than merely its unworkability as an economic system, however central this was to the case against socialism. It was also necessary to challenge and refute the philosophical and political underpinnings of the socialist and Marxian conceptions of man and society. His 1922 book on *Socialism* attempted to do this in great detail. And he returned to this theme a few years after he delivered these lectures in San Francisco in his work on *Theory and History*.<sup>18</sup>

What Mises offered those attending these lectures in late June and early July of 1952 was a clear understanding and insight into the fundamental errors and misconceptions to be found in Marx’s theories of dialectical materialism and class warfare, as well as a historical analysis of the real benefits from the Industrial Revolution that coincided with the emergence of modern capitalist society. He also explains the role of savings, investment, and the profit and loss system as the engines for economic and cultural progress, and which have helped eliminate the poverty that has plagued mankind through most of history.

In an especially insightful lecture, Mises discusses the nature and workings of capital markets and the importance of market-based interest

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16 See also Richard M. Ebeling, “Why Socialism is ‘Impossible,’” *The Freeman: Ideas on Liberty* (October 2004), pp. 8–12.

17 Ludwig von Mises, “On the Development of the Subjective Theory of Value” [1931] in *Epistemological Problems of Economics* [1933] (New York: New York University Press, 1981), p. 157.

18 Ludwig von Mises, *Theory and History: An Interpretation of Social and Economic Evolution* [1957] (Indianapolis: Liberty Fund, 2005).

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rates free from government manipulation and inflation. In addition, he shows that foreign investment in underdeveloped parts of the world have not been the cause of poverty or exploitation, as socialists have constantly claimed, but the source of accelerated prosperity and human improvement for tens of millions of people in these countries.

All of these arguments and analyses are placed in the wider context of individualism versus collectivism, the importance of freedom for the dignity and betterment of every human being, and the dangers from surrendering liberty and property to the paternalistic state. Through it all, the reader is offered a vision of the classical-liberal ideal of the free and prosperous society.

As with an earlier series of lectures that Ludwig von Mises delivered in 1951, and which was published by FEE under the title *The Free Market and Its Enemies*,<sup>19</sup> a unique quality of *Marxism Unmasked* is that it captures Mises as teacher. Unlike many of his longer, more formal writings, these lectures are peppered with numerous historical asides and common-sense examples that convey the ease and spirit of the spoken word.

These lectures, like the earlier ones, were taken down, word for word, in shorthand and then transcribed by Bettina Bien Greaves, a long-time former senior staff member at the Foundation for Economic Education. Mrs. Greaves is one of the leading experts on the ideas and writings of Ludwig von Mises, and her deep appreciation for his contributions to economic theory and policy is reflected in the care with which she transcribed these lectures for eventual publication. They would not be available now in print if not for her dedication and diligent scholarship, for which we are all especially grateful.

When Mises delivered these lectures Marxian socialism seemed to be conquering the world. Despite the fall of the Berlin Wall in 1989 and the collapse of the Soviet Union in 1991, Marxian criticisms of capitalist society still set the tone for those around the world who persistently hope for the end of human freedom and the market economy.<sup>20</sup> For that reason, what Mises had to say more than 50 years ago still has much meaning for us today.

But now, simply enjoy “listening” to the mind of one of the greatest economists of the twentieth century as you read this book.

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19 Ludwig von Mises, *The Free Market and Its Enemies: Pseudo-Science, Socialism, and Inflation* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 2004).

20 Richard M. Ebeling, “Is the ‘Specter of Communism’ Still Haunting the World?” *Notes from FEE* (March 2006).

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1ST LECTURE

# Mind, Materialism, and the Fate of Man

THE FIRST FIVE LECTURES IN THIS SERIES will be on philosophy, not on economics. Philosophy is important because everybody, whether or not he knows it, has a definite philosophy, and his philosophical ideas guide his actions.

The philosophy of today is that of Karl Marx [1818–1883]. He is the most powerful personality of our age. Karl Marx and the ideas of Karl Marx—ideas which he did not invent, develop, or improve, but which he combined into a system—are widely accepted today, even by many who emphatically declare that they are anti-communist and anti-Marxist. To a considerable extent, without knowing it, many people are philosophical Marxists, although they use different names for their philosophical ideas.

Marxists today speak of Marxism-Leninism-Stalinism. Volumes are written today in Russia about the contributions of [Vladimir Ilyich] Lenin [1870–1924] and [Josef] Stalin [1879–1953]. Yet the system remains what it was in the days of Karl Marx; Marxism is in effect petrified. Lenin contributed only very strong invectives against his adversaries; Stalin contributed nothing. Thus, it is questionable to call any of these contributions “new,” when we realize that the most important contribution of Marx to this philosophy was published in 1859.<sup>1</sup>

It takes a long time for ideas to conquer the world. When Marx died in 1883, his name was by and large unknown. A few newspapers reported

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1 [A Contribution to the Critique of Political Economy (Moscow: Progress Publishers, 1859).]

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in a couple of lines that Karl Marx, the author of various books, had died. Eugen von Böhm-Bawerk [1851–1914] published a critique of Marx’s economic ideas<sup>2</sup> in 1896, but it was only 20 years later that people began to consider Marx a philosopher.

The ideas of Marx and of his philosophy truly dominate our age. The interpretation of current events and the interpretation of history in popular books, as well as in philosophical writings, novels, plays, and so forth, are by and large Marxist. At the center is the Marxian philosophy of history. From this philosophy is borrowed the term “dialectical,” which is applied to all his ideas. But this is not so important as it is to realize what Marxist materialism means.

Materialism has two different meanings. The first refers exclusively to ethical problems. A material man is interested only in material things—food, drink, shelter—not in art, culture, and so forth. In this sense, the majority of men are materialists. The second meaning of materialism refers to a special group of solutions proposed to a basic philosophical problem—the relation between the human mind or soul on the one side, and the human body and the physiological functions of the body on the other side. Various answers to this problem have been offered—among them religious answers. We know very well that there is a connection between body and mind; surgery has proved that certain damages to the brain bring about certain changes in the function of the human mind. However, materialists of this second variety explain all manifestations of the human mind as products of the body.

Among these philosophical materialists, there are two schools of thought:

A. One school considers man as a machine. This machine variety of materialists say these problems are very simple—the human “machine” works precisely as any other machine works. A Frenchman, Julien de La Mettrie [1709–1751], wrote a book containing this idea, *Man, the Machine*; and today many people still want to explain all operations of the human mind, directly or indirectly, as if they were mechanical operations. For instance, see the *Encyclopedia of the Social Sciences*. One of the contributors, a teacher at the New School for Social Research, says the newborn child

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2 [“The Unresolved Contradiction in the Economic Marxian System” in *Shorter Classics of Eugen von Böhm-Bawerk* (South Holland, Ill.: Libertarian Press, 1962 [1896; Eng. Trans. 1898]), pp. 201–302.]

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is like a Ford car, ready to run. Perhaps! But a machine, a newborn Ford, does not run by itself. A machine doesn't achieve anything, doesn't do anything alone—it is always men or a number of men who achieve something by means of the machine. Someone must run the machine. If the operation of the man ceases, the operation of the machine ceases too. We must ask this professor of the New School for Social Research, "Who runs the machine?" The answer would destroy the materialist machine doctrine.

People also talk sometimes about "feeding" the machine, as if it were alive. But, of course, it isn't alive. Then too people sometimes say the machine suffers a "nervous breakdown." But how can an object without nerves suffer a nervous breakdown? This machine doctrine has been repeated again and again, but it is not very realistic. We don't have to deal with it because no serious men really believe it.

B. The physiological doctrine put forth by the second class of materialists is more important. This doctrine was formulated in a primitive way by Ludwig Feuerbach [1804–1872] and Karl Vogt [1817–1895] in the early days of Karl Marx. This idea was that thoughts and ideas are "simply" secretions of the brain. (No materialist philosopher ever fails to use the word "simply." That means, "I know, but I can't explain it.") Today scientists know that certain pathological conditions cause certain secretions, and that certain secretions cause certain activities in the brain. But these secretions are chemically the same for all people in the same situation and condition. However, ideas and thoughts are not the same for all people in the same situation and condition; they are different.

First, ideas and thoughts are not tangible. And second, the same external factors do not produce the same reaction with everybody. An apple once fell from a tree and hit a certain young man [Isaac Newton]. This may have happened to many other young men before, but this particular happening challenged this particular young man and he developed some ideas from it.

But people do not always have the same thoughts when they are presented with the same facts. For instance, in school some learn; some don't. There are differences in men.

Bertrand Russell [1872–1970] asked, "What is the difference between men and stones?" He said there was no difference except that men react to more stimuli than do stones. But actually there is a difference. Stones react according to a definite pattern which we can know; we can anticipate what will happen to a stone if it is treated in a certain way. But men don't all

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react the same way when treated a certain way; we cannot establish such categories of actions for men. Thus, even though many people think physiological materialism is a solution, it actually leads to a dead end. If it were really the solution to this problem, it would mean that in any event we could know the way everyone would react. We cannot even imagine what the consequences would be if everybody knew what everybody else was going to do.

Karl Marx was not a materialist in the first sense—the machine sense. But the physiological idea was very popular in his day. It is not easy to know exactly what influenced Marx because he had personal hatreds and envies. Karl Marx hated Vogt, the exponent of physiological materialism. As soon as materialists like Vogt began to talk politics, Karl Marx said they had bad ideas; that meant Marx didn't like them.

Marx developed what he thought was a new system. According to his materialist interpretation of history, the “material productive forces” (this is an exact translation of the German) are the bases of everything. Each stage of the material productive forces corresponds to a definite stage of production relations. The material productive forces determine the production relations, that is, the type of ownership and property which exists in the world. And the production relations determine the superstructure. In the terminology of Marx, capitalism or feudalism are production relations. Each of these was necessarily produced by a particular stage of the material productive forces. In 1859, Karl Marx said a new stage of material productive forces would produce socialism.

But what are these material productive forces? Just as Marx never said what a “class” was, so he never said exactly what the “material productive forces” are. After looking through his writings we find that the material productive forces are the tools and machines. In one of his books [*Misère de la philosophie*—*The Poverty of Philosophy*], written in French in 1847, Marx said “the hand mill produces feudalism—the steam mill produces capitalism.”<sup>3</sup> He didn't say it in this book, but in other writings he wrote that other machines will come which will produce socialism.

Marx tried hard to avoid the geographical interpretation of progress, because that had already been discredited. What he said was that “tools”

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3 [“Le moulin à bras vous donnera la société avec le souzerain; le moulin à vapeur, la société avec le capitaliste industriel.” Karl Marx, *Misère de la philosophie* (Paris and Brussels, 1847), p. 100.—Ed.]

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were the basis of progress. Marx and [Friedrich] Engels [1820–1895] believed that new machines would be developed which would lead to socialism. They rejoiced at every new machine, thinking that meant socialism was just around the corner. In the French book of 1847, he criticized those who attached importance to the division of labor; he said the important thing was the tools.

We must not forget that tools don't fall from heaven. They are the products of ideas. To explain ideas, Marx said the tools, the machines—the material productive forces—reflect themselves in the brains of men and in this way ideas come. But the tools and machines are themselves the product of ideas. Also, before there can be machines, there must be division of labor. And before there can be division of labor, definite ideas must be developed. The origin of these ideas cannot be explained by something which is possible only in a society, which is itself the product of ideas.

The term “material” fascinated people. To explain changes in ideas, changes in thoughts, changes in all those things which are the products of ideas, Marx reduced them to changes in technological ideas. In this he was not original. For example, Hermann Ludwig Ferdinand von Helmholtz [1821–1894] and Leopold von Ranke [1795–1886] interpreted history as the history of technology.

It is the task of history to explain why definite inventions were not put into practice by people who had all the physical knowledge required for their construction. Why, for instance, did the ancient Greeks, who had the technical knowledge, not develop railroads?

As soon as a doctrine becomes popular, it is simplified in such a way as to be understood by the masses. Marx said everything depends on economic conditions. As he stated in his 1847 French book [*The Poverty of Philosophy*], he meant that the history of factories and tools developed independently. According to Marx, the whole movement of human history appears as a corollary to the development of the material productive forces, the tools. With this development of tools, the construction of society changes and as a consequence everything else changes too. By everything else, he meant the superstructure. Marxian authors, writing after Marx, explained everything in the superstructure as due to definite changes in the production relations. And they explained everything in the production relations as due to changes in the tools and machines. This was a vulgarization, a simplification, of the Marxian doctrine for which Marx and Engels were not completely responsible. They created a lot of nonsense, but they

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are not responsible for all the nonsense today.

What is the influence of this Marxian doctrine on ideas? The philosopher René Descartes [1596–1650], who lived in the early seventeenth century, believed that man had a mind and that man thinks, but that animals were merely machines. Marx said, of course, Descartes lived in an age in which the “Manufakturperioden,” the tools and machines, were such that he was forced to explain his theory by saying that animals were machines. Albrecht von Hailer [1708–1777], a Swiss, said the same thing in the eighteenth century (he didn’t like liberal government’s equality under law). Between these two men, lived de La Mettrie, who also explained man as a machine. Therefore, Marx’s concept that ideas were a product of the tools and machines of a particular era is easily disproved.

John Locke [1632–1704], the well-known philosopher of empiricism, declared that everything in men’s minds comes from sensual experience. Marx says John Locke was a spokesman for the class doctrine of the bourgeoisie. This leads to two different deductions from the writings of Karl Marx: (1) The interpretation he gave to Descartes is that he was living in an age when machines were introduced and, therefore, Descartes explained the animal as a machine; and (2) The interpretation he gave to John Locke’s inspiration—that it came from the fact that he was a representative of bourgeois class interests. Here are two incompatible explanations for the source of ideas. The first of these two explanations, to the effect that ideas are based on material productive forces, the tools and machines, is irreconcilable with the second, namely that class interests determine ideas.

According to Marx, everybody is forced—by the material productive forces—to think in such a way that the result shows his class interests. You think in the way in which your “interests” force you to think; you think according to your class “interests.” Your “interests” are something independent of your mind and your ideas. Your “interests” exist in the world apart from your ideas. Consequently, the production of your ideas is not truth. Before the appearance of Karl Marx, the notion of truth had no meaning for the whole historical period. What the thinking of the people produced in the past was always “ideology,” not truth.

“Les idéologues” in France were well advertised by Napoleon [1769–1821], who said everything would be all right in France but for these “idéologues.” In 1812, Napoleon was defeated. He left the army in Russia, returned alone, incognito, and appeared at the end of December 1812 in Paris. He blamed the evils that happened to his country on the bad “idéologues” which influenced the country.

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Marx used ideology in a different sense. According to Marx, ideology was a doctrine thought out by members of a class. These doctrines were necessarily *not* truths, but merely the expressions of the interests of the class concerned. Of course, one day there will be a classless society. One class—the proletarian class—prepares the way for the classless society. The truth of today is the idea of the proletarians. The proletarians will abolish all classes and then will come the Golden Age, the classless society.

Marx called Joseph Dietzgen [1828–1888] a proletarian, but Marx would have called him a petty bourgeois if he had known more about him. Officially Marx approved all the ideas of Dietzgen, but in his private correspondence with Ferdinand Lassalle [1825–1864] he expressed some disagreement. There is no universal logic. Every class has its own logic. But, of course, the logic of the proletariat is already the true logic of the future. (These people were offended when the racists took over the same ideas, claiming that the various races have different logics but the logic of the Aryans is the true logic.)

Karl Mannheim's [1893–1947] sociology of knowledge grew out of Hitler's ideas. Everybody thinks in ideologies—i.e., false doctrines. But there is one class of men which enjoys a special privilege—Marx called them the “unattached intellectuals.” These “unattached intellectuals” have the privilege of discovering truths which are not ideology.

The influence of this idea of “interests” is enormous. First of all, remember that this doctrine doesn't say men act and think according to what they consider to be their interests. Secondly, remember that they consider “interests” as independent of the thoughts and ideas of men. These independent interests force men to think and to act in a definite way. As an example of the influence this idea has on our thinking today, I might mention a U.S. Senator—not a Democrat—who said that people vote according to their “interests”; he didn't say in accordance with what they think to be their interests. This is Marx's idea—assuming that “interests” are something definite and apart from a person's ideas. This idea of class doctrine was first developed by Karl Marx in the *Communist Manifesto*.

Neither Engels nor Marx was of the proletariat. Engels was very wealthy. He hunted for fox in a red coat—this was the pastime of the rich. He had a girlfriend he considered too far beneath him to think of marrying. She died, and her sister became her successor. He finally married the sister, but just as she was dying—only two days before her death.

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Karl Marx never made much money himself. He received some money as a regular contributor to *The New York Tribune*. But he was almost completely supported by his friend Engels. Marx was not a proletarian; he was the son of a well-to-do lawyer. His wife, Mrs. Karl Marx [Jenny von Westphalen, 1814–1881], was the daughter of a high Prussian *Junker*. And Marx's brother-in-law was the head of the Prussian police.

Thus, these two men, Marx and Engels, who claimed that the proletarian mind was different from the mind of the bourgeoisie, were in an awkward position. So they included a passage in the *Communist Manifesto* to explain: "When the time comes, some members of the bourgeoisie join the rising classes." However, if it is possible for some men to free themselves from the law of class interests, then the law is no longer a general law.

Marx's idea was that the material productive forces lead men from one stage to another, until they reach socialism, which is the end and the height of it all. Marx said socialism cannot be planned in advance; history will take care of it. In Marx's view, those who say how socialism will work are just "utopians."

Socialism was already defeated intellectually at the time Marx wrote. Marx answered his critics by saying that those who were in opposition were only "bourgeois." He said there was no need to defeat his opponents' arguments, but only to unmask their bourgeois background. And as their doctrine was only bourgeois ideology, it was not necessary to deal with it. This would mean that no bourgeois could write anything in favor of socialism. Thus, all such writers were anxious to prove they were proletarians. It might be appropriate to mention at this time also that the ancestor of French socialism, Saint-Simon,<sup>4</sup> was a descendant of a famous family of dukes and counts.

It is simply not true that inventions develop because people search for practical purposes and not for truths.

When Marx published his writings, German thought was dominated by George Wilhelm Friedrich Hegel [1770–1831], professor at the University of Berlin. Hegel had developed the doctrine of the philosophical evolution of history. In some respect his ideas were different from, even the very opposite to, those of Marx. Hegel was the man who

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4 [Claude Henri de Rouvroy, Comte de Saint-Simon [1760–1825]—Ed.]

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destroyed German thinking and German philosophy for more than a century, at least. He found a warning in Immanuel Kant [1724–1804] who said the philosophy of history can only be written by a man who has the courage to pretend that he sees the world with the eyes of God. Hegel believed he had the “eyes of God,” that he knew the end of history, that he knew the plans of God. He said *Geist* (mind) develops itself and manifests itself in the course of historical evolution. Therefore, the course of history is inevitably progress from less satisfactory to more satisfactory conditions.

In 1825, Hegel said that we have reached a wonderful state of affairs. He considered the Prussian kingdom of Friedrich Wilhelm III [1770–1840] and the Prussian Union Church as the perfection of secular and spiritual government. Marx said, as Hegel had, that there was history in the past, but there will be no history anymore when we have reached a state that is satisfactory. Thus, Marx adopted the Hegelian system, although he used material productive forces instead of *Geist*. Material productive forces go through various stages. The present stage is very bad, but there is one thing in its favor—it is the necessary preliminary stage for the appearance of the perfect state of socialism. And socialism is just around the corner.

Hegel was called the philosopher of Prussian absolutism. He died in 1831. His school thought in terms of left and right wings. (The left didn’t like the Prussian government and the Prussian Union Church.) This distinction between the left and the right has existed since then. In the French Parliament, those who didn’t like the king’s government were seated on the left side of the assembly hall. Today no one wants to sit on the right.

Originally, i.e., before Karl Marx, the term “right” meant the supporters of representative government and civil liberties, as opposed to the “left” who favored royal absolutism and the absence of civil rights. The appearance of socialist ideas changed the meaning of these terms. Some of the “left” have been outspoken in expressing their views. For instance, Plato [427–347 BC] was frank in stating that a philosopher shall rule. And Auguste Comte [1798–1857] said that freedom was necessary in the past because it made it possible for him to publish his books, but now that these books have been published there is no longer any need for freedom. And in the same way Etienne Cabet [1788–1856] spoke of three classes of books—the bad books, which should be burned; the intermediate books, which should be amended; and the remaining “good” books. Therefore, there was great confusion as to the civil liberties to be assigned to the

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citizens of the socialist state. This was because Marxian ideas did not develop in countries which had civil liberties, but in countries in which the people did not have civil liberties.

Nikolai Bukharin [1888–1938], a Communist author who lived in a Communist country, wrote a pamphlet in 1917<sup>5</sup>, in which he said, we asked for freedom of the press, thought, and civil liberties in the past because we were in the opposition and needed these liberties to conquer. Now that we have conquered, there is no longer any need for such civil liberties. [Bukharin was tried and condemned to death in the Moscow Purge Trial of March 1938.] If Mr. Bukharin had been an American Communist, he would probably still be alive and free to write more pamphlets about why freedom is not necessary.

These peculiarities of Marxian philosophy can only be explained by the fact that Marx, although living in Great Britain, was not dealing with conditions in Great Britain, where he felt civil liberties were no longer needed, but with the conditions in Germany, France, Italy, and so on, where civil liberties were still needed. Thus we see that the distinction between right and left, which had meaning in the days of the French Revolution, no longer has any meaning.

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5 ["The Russian Revolution and Its Significance," *The Class Struggle*, Vol. I, No. 1, May–June, 1917.—Ed.]

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2ND LECTURE

# Class Conflict and Revolutionary Socialism

MARX ASSUMED that “interests” were independent of human ideas and thoughts. He said that socialism was the ideal system for the proletariat. He said class interests determine the thinking of individuals and that this situation causes irreconcilable conflicts between the various classes. Marx then returned to the point at which he had started—namely, that socialism is the ideal state.

The fundamental concept of the *Communist Manifesto* (1848) was that of “class” and “class conflict.” But Marx didn’t say what a “class” was. Marx died in 1883, 35 years after the publication of the *Communist Manifesto*. In those 35 years he published many volumes, but in not one of them did he say what he meant by the term “class.” After Marx’s death, Friedrich Engels published the unfinished manuscript of the third volume of Marx’s *Das Kapital*. Engels said this manuscript, on which Marx had stopped work, many years before he died, had been found in Marx’s desk after his death. In one three-page chapter in that volume, Marx tells us what a “class” was *not*. But you may search through all his writings to learn what a “class” was without ever finding out. In fact, “classes” don’t exist in nature. It is our thinking—our arranging in categories—that constructs classes in our minds. The question is not whether social classes exist in the sense of Karl Marx; the question is whether we can use the concept of social classes in the way in which Karl Marx meant it. We can’t.

Marx did not see that the problem of the “interest” of an individual, or of a class, cannot be solved simply by referring to the fact that there is such

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an interest and that men must act according to their interests. Two questions must be asked: (1) Toward what ultimate ends do these “interests” lead people? (2) What methods do they want to apply in order to reach these ends?

The First International was a small group of people, a committee of a few men in London, friends and enemies of Karl Marx. Someone suggested that they cooperate with the British labor-union movement. In 1865, Karl Marx read at the meeting of the International Committee, a paper, *Value, Price, and Profit*, one of his few writings originally written in English. In this paper, he pointed out that the methods of the union movement were very bad and must be changed. Paraphrasing: “The unions want to improve the fate of the workers within the framework of the capitalist system—this is hopeless and useless. Within the framework of the capitalist system there is no possibility of improving the state of the workers. The best the union could achieve in this way would be some short-term success. The unions must abandon this ‘conservative’ policy; they must adopt the revolutionary policy. They must fight for the abolition of the wage society as such and work for the coming of socialism.” Marx didn’t have the courage to publish this paper during his lifetime; it was published only after his death by one of his daughters. He didn’t want to antagonize the labor unions; he still had hopes they would abandon their theory.

Here is an obvious conflict of opinions among the proletarians themselves concerning the right means to use. The proletarian unions and Marx disagreed as to what was in the “interest” of the proletarians. Marx said that the “interest” of a class was obvious—there could be no doubt about it—everyone would know it. Then here comes a man who doesn’t belong to this proletarian class at all, a writer and a lawyer who tells the unions they were wrong. “This is bad policy,” he said. “You must radically change your policy.” Here the whole idea of the class breaks down, the idea that an individual may sometimes err but that a class as a whole can never err.

Criticisms of Marxian doctrines have always been superficial. They haven’t pointed out how Marx contradicted himself and how he failed to explain his ideas. Böhm-Bawerk’s critique<sup>1</sup> was good but he didn’t cover

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1 [“The Unresolved Contradiction in the Economic Marxian System” in *Shorter Classics of Eugen von Böhm-Bawerk*, (South Holland, Ill.: Libertarian Press, 1962 [1896; Eng. Trans. 1898]), pp. 201–302.—Ed.]

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the entire system. Critics of Marx didn't even discover Karl Marx's most manifest contradictions.

Marx believed in the "iron law of wages." He accepted that as the fundamental basis of his economic doctrine. He didn't like the German term for this law, the "brazen" law of wages, about which Ferdinand Lassalle [1825–1864] had published a pamphlet. Karl Marx and Ferdinand Lassalle were not friends; they were competitors, very serious competitors. Marx said Lassalle's only contribution was the term itself, the "brazen" law of wages. And what was more, the term, was borrowed, borrowed from the dictionary and from Goethe.<sup>2</sup>

The "iron law of wages" still survives in many textbooks, in the minds of politicians, and consequently in many of our laws. According to the "iron law of wages," the wage rate is determined by the amount of food and other necessities required for the preservation and reproduction of life, to support the workers' children until they can themselves work in the factories. If wage rates rise above this, the number of workers would increase and the increased number of workers would bring wage rates down again. Wages cannot drop below this point because there would then develop a shortage of labor. This law considers the worker to be some kind of microbe or rodent without free choice or free will.

If you think it is absolutely impossible under the capitalist system for wages to deviate from this rate, how then can you still talk, as Marx did, about the progressive impoverishment of the workers as being inevitable? There is an insoluble contradiction between the Marxian idea of the iron law of wage rates, according to which wages will remain at a point at which they are sufficient to support the progeny of workers until they can themselves become workers, and his philosophy of history, which maintains that the workers will be more and more impoverished until they are driven to open rebellion, thus bringing about socialism. Of course, both doctrines are untenable. Even 50 years ago the leading socialist writers were forced to resort to other elaborate schemes in the attempt to support their theories. What is amazing is that, during the century since Marx's writings, no one has pointed out this contradiction. And this contradiction is not the only contradiction in Marx.

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2 [Marx also criticized Lassalle for using the term "Arbeiterstand" (state of work); Marx said Lassalle was confused, but Marx never explained how Lassalle was confused.—Ed.]

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What really destroyed Marx was his idea of the progressive impoverishment of the workers. Marx didn't see that the most important characteristic of capitalism was large-scale production for the needs of the masses; the main objective of capitalists is to produce for the broad masses. Nor did Marx see that under capitalism the customer is always right. In his capacity as a wage earner, the worker cannot determine what is to be made. But in his capacity as a customer, he is really the boss and tells his boss, the entrepreneur, what to do. His boss must obey the orders of the workers as they are members of the buying public. Mrs. Webb<sup>3</sup>, like other socialists, was the daughter of a well-to-do businessman. Like other socialists, she thought her father was an autocrat who gave orders to everybody. She didn't see that he was subject to the sovereignty of the orders of the customers on the market. The "great" Mrs. Webb was no smarter than the dumbest messenger boy who sees only that his boss gives orders.

Marx had no doubt as to what the ends were toward which men aim. Nor did he have any doubts as to the best way to attain these ends. How is it that a man who read so much and interrupted his reading only to write, didn't realize the discrepancy in his ideas?

To answer that question, we must go back to the thinking of his time. That was the time of Charles Darwin's *Origin of the Species* [1859]. It was the intellectual fashion of that day to look upon men merely from the point of view of their membership in the zoological class of mammals, which acted on the basis of instincts. Marx didn't take into account the evolution of mankind above the level of very primitive men. He considered unskilled labor to be the normal type of labor and skilled labor as the exception. He wrote in one of his books that progress in the technological improvement of machines causes the disappearance of specialists because the machine can be operated by anyone; it takes no special skill to operate a machine. Therefore, the normal type of man in the future will be the non-specialist.

With regard to many of his ideas, Marx belonged to much earlier ages, especially in constructing his philosophy of history. Marx substituted for Hegel's evolution of *Geist* the evolution of the material factors of

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3 [Beatrice Webb (1858–1943), wife of Sidney Webb (1859–1947), later Lady and Lord Passfield, British Fabians.—Ed.]

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production. He didn't realize that the material factors of production, i.e., the tools and machines, are actually products of the human mind. He said these tools and machines, the material productive forces, inevitably bring about the coming of socialism. His theory has been called "dialectical materialism," abbreviated by the socialists to "diamet."

[In an aside, Dr. Mises told of visiting a school in Mexico, an "escuela socialista," a "socialist school." Mises asked the school's Mexican dean what "socialist school" meant. The dean explained that Mexican law required schools to teach the Darwinian doctrine of evolution and dialectical materialism. Then he commented on the provision in the law making this requirement and on the school system itself: "There is a great difference between the letter of the law and the practice. Ninety percent of the teachers in our schools are female and most of them are practicing Catholics."]

Marx reasoned from the *thesis* to the *negation of the thesis* to the *negation of the negation*. Private ownership of the means of production by every individual worker was the beginning, *the thesis*. This was the state of affairs in a society in which every worker was either an independent farmer or an artisan who owned the tools with which he was working. *Negation of the thesis*—ownership under capitalism—when the tools were no longer owned by the workers, but by the capitalists. *Negation of the negation* was ownership of the means of production by the whole society. Reasoning in this way, Marx said he had discovered the law of historical evolution. And that is why he called it "scientific socialism."

Marx branded all previous socialists "utopian socialists" because they tried to point out why socialism was better. They wanted to convince their fellow citizens to their view because they expected people would adopt the socialist social system if they were convinced it was better. They were "utopians," Marx said, because they tried to describe the future earthly paradise. Among the forerunners of Marx whom he considered "utopians" were Saint-Simon, a French aristocrat; Robert Owen [1757–1858], a British manufacturer; and Charles Fourier [1772–1837], a Frenchman who was without doubt a lunatic. (Fourier was called the "fou [fool] du Palais-Royal." He used to make such statements as "In the age of socialism, the ocean will no longer be salt but lemonade.") Marx considered these three as great forerunners. But, he said, they didn't realize that what they were saying was just "utopian." They expected the coming of socialism because of a change in the opinions of the people. But for Marx,

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the coming of socialism was inevitable; it would come with the inevitability of nature.

On the one hand, Karl Marx wrote of the *inevitability* of socialism. But on the other hand, he organized a socialist movement, a socialist party, declared again and again that his socialism was revolutionary, and that the violent overthrow of the government was necessary to bring about socialism.

Marx borrowed his metaphors from the field of gynecology. The socialist party is like obstetrics, Marx said; it makes the coming of socialism possible. When asked if you consider the whole process inevitable, why do you not favor *evolution* instead of *revolution*, the Marxists reply, "There are no evolutions in life. Is not birth itself a revolution?"

According to Marx, the goal of the socialist party was not to influence, but only to help the inevitable. But obstetrics itself influences and changes conditions. Obstetrics has actually brought about progress in this branch of medicine, and even saved lives. And by saving lives it could be said obstetrics has actually changed the course of history.

The term "scientific" acquired prestige during the course of the nineteenth century. Engels' *Anti-Dühring* (1878) became one of the most successful books among the writings of philosophical Marxists. One chapter in this book was reprinted as a pamphlet under the title "The Development of Socialism from Utopia to Science," and it had enormous success. Karl Radek [1885–1939], a Soviet Communist, later wrote a pamphlet called "The Development of Socialism, from Science to Action."

Marx's doctrine of ideology was concocted to discredit the writings of the bourgeoisie. [Tomás] Masaryk [1850–1937] of Czechoslovakia was born of poor people, farmers and workers, and he wrote about Marxism. Yet the Marxians called him a bourgeois. How could he be considered "bourgeois" if Marx and Engels called themselves "proletarian"?

If the proletarians must think according to the "interests" of their class, what does it mean if there are disagreements and dissent among them? The confusion makes the situation very difficult to explain. When there is dissent among proletarians, they call a dissenter a "social traitor." After Marx and Engels, the great man of the Communists was a German, Karl Kautsky [1854–1938]. In 1917, when Lenin tried to revolutionize the whole world, Karl Kautsky was opposed to the idea. And because of this disagreement, the former great man of the party became overnight a "social traitor," and he was called that as well as many other names.

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This idea is like that of the racists. The German racists declared that a definite set of political ideas were German and every real German must necessarily think according to this particular set of ideas. This was the Nazi idea. According to the Nazis, the best situation was to be in a state of war. But some Germans—Kant, Goethe, and Beethoven, for instance—had different “un-German” ideas. If not every German must think in a certain way, who is to decide which ideas are German and which are un-German? The answer can only be that an “inner voice” is the ultimate standard, the ultimate yardstick. This position necessarily leads to conflicts that must result in civil, or even international, war.

There were two groups of Russians, both of whom considered themselves proletarians—the Bolsheviks and the Mensheviks. The only method to “settle” disagreements between them was to use force and liquidation. The Bolsheviks won. Then within the ranks of the Communist Bolsheviks there arose other differences of opinion—between Trotsky<sup>4</sup> and Stalin—and the only way to resolve their conflicts was a purge. Trotsky was forced into exile, trailed to Mexico, and there in 1940 he was hacked to death. Stalin originated nothing; he went back to the revolutionary Marx of 1859—not to the interventionist Marx of 1848.

Unfortunately, purges are not something which happen just because men are imperfect. Purges are the necessary consequences of the philosophical foundation of Marxian socialism. If you cannot discuss philosophical differences of opinion in the same way you discuss other problems, you must find another solution—through violence and power. This refers not only to dissent concerning policies, economic problems, sociology, law, and so on. It refers also to problems of the natural sciences. The Webbs, Lord and Lady Passfield, were shocked to learn that Russian magazines and papers dealt even with problems of the natural sciences from the point of view of the philosophy of Marxism-Leninism-Stalinism. For instance, if there is a difference of opinion with regard to science or genetics, it must be decided by the “leader.” This is the necessary unavoidable consequence of the fact that, according to Marxist doctrine, you do not consider the possibility of dissent among honest people; either you think as I do, or you are a traitor and must be liquidated.

The *Communist Manifesto* appeared in 1848. In that document, Marx preached revolution; he believed the revolution was just around the corner.

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4 [Leon Trotsky (1879–1940)]

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He believed then that socialism was to be brought about by a series of interventionist measures. He listed ten interventionist measures—among them the progressive income tax, the abolition of the rights of inheritance, agricultural reform, and so on. These measures were untenable, he said, but necessary for socialism to come.

Thus, Karl Marx and Engels believed in 1848, that socialism could be attained by interventionism. By 1859, eleven years after the *Communist Manifesto*, Marx and Engels had abandoned the advocacy of interventions; they no longer expected socialism to come from legislative changes. They wanted to bring about socialism by a radical change overnight. From this point of view, followers of Marx and Engels considered later measures—the New Deal, the Fair Deal, and so forth—to be “petty bourgeois” policies. In the 1840s Engels had said British labor laws were a sign of progress and a sign of the breakdown of capitalism. Later they called such interventionist measures or interventionist policy (*Sozialpolitik*) very bad.

In 1888—40 years after the publication of the *Communist Manifesto*—a translation was made by an English writer. Engels added some comments to this translation. Referring to the ten interventionist measures advocated in the *Manifesto*, he said these measures were not only untenable, as the *Manifesto* claimed, but precisely because they were untenable, they would necessarily push further and further toward still more measures of this kind, until eventually *these* more advanced measures would lead to socialism.

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### 3RD LECTURE

# Individualism and the Industrial Revolution

LIBERALS STRESSED THE IMPORTANCE OF THE INDIVIDUAL. The nineteenth-century liberals already considered the development of the individual the most important thing. “Individual and individualism” was the progressive and liberal slogan. Reactionaries had already attacked this position at the beginning of the nineteenth century.

The rationalists and liberals of the eighteenth century pointed out that what was needed was good laws. Ancient customs that could not be justified by rationality should be abandoned. The only justification for a law was whether or not it was liable to promote the public social welfare. In many countries the liberals and rationalists asked for written constitutions, the codification of laws, and for new laws which would permit the development of the faculties of every individual.

A reaction to this idea developed, especially in Germany where the jurist and legal historian Friedrich Karl von Savigny [1779–1861] was active. Savigny declared that laws cannot be written by men; laws are developed in some mystical way by the soul of the whole unit. It isn't the individual that thinks—it is the nation or a social entity which uses the individual only for the expression of its own thoughts. This idea was very much emphasized by Marx and the Marxists. In this regard the Marxists were not followers of Hegel, whose main idea of historical evolution was an evolution toward freedom of the individual.

From the viewpoint of Marx and Engels, the individual was a negligible thing in the eyes of the nation. Marx and Engels denied that

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the individual played a role in historical evolution. According to them, history goes its own way. The material productive forces go their own way, developing independently of the wills of individuals. And historical events come with the inevitability of a law of nature. The material productive forces work like a director in an opera; they must have a substitute available in case of a problem, as the opera director must have a substitute if the singer gets sick. According to this idea, Napoleon and Dante, for instance, were unimportant—if they had not appeared to take their own special place in history, someone else would have appeared on stage to fill their shoes.

To understand certain words, you must understand the German language. From the seventeenth century on, considerable effort was spent in fighting the use of Latin words and in eliminating them from the German language. In many cases a foreign word remained although there was also a German expression with the same meaning. The two words began as synonyms, but in the course of history, they acquired different meanings. For instance, take the word *Umwälzung*, the literal German translation of the Latin word *revolution*. In the Latin word there was no sense of fighting. Thus, there evolved two meanings for the word “revolution”—one by violence, and the other meaning a gradual revolution like the “Industrial Revolution.” However, Marx uses the German word *Revolution* not only for violent revolutions such as the French or Russian revolutions, but also for the gradual Industrial Revolution.

Incidentally, the term Industrial Revolution was introduced by Arnold Toynbee [1852–1883]. Marxists say that “What furthers the overthrow of capitalism is not revolution—look at the Industrial Revolution.”

Marx assigned a special meaning to slavery, serfdom, and other systems of bondage. It was necessary, he said, for the workers to be free in order for the exploiter to exploit them. This idea came from the interpretation he gave to the situation of the feudal lord who had to care for his workers even when they weren’t working. Marx interpreted the liberal changes that developed as freeing the exploiter of the responsibility for the lives of the workers. Marx didn’t see that the liberal movement was directed at the abolition of inequality under law, as between serf and lord.

Karl Marx believed that capital accumulation was an obstacle. In his eyes, the only explanation for wealth accumulation was that somebody

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had robbed somebody else. For Karl Marx the whole Industrial Revolution simply consisted of the exploitation of the workers by the capitalists. According to him, the situation of the workers became worse with the coming of capitalism. The difference between their situation and that of slaves and serfs was only that the capitalist had no obligation to care for workers who were no longer exploitable, while the lord was bound to care for slaves and serfs. This is another of the insoluble contradictions in the Marxian system. Yet it is accepted by many economists today without realizing of what this contradiction consists.

According to Marx, capitalism is a necessary and inevitable stage in the history of mankind leading men from primitive conditions to the millennium of socialism. If capitalism is a necessary and inevitable step on the road to socialism, then one cannot consistently claim, from the point of view of Marx, that what the capitalist does is ethically and morally bad. Therefore, why does Marx attack the capitalists?

Marx says part of production is appropriated by the capitalists and withheld from the workers. According to Marx, this is very bad. The consequence is that the workers are no longer in a position to consume the whole production produced. A part of what they have produced, therefore, remains unconsumed; there is "underconsumption." For this reason, because there is underconsumption, economic depressions occur regularly. This is the Marxian underconsumption theory of depressions. Yet Marx contradicts this theory elsewhere.

Marxian writers do not explain why production proceeds from simpler to more and more complicated methods.

Nor did Marx mention the following fact: About 1700, the population of Great Britain was about five and a half million; by the middle of 1700, the population was six and a half million, about 500,000 of whom were simply destitute. The whole economic system had produced a "surplus" population. The surplus population problem appeared earlier in Great Britain than on continental Europe. This happened, first of all, because Great Britain was an island and so was not subject to invasion by foreign armies, which helped to reduce the populations in Europe. The wars in Great Britain were civil wars, which were bad, but they stopped. And then this outlet for the surplus population disappeared, so the numbers of surplus people grew. In Europe the situation was different; for one thing, the opportunity to work in agriculture was more favorable than in England.

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The old economic system in England couldn't cope with the surplus population. The surplus people were mostly very bad people—beggars and robbers and thieves and prostitutes. They were supported by various institutions, the poor laws,<sup>1</sup> and the charity of the communities. Some were impressed into the army and navy for service abroad. There were also superfluous people in agriculture. The existing system of guilds and other monopolies in the processing industries made the expansion of industry impossible. In those pre-capitalist ages, there was a sharp division between the classes of society who could afford new shoes and new clothes, and those who could not. The processing industries produced by and large for the upper classes. Those who could not afford new clothes wore hand-me-downs. There was then a very considerable trade in secondhand clothes—a trade which disappeared almost completely when modern industry began to produce also for the lower classes. If capitalism had not provided the means of sustenance for these “surplus” people, they would have died from starvation. Smallpox accounted for many deaths in pre-capitalist times; it has now been practically wiped out. Improvements in medicine are also a product of capitalism.

What Marx called the great catastrophe of the Industrial Revolution was not a catastrophe at all; it brought about a tremendous improvement in the conditions of the people. Many survived who wouldn't have survived otherwise. It is not true, as Marx said, that the improvements in technology are available only to the exploiters and that the masses are living in a state much worse than on the eve of the Industrial Revolution. Everything the Marxists say about exploitation is absolutely wrong! Lies! In fact, capitalism made it possible for many persons to survive who wouldn't have otherwise. And today many people, or most people, live at a much higher standard of living than that at which their ancestors lived 100 or 200 years ago.

During the eighteenth century, there appeared a number of eminent authors—the best known was Adam Smith [1723–1790]—who pleaded for freedom of trade. And they argued against monopoly, against the guilds, and against privileges given by the king and Parliament. Secondly,

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<sup>1</sup> [English legislation relating to public assistance for the poor, dating from the Elizabethan era and amended in 1834 in order to institute nationally supervised uniform relief.—Ed.]

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some ingenious individuals, almost without any savings and capital, began to organize starving paupers for production, not in factories but outside the factories, and not for the upper classes only. These newly organized producers began to make simple goods precisely for the great masses. This was the great change that took place; this was the Industrial Revolution. And this Industrial Revolution made more food and other goods available so that the population rose. Nobody saw less of what really was going on than Karl Marx. By the eve of the Second World War, the population had increased so much that there were 60 million Englishmen.

You can't compare the United States with England. The United States began almost as a country of modern capitalism. But we may say by and large that out of eight people living today in the countries of Western civilization, seven are alive only because of the Industrial Revolution. Are you personally sure that you are the one out of eight who would have lived even in the absence of the Industrial Revolution? If you are not sure, stop and consider the consequences of the Industrial Revolution.

The interpretation given by Marx to the Industrial Revolution is applied also to the interpretation of the "superstructure." Marx said the "material productive forces," the tools and machines, produce the "production relations," the social structure, property rights, and so forth, which produce the "superstructure," the philosophy, art, and religion. The "superstructure," said Marx, depends on the class situation of the individuals, i.e., whether he is a poet, painter, and so on. Marx interpreted everything that happened in the spiritual life of the nation from this point of view. Arthur Schopenhauer [1788–1860] was called a philosopher of the owners of common stock and bonds. Friedrich Nietzsche [1844–1900] was called the philosopher of big business. For every change in ideology, for every change in music, art, novel writing, play writing, the Marxians had an immediate interpretation. Every new book was explained by the "superstructure" of that particular day. Every book was assigned an adjective—"bourgeois" or "proletarian." The bourgeoisie were considered an undifferentiated reactionary mass.

Don't think it is possible for a man to practice all his life a certain ideology without believing in it. The use of the term "mature capitalism" shows how fully persons, who don't think of themselves as Marxian in any way, have been influenced by Marx. Mr. and Mrs. Hammond, in fact

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almost all historians, have accepted the Marxian interpretation of the Industrial Revolution.<sup>2</sup> The one exception is Ashton.<sup>3</sup>

Karl Marx, in the second part of his career, was not an interventionist; he was in favor of *laissez faire*. Because he expected the breakdown of capitalism and the substitution of socialism to come from the full maturity of capitalism, he was in favor of letting capitalism develop. In this regard he was, in his writings and in his books, a supporter of economic freedom.

Marx believed that interventionist measures were unfavorable because they delayed the coming of socialism. Labor unions recommended interventions and, therefore, Marx was opposed to them. Labor unions don't produce anything anyway and it would have been impossible to raise wage rates if producers had not actually produced more.

Marx claimed interventions hurt the interests of the workers. The German socialists voted against [Otto von] Bismarck's social reforms that he instituted circa 1881 (Marx died in 1883). And in this country the Communists were against the New Deal. Of course, the real reason for their opposition to the government in power was very different. No opposition party wants to assign so much power to another party. In drafting socialist programs, everybody assumes tacitly that he himself will be the planner or the dictator, or that the planner or dictator will be intellectually completely dependent on him and that the planner or dictator will be his handyman. No one wants to be a single member in the planning scheme of somebody else.

These ideas of planning go back to Plato's treatise on the form of the commonwealth. Plato was very outspoken. He planned a system ruled exclusively by philosophers. He wanted to eliminate all individual rights and decisions. Nobody should go anywhere, rest, sleep, eat, drink, wash, unless he was told to do so. Plato wanted to reduce persons to the status of pawns in his plan. What is needed is a dictator who appoints a philosopher as a kind of prime minister or president of the central board of production management. The program of all such consistent

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2 [J. L. and Barbara Hammond, authors of the trilogy *The Village Labourer* (1911), *The Town Labourer* (1917), and *The Skilled Labourer* (1919)—Ed.]

3 [T.S. Ashton, *The Industrial Revolution 1760-1830* (London: Oxford University Press, 1998 [1948, 1961])—Ed.]

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socialists—Plato and Hitler, for instance—planned also for the production of future socialists, the breeding and education of future members of society.

During the 2300 years since Plato, very little opposition has been registered to his ideas. Not even by Kant. The psychological bias in favor of socialism must be taken into consideration in discussing Marxian ideas. This is not limited to those who call themselves Marxian.

Marxians deny that there is such a thing as the search for knowledge for the sake of knowledge alone. But they are not consistent in this case either, for they say one of the purposes of the socialist state is to eliminate such a search for knowledge. It is an insult, they say, for persons to study things that are useless.

Now I want to discuss the meaning of the ideological distortion of truths. Class consciousness is not developed in the beginning, but it must inevitably come. Marx developed his doctrine of ideology because he realized he couldn't answer the criticisms raised against socialism. His answer was, "What you say is not true. It is only ideology. What a man thinks, so long as we do not have a classless society, is necessarily a class ideology—that is, it is based on a false consciousness." Without any further explanation, Marx assumed that such an ideology was useful to the class and to the members of the class that developed it. Such ideas had for their goal the pursuit of the aims of their class.

Marx and Engels appeared and developed the class ideas of the proletariat. Therefore, from this time on the doctrine of the bourgeoisie is absolutely useless. Perhaps one may say that the bourgeoisie needed this explanation to solve a bad conscience. But why should they have a bad conscience if their existence is necessary? And it is necessary, according to Marxian doctrine, for without the bourgeoisie, capitalism cannot develop. And until capitalism is "mature," there cannot be any socialism.

According to Marx, bourgeois economics, sometimes called "apologetics for bourgeois production," aided them, the bourgeoisie. The Marxians could have said that the thought the bourgeoisie gave to this bad bourgeois theory justified, in their eyes, as well as in the eyes of the exploited, the capitalist mode of production, thus making it possible for the system to exist. But this would have been a very un-Marxist explanation. First of all, according to Marxian doctrine, no justification is needed for the bourgeois system of production; the bourgeoisie exploit because it is their business to exploit, just as it is the business of the

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microbes to exploit. The bourgeoisie don't need any justification. Their class consciousness shows them that they have to do this; it is the capitalist's nature to exploit.

A Russian friend of Marx wrote him that the task of the socialists must be to help the bourgeoisie exploit better and Marx replied that that was not necessary. Marx then wrote a short note saying that Russia could reach socialism without going through the capitalist stage. The next morning he must have realized that, if he admitted that one country could skip one of the inevitable stages, this would destroy his whole theory. So he didn't send the note. Engels, who was not so bright, discovered this piece of paper in the desk of Karl Marx, copied it in his own handwriting, and sent his copy to Vera Zasulich [1849–1919], who was famous in Russia because she had attempted to assassinate the Police Commissioner in St. Petersburg and been acquitted by the jury—she had a good defense counsel. This woman published Marx's note, and it became one of the great assets of the Bolshevik Party.

The capitalist system is a system in which promotion is precisely according to merit. If people do not get ahead, there is bitterness in their minds. They are reluctant to admit that they do not advance because of their lack of intelligence. They take their lack of advancement out on society. Many blame society and turn to socialism. This tendency is especially strong in the ranks of intellectuals. Because professionals treat each other as equals, the less capable professionals consider themselves "superior" to non-professionals and feel they deserve more recognition than they receive. Envy plays an important role. There is a philosophical predisposition among persons to be dissatisfied with the existing state of affairs. There is dissatisfaction, also, with political conditions. If you are dissatisfied, you ask what other kind of state can be considered.

Marx had "anti-talent"—i.e., a lack of talent. He was influenced by Hegel and Feuerbach, especially by Feuerbach's critique of Christianity. Marx admitted that the exploitation doctrine was taken from an anonymous pamphlet published in the 1820s. His economics were distortions taken over from [David] Ricardo [1772–1823].<sup>4</sup>

Marx was economically ignorant; he didn't realize that there can be doubts concerning the best means of production to be applied. The big

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4 [*On the Principles of Political Economy and Taxation* (London: John Murray, 1821 [1817]).]

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question is, how shall we use the available scarce factors of production. Marx assumed that what has to be done is obvious. He didn't realize that the future is always uncertain, that it is the job of every businessman to provide for the unknown future. In the capitalist system, the workers and technologists obey the entrepreneur. Under socialism, they will obey the socialist official. Marx didn't take into consideration the fact that there is a difference between saying what has to be done and doing what somebody else has said must be done. The socialist state is necessarily a police state.

The withering away of the state was just Marx's attempt to avoid answering the question about what would happen under socialism. Under socialism, the convicts will know that they are being punished for the benefit of the whole society.

The third volume of *Das Kapital* was filled with lengthy quotations from the hearings of British Parliamentary Committees on money and banking, and they don't make any sense at all.<sup>5</sup> For instance, "The monetary system is essentially Catholic, the credit system essentially Protestant. . . . But the credit system does not emancipate itself from the basis of the monetary system any more than Protestantism emancipates itself from the foundations of Catholicism."<sup>6</sup> Utterly nonsensical!

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5 [*Capital: A Critique of Political Economy, III* (Chicago: Charles H. Kerr, Chicago, 1909), pp. 17, 530–677ff.]

6 [*Ibid.*, p. 696.]

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4TH LECTURE

# Nationalism, Socialism, and Violent Revolution

MARXIAN DOCTRINE DOESN'T DENY THE POSSIBILITY OF ABSOLUTE TRUTH, but it maintains that absolute truth can be attained only in the classless society. Or in the proletarian class society.

Lenin's main book<sup>1</sup>, or at least his most voluminous book (now available in the *Collected Works of Lenin*), led some people to call him a philosopher. Most of Lenin's critique of the ideas of his adversaries consists of calling them "bourgeois." Lenin's philosophy is merely a restatement of the philosophical ideas of Marx; to some extent it is not even up to the level of other Russian writers on Marxism.

Marxist theory or philosophy had no development in countries where there were Communist parties. Persons whom we call Marxians consider themselves merely interpreters of Marx; they never tried to change anything in Marx. However, there are contradictions in Marx. So it is possible to quote passages from his writings from all points of view. The influence of Marx on *all* authors and writers who have lived since Marx died has been considerable, even though it is not usually admitted that these authors were influenced by Marx.

Although Marxians considered themselves solely interpreters of Marx, one Marxian, one writer, added something and had a strong influence, not

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<sup>1</sup> [V.I. Lenin, *Materialism and Empirio-criticism: Critical Comments on a Reactionary Philosophy* (Moscow: Zveno Publishers, 1909).—Ed.]

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only on the small group of his followers, but also on other authors. Georges Sorel [1847–1922]—not to be confused with Albert Sorel [1842–1906]—an important historian, developed a philosophy in many respects different from the Marxian philosophy. And it influenced political action and philosophic thinking. Sorel was a timid bourgeois intellectual, an engineer. He retired to discuss these things with his friends at a bookshop owned by Charles Péguy [1873–1914], a revolutionary socialist. In the course of the years, Péguy changed his opinions and at the end of his life he was a very ardent Catholic author. Péguy had serious conflicts with his family. Péguy was remarkable for his intercourse with Sorel. Péguy was a man of action; he died in action in 1914 in the first weeks of the war.

Sorel belonged psychologically to the group of people who dream of action but never act; he didn't fight. As a writer, however, Sorel was very aggressive. He praised cruelty and deplored the fact that cruelty is more and more disappearing from our life. In one of his books, *Reflections on Violence*, he considered it a manifestation of decay that Marxian parties, calling themselves revolutionary, had degenerated into parliamentary parties. Where is the revolution if you are in Parliament? He also didn't like labor unions. He thought the labor unions should abandon the hopeless venture of seeking higher wage rates and should adopt, instead of this conservative pattern, the revolutionary process.

Sorel saw clearly the contradiction in the system of Marx who spoke of revolution on the one hand and then said, "The coming of socialism is inevitable, and you cannot accelerate its coming because socialism cannot come before the material productive forces have achieved all that is possible within the frame of the old society." Sorel saw that this idea of inevitability was contradictory to the idea of revolution. This is the contradiction all socialists ask themselves about—Kautsky, for one. Sorel completely adopted the idea of revolution.

Sorel asked of the labor unions a new tactic, *action directe*—attack, destroy, sabotage. He considered these aggressive policies only preliminary to the great day when the unions would declare a "general strike." That is the day when the unions will declare "Now we don't work at all. We want to destroy the life of the nation completely." General strike is only a synonym for the live revolution. The idea of *action directe* is called "syndicalism."

Syndicalism can mean ownership of the industry by the workers. Socialists mean by this term ownership by the state and operation for the account of the people. Sorel wanted to attain this by revolution. He didn't

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question the idea that history leads toward socialism. There is a kind of instinct that pushes men toward socialism, but Sorel accepted this as superstition, an inner urge that cannot be analyzed. For this reason his philosophy has been compared with that of Henri Bergson's *élan vital* (myths, fairy stories, fables, legends). However, in the doctrine of Sorel, "myth" means something else—a statement which cannot be criticized by reason.

1. Socialism is an end.

2. The general strike is the great means.

Most of Sorel's writings date from 1890 to 1910. They had an enormous influence on the world, not only on the revolutionary socialists, but also on the royalists, supporters of the restoration of the House of Orange, the "Action française," and in other countries the "Action nationale." But all these parties gradually became a little bit more "civilized" than Sorel thought they should be.

It was the idea of French Syndicalism that influenced the most important movement of the twentieth century. Lenin, Mussolini, and Hitler were all influenced by Sorel, by the idea of action, by the idea not to talk but to kill. Sorel's influence on Mussolini and Lenin has not been questioned. For his influence on Nazism, see the book by Alfred Rosenberg<sup>2</sup> titled *The Myth of the 20th Century*. The fundamental idea of racism was borrowed from Frenchmen. The only man who really contributed something to the Marxian idea was Sorel, along with a group of syndicalists—a comparatively small group composed exclusively of intellectuals and even of idle rich and intellectuals, like the "penthouse Bolsheviks" of New York. They repeated again and again that only the workers have enough vigor and enough class consciousness in order to search out and to destroy the bourgeois system.

The center of Marxian activity shifted from Germany to France. The greatest portion of Marxian writings are in French. Sorel's work was done in France. Outside of Russia, there are more Marxians in France than in any other country; there is, however, more discussion of communism in France than in Russia. The *École Normale Supérieure* in Paris was an important center of Marxian teachings. Lucien Herr [1864–1926], the librarian, had a great deal of influence. He was the father of French

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2 [Rosenberg [1893–1946] was a Nazi ideologist condemned to death for war crimes at Nuremberg on October 1, 1946. He was executed on October 16, 1946.—Ed.]

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Marxism. As former students of *École Normale Supérieure* became more and more important, the school spread Marxism all over France.

By and large, the same condition prevailed in most European countries. When the universities seemed slow to accept Marxism, special schools were endowed to educate the rising generations in orthodox socialism. This was the goal of the London School of Economics, a Fabian institution founded by the Webbs. But it couldn't avoid being invaded by persons of other ideas. For instance, [Friedrich A.] Hayek [1899–1992] taught for some years at the London School of Economics. This was the case in all countries—European countries had state universities. People generally ignored the fact that Marxians, not free traders, were appointed by the Tsar at the imperial universities in Russia. These professors were called legal, or better “loyal,” Marxians. When the Bolsheviks came to power in Russia, it was not necessary to fire the professors.

Marx didn't see any differences between the various parts of the world. One of his doctrines was that capitalism is one stage in the development of socialism. In this regard, there are some nations that are more backward than others. But capitalism was destroying the trade barriers and migration barriers that once prevented the unification of the world. Therefore, the differences in the evolution of the various countries with regard to their maturity toward socialism will disappear.

In the *Communist Manifesto* in 1848, Marx declared that capitalism was destroying all national peculiarities and unifying into one economic system all the countries of the world. The cheap prices of products were the means capitalism used to destroy nationalism. But in 1848, the average person didn't know anything about Asia or Africa. Marx was even less informed than the average English businessman who knew something about business relations with China and India. The only attention Marx gave to this problem was his remark, later published by Vera Zasulich, to the effect that it might be possible for a country to skip the capitalist stage and proceed directly to socialism. Marx saw no distinction between various nations. Capitalism, feudalism, brings about progressive impoverishment everywhere. Everywhere there will be mature economies. And when the age of mature capitalism comes, the whole world will have reached socialism.

Marx lacked the ability to learn by observing political events and the political literature being published around him. For him practically nothing existed but the books of the classical economists, which he found in the library of the British Museum, and the hearings of the British

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Parliamentary Commissions. He didn't even see what was going on in his own neighborhood. He didn't see that many people were fighting, not for the interests of the proletariat, but for the principles of nationality.

Marx completely ignored this principle of nationality. The principle of nationality asked that every linguistic group form an independent state and that all the members of such a group should be recognized and unified. This was the principle which brought about the European conflicts, led to the complete destruction of the European system, and created the present-day chaos in Europe. The principle of nationality doesn't take into account that there are large territories in which linguistic populations are mixed. Consequently there were struggles between the various linguistic groups which finally resulted in the situation we have today in Europe. I mention this because it is a principle of government which was unknown up to now.

According to this principle there is no such nation as India. It is possible that this principle of nationality will break India up into many independent states fighting one another. The Indian Parliament uses the English language. The members of the various states cannot communicate with one another, other than by employing the language of the government, a language which they have practically expelled from their country. But this situation will not last forever.

In 1848, when the Slavs of Europe met for a Panslavist Congress in Moscow, they had to speak with one another in German. But this didn't prevent later developments in a different way.

Karl Marx and Engels didn't like the nationalistic movement and never took notice of it. It didn't fit into their plans or schemes. If, on account of the unfriendly remarks Marx and Engels made about various linguistic groups of Austria-Hungary and the Balkans, some authors, especially French authors, think Marx was a forerunner of National Socialism—Nazism—they are wrong. Marx said that what he wanted was to create a one-world state. And that was Lenin's idea too.

By 1848 Marx had already assumed that socialism was just around the corner. Given such a theory, there was no reason to form a separate linguistic state. Such a state could only be very temporary. Marx simply assumed that the age of nationalities would come to an end, and that we were on the eve of an age in which there would no longer be differences between various types, classes, nations, linguistic groups, etc. Marx absolutely denied any differences among men. Men would all be of the

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same type. There was never any answer in Marx as to what language the people in his one-world state would use, or what the nationality of the dictator would be.

Marx was furious when someone said there were differences between men in the same nation, the same city, the same branch of business, just as all Marxists became furious when someone told them there were differences between Englishmen and Eskimos. According to Marx, the only difference was due to education. If an idiot and Dante had been educated in the same way, there would have been no difference between them. This idea influenced Marx's followers, and it is still one of the guiding principles of American education. Why is not everybody equally intelligent? Many Marxians assume that in the future socialist commonwealth the average person will be equal in talents, gifts, intelligence, artistic attainments, to the greatest men of the past, such as Trotsky, Aristotle, Marx, and Goethe, although there will still be some more gifted people.

It never occurred to Marx that, in the best case, education can only transfer to the pupil what the teacher already knows. In the case of Marx, it wouldn't have been enough for him to have been educated in a school by perfect Hegelian teachers because then everything he would have produced would have only been Hegelianism again. By educating people in the knowledge of the generation preceding motor cars, it wouldn't have been possible to produce motor cars. Education can never bring about progress as such. That some people, thanks to their positions, inheritance, education, and so on, have the gift to go one step farther than preceding generations cannot be explained simply by education.

Similarly, it is impossible to explain great things and the great acts of some men simply by referring to their national affiliation. The problem is, why were these people different from their brothers and sisters? Marx simply assumed, without any reason, that we are now living in the age of internationalism and that all national traits will disappear. In the same way that he assumed that specialization would disappear, because machines can be operated by unskilled workers, he assumed there would no longer be any differences between various parts of the world and various nations. Every kind of conflict between nations was interpreted as the consequence of the machinations of the bourgeoisie. Why do Frenchmen and Germans fight? Why did they fight in 1870? Because the ruling classes of Prussia and the ruling classes of France wanted to fight. But this had nothing to do with the interests of nations.

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In regard to his attitude toward war, Marx was, of course, influenced by the idea of the Manchester laissez-faire liberals. In using the term “Manchester liberalism” always as an insult, we tend to forget the essential statement in that famous declaration of the Manchester Congress where the term originated. It was said there that in the world of free trade there is no longer any reason for nations to fight one another. If there is free trade and every nation can enjoy the products of every other nation, the most important cause of war disappears. The princes are interested in increasing the territorial size of their princely province to get greater income and power, but nations as such are not interested, because it doesn’t make any difference under free trade. And in the absence of immigration barriers it doesn’t matter to the individual citizen whether his country is large or small. Therefore, according to the Manchester Liberals, war will disappear under popular democratic rule. The people will not then be in favor of war because they have nothing to win—they have only to pay and to die in the war.

It was this idea that was in the mind of President [Woodrow] Wilson [1856–1924] when he went to war against Germany. What President Wilson didn’t see was that all this about the uselessness of war is true only in a world when there is free trade between the nations. It is not true in a world of interventionism.

Sir Norman Angell [1872–1967] still argues in the same way. What did the individual Germans gain in 1870? This was almost true then, because there was comparatively free trade. But today the situation is different. Italy’s own policies made it impossible for Italians, in the world of interventionism, to get the raw materials they needed. It is not true in today’s interventionist world that the individual person does not gain something from war.

The League of Nations is one of the great failures in world history—and there have been many failures in world history. During the League’s 20 years the trade barriers had been more and more intensified. Tariffs became unimportant as trade barriers because embargoes were established.

Because the liberals said war was no longer economically advantageous because the people will not gain anything from it, therefore, a democratic nation will no longer be eager to fight wars. Marx assumed that this was true even in the interventionist world which was developing under his very eyes. This was one of the fundamental errors of Marxism. Marx was not a pacifist. He didn’t say war was bad. He only said—because the liberals said so—that war between nations had no importance or meaning at all.

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He said war—i.e., revolution, by which he meant civil war—was necessary. Nor was Friedrich Engels a pacifist; he studied military science day in and day out in order to prepare himself for the position he had assigned himself as commander-in-chief of all nations, as commander-in-chief for the proletarians of all countries united. Remember that he participated in fox hunting in a red coat, which he told Marx this was the best exercise for a future general.

Because of this idea of revolution—civil war, not international war—the Marxian International began to discuss peace. In 1864 Marx founded in London the First International. A group of persons who had very little to do with the people and the masses met together. There was a secretary for every country. The secretary for Italy was Friedrich Engels and many of the other countries were represented by persons who only knew the countries they represented as tourists. Arguments between the members disrupted the whole International. Finally it was moved to the United States and then fell apart in 1876.

The Second International was formed in Paris in 1869. But this Second International didn't know what to deal with. The unions had arisen and the unions were opposed to free trade and free migration. Under such conditions, how could you find subjects to be discussed at an international congress? Then they decided to discuss peace and war, but only on a national level. They said they were all proletarians and they agreed they would never fight the wars of the bourgeoisie. The Germans included Engels and Karl Kautsky. There were some "bad" Frenchmen in the group who asked, "What do you mean when you say we can't defend our own country? We don't like the Hohenzollerns." The French at this time made an agreement with the Russians and the Germans didn't like that. Every few years there was such an international congress and each time the newspapers said it heralded the end of war. But these "nice fellows" didn't discuss the real causes of friction, migration barriers, etc. The outbreak of World War I disrupted the International Congresses.

What Marx planned was a revolution. But what really happened was that he created a bureaucratic organization in the European countries which was, by and large, innocent because it lacked the power to execute its theories. Then there developed in the East a Communist organization that unfortunately has the power to execute people and to threaten the whole world. And all this was started in the Reading Room of the British Museum in London by a man, who was not in this regard a man of action, but who was able to bring about violent action. It was the timid bourgeois

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characters, Karl Marx and Georges Sorel, who created all this mischief. Most of the violent ideas of our times have come from men who themselves wouldn't have been able to resist any aggression.

Wilson accepted the doctrine of the Manchester Liberals, namely that so far as war was concerned, democracies don't like to fight wars; democracies fight only wars of defense because the individual citizen cannot expect any improvement of his conditions from war, not even if his country is victorious. But Wilson didn't see that this was true only in a world of free trade. He didn't see that this was quite different already in the age in which he lived, which was an age of interventionism. He didn't realize that an enormous change in economic policies had deprived this theory of the Manchester Liberals of its practicability. Trade barriers were comparatively innocent in 1914. But they were very much worsened during the years of the League of Nations. While free traders were meeting with the League in Geneva and talking about reducing trade barriers, people at home were increasing them. In 1933, there was a meeting in London to bring about cooperation among the nations. And precisely at this time the richest country, the United States, nullified the whole thing with monetary and financial regulations. After this the whole apparatus was absolutely useless.

Ricardo's theory of comparative advantage is that it is to the advantage to a nation to have free trade even if all other nations cling to their trade barriers. If the United States alone today adopted free trade there would be certain changes. But if all other countries clung to protectionism with import barriers, it would not be possible for the United States to buy more goods from other countries.

There are isolationists not only in this country; there are also isolationists in other countries. Imports must be paid for by exports and exports have no other purpose than to pay for imports. Thus the establishment of free trade by the richest and most powerful nation only would not change the situation for the Italians, for instance, if they retained their trade barriers. It would not make any difference for other countries either. It is advantageous for any country to have free trade even if all other countries do not, but the problem is to remove the barriers of the other countries.

The term "socialism," when it was new in the second part of the 1830s, meant exactly the same as "communism"—i.e., the nationalization of the means of production. "Communism" was the more popular term in

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the beginning. Slowly the term “communism” fell into oblivion and the term “socialism” came into use almost exclusively.

Socialist parties, social democratic parties, were formed and their fundamental dogma was the *Communist Manifesto*. In 1918, Lenin needed a new term to distinguish his group of socialists from those groups which he called “social traitors.” So he gave to the term “communism” a new meaning; he used it to refer, not to the final goal of socialism and communism, but only to the tactical means for attaining them. Until Stalin, communist meant simply a better method—the revolutionary method—as against the peaceful, socialist, method of the “socialist traitors.” At the end of the 1920s, without great success, Stalin in the Third International tried to give a different meaning to the term “communism.” However, Russia is still called the Union of the Soviet Socialist Republics (USSR).

In a letter, Karl Marx distinguished between two stages of socialism—the lower preliminary stage and the higher stage. But Marx didn’t give different names to these two stages. At the higher stage, he said, there will be such an abundance of everything that it will be possible to establish the principle “to everybody according to his needs.” Because foreign critics noticed differences in the standards of living of various members of the Russian Soviets, Stalin made a distinction. At the end of the 1920s he declared that the lower stage was “socialism” and the higher stage was “communism.” The difference was that at the lower socialist stage there was inequality in the rations of the various members of the Russian Soviets; equality will be attained only in the later, communist, stage.

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5TH LECTURE

# Marxism and the Manipulation of Man

IT IS AN ASTONISHING FACT that a philosophy like Marxism, which attacks the whole social system, remained for many decades more or less unattacked and uncontested. Karl Marx was not very well known in his lifetime and his writings remained practically unknown to the greater part of his contemporaries. The great socialists of his age were other men—for instance, Ferdinand Lassalle. Lassalle's agitations lasted only a year because he was killed in duel as a result of a private affair, but he was considered a great man in his age. Marx, on the other hand, was more or less unknown. People neither approved, nor criticized, his teachings. He died in 1883. After his death, there appeared the first part of Böhm-Bawerk's critique of the economic doctrines of Karl Marx.<sup>1</sup> And later in the 1890s, when the last volume of *Das Kapital* was published, there appeared the second part of this critique, which completely killed Marx's economic doctrines.<sup>2</sup> The most orthodox Marxians tried to revive and restate his doctrines. But there was practically no sensible critique of the philosophical doctrines of Karl Marx.

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1 [Eugen von Böhm-Bawerk, "The Exploitation Theory" in *Capital and Interest*, Vol. 1, *History and Critique of Interest Theories* (South Holland, Ill: Libertarian Press, 1959 [1884]), pp. 241–321—Ed.]

2 [Eugen von Böhm-Bawerk, "The Unresolved Contradiction in the Economic Marxian System" in *Shorter Classics of Eugen von Böhm-Bawerk*, (South Holland, Ill.: Libertarian Press, 1962 [1896; Eng. Trans. 1898]), pp. 201–302—Ed.]

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Marx's philosophical doctrines became popular in that people became familiar with some of his terms, slogans, and so forth, although they used them differently from the way they were used in the system of Karl Marx. Such simplification happens to many doctrines. For instance, Darwinism became known as the theory based on the idea that man is the grandson of an ape. What remains of Nietzsche is not much more than his term "superman," which later acquired popularity in the United States without any connection to Nietzsche. Regarding Marx, people know his terms but they use them very loosely. But by and large, Marxian ideas have little or no opposition.

One of the reasons why the doctrine of Marx was so diluted in the public mind was the way Engels tried to explain Marxian theory. See his statement at the graveside of Marx: "Marx discovered the law of mankind's historical evolution, i.e., the simple fact, hitherto hidden beneath ideological overgrowths, that men must first of all eat, drink, have shelter and clothing before they can pursue politics, science, art, religion, and the like."<sup>3</sup> Yet no one ever denied this. But now if someone says something against Marxian doctrine then they can be asked: "How can you be so stupid as to deny that one must first eat before one becomes a philosopher?"

Again there is the theory of the material productive forces. But no explanation is offered for their formation. Dialectical materialism states that the material productive forces come to the world—one doesn't know how they come, nor where they come from—and it is these material productive forces that create everything else, i.e., the superstructure.

People sometimes believe that there has been a very sharp conflict between the various churches and Marxism. They consider Marxism and socialism as incompatible with the teachings of all Christian churches and sects. The early communist sects and early monastic communities were based on a peculiar interpretation of the Bible in general, and of the book of Acts especially. We don't know much about these early communist sects but they existed in the Middle Ages and also in the early years of the Reformation. All these sects were in conflict with the established doctrines

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3 [Friedrich Engels, "Speech at the Grave of Karl Marx," Highgate Cemetery, London. March 17, 1883 (a version of this eulogy was published in the newspaper *La Justice*, March 20, 1883)—Ed.]

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of their churches or denominations. So it would be absolutely wrong to make the Christian church responsible for them. I mention this to show that, at least in the minds of some groups, most of which the church considered heretical, there is no absolute conflict between socialism and the teachings of the church. The anti-Christian tendencies of the socialist forerunners of Karl Marx, of Karl Marx himself; and later of his followers, the Marxians, must first of all be understood within the whole framework which later gave rise to modern socialism.

The states, the governments, the conservative parties, were not always opposed to socialism. On the contrary; the personnel of a government has a tendency or a bias in favor of the expansion of government power; one could even say that there is an “occupational disease” on the part of government personnel to be in favor of more and more governmental activities. It was precisely this fact, this propensity of governments to adopt socialism—and many governments really did adopt socialism—that brought Marxism into conflict with the various governments.

I have pointed out that the worst thing that can happen to a socialist is to have his country ruled by socialists who are not his friends. This was the case with respect to Karl Marx and the Prussian government. The Prussian government was not against socialism. Ferdinand Lassalle attacked the liberal parties of Prussia, which were at that time fighting a great constitutional battle against the Hohenzollern kings, headed by Bismarck. The majority in Prussia at that time was against the government; the government couldn't get a majority in the Prussian Parliament. The Prussian government was not very strong at that time. The King and the Prime Minister ruled the country without consent, without the cooperation of the Parliament. This was the case in the early 1860s. As an illustration of the weakness of the Prussian government, Bismarck, in his *Memoirs*, reported a conversation he had with the King. Bismarck said he would defeat the Parliament and the liberals. The King answered, “Yes, I know how that will end. Here in the square in front of the palace. First they will execute you and then they will execute me.”

Queen Victoria [1819–1901], whose oldest daughter [Victoria, 1840–1901] had married the royal prince of Prussia, was not very pleased by these developments; she was convinced that the Hohenzollerns would be defeated. At this critical moment Ferdinand Lassalle, who was at the head of a labor movement which was then still very modest, very small, came to the aid of the Hohenzollern government. Lassalle had meetings

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with Bismarck and they “planned” socialism. They introduced state aid, production cooperatives, nationalization, and general manhood suffrage. Later Bismarck really embarked on a program of social legislation. The greatest rival of the Marxians was the Prussian government, and they fought with every possible movement.

Now you must realize that in Prussia, the Prussian Church, the Protestant Church, was simply a department of the government, administered by a member of the Cabinet—the Minister of Education and Affairs of Culture. One of the councilors in the lower levels of the administration dealt with the problems of the church. The church in this regard was a state church; it was even a state church in its origin. Until 1817, there were Lutherans and Calvinists in Prussia. The Hohenzollerns didn’t like this state of affairs. The Lutherans were in the majority in the old Prussian territories, but in the newly acquired territories there were both groups. In spite of the fact that the majority of the whole Prussian people were Lutherans, the electorate of the Brandenburgs had changed from Lutherans to Calvinists. The Hohenzollerns were Calvinists, but they were the head of the Lutheran Church in their country. Then in 1817, under Frederick Wilhelm III of Prussia, the two churches were merged to form the Prussian Union Church. The Church was a branch of the country’s government.

From the seventeenth century on in Russia, the church was simply a department of the government. The church was not independent. Dependence of the church on the secular power was one of the characteristics of the Eastern Church at Constantinople. The head of the Eastern Empire was in fact the Superior of the Patriarch. This same system was to some extent carried over into Russia, but there the church was only a part of the government. Therefore, if you attacked the church, you also attacked the government.

The third country in which the problem was very critical was Italy, where the nationalist unification implied the abolition of the secular rule of the Pope. Until the second part of the nineteenth century the central part of Italy was ruled independently by the Pope. In 1860, the king of Sardinia conquered these states. The Pope retained only Rome, under the protection of a detachment of the French Army until 1860, when the French had to withdraw to fight Prussia. Therefore, there was a very violent feud between the Catholic Church and the Italian secular state. The struggle of the Church against the ideas of the Marxians concerning

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religion is something different from their struggle against the socialist program. Today it is complicated even more by the fact that the Russian Church, the Oriental Orthodox Church, came as it seems, to some agreement with the Bolsheviks. The struggle in the East is to a great extent a struggle between the Eastern Church and the Western Church—a continuation of the struggle that originated more than a thousand years ago between the two churches. Therefore, the conflicts in these countries, between Russia and the western boundaries of the Iron Curtain, are very complicated. It is not only a struggle against totalitarian economic methods for economic freedom; it is also a struggle of various nationalities, of different linguistic groups. Consider, for instance, the attempts of the present Russian government to make the various Baltic nationalities over into Russians—a continuation of something that had been started by the Tsars—and the struggle in Poland, Czechoslovakia, Hungary, and so on, against the attempts of the Russian Church to bring them back, as they say, to the Oriental Creed. To understand all these struggles one needs a special familiarity with these nationalities and with the religious histories of these parts of the world.

In the sixteenth and seventeenth centuries there were changes that expanded the size of the territory in which the Pope's supremacy was acknowledged. Therefore, there existed a Russian Church, the Orthodox Church, and a Ukrainian or Russian Catholic Church which acknowledged the supremacy of the Pope. All these things together constituted the great religious struggles of the East. However, one must not confuse the events happening in these nationalistic and religious struggles with the fight against communism. For instance, the politicians fighting against the Russians today are not always, or at least not in most cases, fighters in favor of a free economic system. They are Marxians, socialists. They would probably like to have a totalitarian police state, but they don't want it to be governed by the Russians.

From this point of view, one cannot say that there is any real opposition to the social teachings and social programs of Marxism. On the other hand, it is important to realize that there isn't necessarily always a connection between anti-Marxism, an ideological philosophy, and economic freedom.

One of the outstanding contemporaries of Karl Marx in Germany was a philosopher, Friedrich Albert Lange [1828–1875]. He wrote a famous

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book, *The History of Marxism*, considered for many years, not only in Germany but also in English-speaking countries, one of the best introductions to philosophy. Lange was a socialist; he wrote another book about socialism. In his book he didn't criticize Marx, but rather materialism. Marxian materialism is a very imperfect materialism because it traces all changes back only to something which is itself already the product of the human mind.

It is important to stress the fact that the critiques of Marxism were sometimes very wrong. I want to point to only one typical example. This is the popular propensity of anti-Marxians to consider dialectical materialism and Marxism as something belonging to the same group of ideas as Freudian psychoanalysis. I am not a psychologist, but I only have to point out how mixed up these people are who believe that materialism in general and Marxian materialism in particular have some connection with Freudian psychoanalysis.

Before Sigmund Freud [1856–1939] and Josef Breuer [1842–1925], who opened up this whole method of thinking, began to develop their doctrines, it was the generally uncontested assumption among all doctors that mental disabilities were caused by pathological changes in the human body. If a man had something that was called a nervous or mental disease they looked for some bodily factor that brought about this state of affairs. From the point of view of the doctor who deals with the human body this is the only possible interpretation. However, sometimes they were absolutely correct when they said, "We don't know the cause." Their only method was to look for a physical cause. One could give many examples. I want to cite only one. It happened in 1889, just a few years before the first book of Freud and Breuer was published. An eminent man in France committed suicide. For political reasons and because of his religion, the question was raised whether or not he was sane. His family wanted to prove that it was a mental disease. In order to prove his mental disease to the Church, they had to discover some physical cause. There was an autopsy by eminent doctors, and their report was published. "We discover certain things in the brain," they said; "there is something that is not regular." At that time, people thought that if a man doesn't behave like other people has no physical sign of abnormality in his body, he is a malingerer. Sometimes this is unfortunate, because one can only discover whether or not a person is a malingerer after he is dead. In this regard,

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psychoanalysis brought about a great change. The case of Crown Prince Rudolf of Austria [1858–1889], who committed suicide at Mayerling, raised similar issues.<sup>4</sup>

The famous first case was that of a woman who was paralyzed. Yet nothing could be discovered in her body to explain her situation. The case was written up by a man who followed the advice of a Latin poet: wait nine years with your manuscript before you publish. Breuer got the idea that the origin of this bodily deficiency was not physical but that it was in the mind. This was a radical change in the field of the natural sciences; such a thing had never happened before—a discovery that mental factors, ideas, superstitions, fables, wrong ideas, what a man thinks, what he believes, can bring about changes in the body. This was something that all the natural sciences had denied and contested before.

Freud was a very conscientious and cautious man. He didn't say, "I have completely discredited the old doctrines." He said, "Perhaps one day, after a very long time, the pathological doctors will discover that ideas are already the product of some physical external bodily factor. Then psychoanalysis will no longer be needed or useful. But for the time being you must at least admit that there is a temporary value in Breuer's and my discovery and that, from the point of view of present-day science, there is nothing that confirms the materialist thesis that every idea or every thought is the product of some external factor, just as urine is a product of the body. Psychoanalysis is the opposite of materialism; it is the only contribution to the problem of materialism vs. idealism that has come from empirical research in the human body.

We have to deal with the ways some people abuse psychoanalysis. I do not defend those psychoanalysts who try to explain everything from the point of view of certain urges, among which the sex urge is considered the most important. There was a book by a Frenchman dealing with Baudelaire [Charles Baudelaire, 1821–1867]. Baudelaire liked to spend money, but he didn't earn money because publishers didn't buy his poems during his lifetime. But his mother had money; she had married money and her husband died and left it to her. Baudelaire wrote his mother a lot

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4 [Carl Menger, founder of the Austrian School of Economics served as one of Rudolf's tutors. See Erich W. Streissler and Monika Streissler, eds., *Carl Menger's Lectures to Crown Prince Rudolf of Austria* (Brookfield, Vt.: Edward Elgar, 1994).—Ed.]

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of letters. This writer found all sorts of subconscious explanations for his letters. I don't defend this attempt. But his letter writing doesn't need any further explanation than that Baudelaire wanted money.

Freud said he didn't know anything about socialism. In this regard he was very different from Einstein [1879–1955] who said, "I don't know anything about economics, but socialism is very good."

If we follow how Marxism became the leading philosophy of our age, we must mention Positivism and the school of Auguste Comte. Comte was a socialist similar to Karl Marx. In his youth, Auguste Comte had been the secretary of Saint-Simon. Saint-Simon was a totalitarian who wanted to rule the whole world by world council and, of course, he believed he would be the president of this world council. According to Comte's idea of world history, it was necessary to search for the truth in the past. "But now, I, August Comte, have discovered the truth. Therefore, there is no longer any need for freedom of thought or freedom of the press. I want to rule and to organize the whole country."

It is very interesting to follow the origin of certain terms which are today so familiar that we assume they must have been in the language from time immemorial. In French, the words "organize" and "organizer" were unknown before the end of the eighteenth century or the beginning of the nineteenth century. With regard to this term, "organize," Balzac<sup>5</sup> observed "This is a new-fangled Napoleonic term. This means you alone are the dictator and you deal with the individual as the builder works with stones."

Another new term, "social engineering," deals with the social structure. The social engineer deals with the social structure or with his fellowmen as the master builder deals with his bricks. Reasoning in this way, the Bolsheviks eliminate those individuals who are useless. In the term "social engineering" you have the idea of planning, the idea of socialism. Today we have many names for socialism. If a thing is popular, then the language has many expressions for it. These planners say in defense of their ideas, you must plan things; you cannot let things act "automatically."

Sometimes "automatically" is used in a metaphorical sense to apply to things that happen on the market. If the supply of a product drops, then

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5 [Honoré de Balzac (1799–1850)]

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they say prices go up “automatically.” But this doesn’t mean that this is done without human consciousness, without some persons bidding and offering. Prices go up precisely because people are anxious to acquire these things. Nothing in the economic system happens “automatically.” Everything happens because certain people behave in a definite way.

Also the planners say, “How can you be so stupid as to advocate the absence of planning?” But no one advocates the absence of plan. The question is not “Plan, or no plan.” The question is “Whose plan? The plan of one dictator only? Or the plan of many individuals?” Everyone plans. He plans to go to work; he plans to go home; he plans to read a book; he plans a thousand other things. A “great” plan eliminates the plans of everybody else; then only one plan can be supreme. If the “great” plan and the plans of individuals come into conflict, whose plan is to be supreme? Who decides? The police decide! And they decide in favor of the “great” plan.

In the early days of socialism, some critics of socialism used to blame socialists for their ignorance of human nature. A man who must execute the plan of somebody else only would no longer be a man of the kind we call human. This objection was answered by those socialists who said, “If human nature is against socialism, then human nature will have to be changed.” Karl Kautsky said this many years before, but he didn’t give any details.

The details were provided by Behaviorism and by [Ivan] Pavlov [1849–1936], the psychologist mentioned in every book by a Marxist. The explanation was offered by Pavlov’s conditioned reflex. Pavlov was a Tsarist; he made his experiments in the days of the Tsar. Instead of human rights, Pavlov’s dog had canine rights. This is the future of education.

The Behaviorist philosophy wants to deal with human individuals as if there were no ideas or no faults in men. Behaviorism considers every human action as a reaction to a stimulus. Everything in the physical and physiological nature responds to certain reflexes. They say, “Man belongs to the same realm as animals. Why should he be different? There are certain reflexes and certain instincts that guide men to certain ends. Certain stimuli bring about certain reactions.” What the Behaviorists and the Marxists did not see was that you cannot even discredit such a theory of stimuli without entering into the meaning that the individual attaches to such stimuli. The housewife, when quoted the price of an object which she is considering buying, reacts differently to \$5 than she does to \$6. You

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cannot determine the stimulus without entering into the meaning. And the meaning itself is an idea.

The Behaviorists' approach says, "We will condition the other people." But who are the "we"? And who are the "other people?" "Today," they say, "people are conditioned for capitalism by many things, by history, by good people, by bad people, by the church, etc., etc."

This philosophy doesn't give us any answer other than the answer we have already seen. The whole idea of this philosophy is that we must accept what Karl Marx told us because he had the great gift—he was entrusted by Providence, by the material productive forces, with discovering the law of historical evolution. He knows the end toward which history leads mankind. This leads eventually to the point where we must accept the idea that the party, the group, the clique, that has defeated the others by force of arms, is the right ruler, that he is called by the material productive forces to "condition" all other people. The fantastic thing is that the school which develops this philosophy calls itself "liberal" and calls its system a "people's democracy," "real democracy," and so on. It is also fantastic that the Vice President of the United States [Henry Wallace, 1888–1965] one day declared, "We in the United States have only a civil rights democracy—but in Russia there is economic democracy."

There was a socialist author, valued highly by the Bolsheviks in the beginning, who said the most powerful man in the world is the man in whose favor the greatest lies are told and believed. (Something similar was said by Adolf Hitler.) Here is the power of this philosophy. The Russians have the power to say, "We are a democracy and our people are happy and enjoy a full life under our system." And other nations seem to be unable to find the right answer to this idea. If they had found the right answer, this philosophy wouldn't be so popular.

There are people living here in the United States, at an American standard of living, who think they are unhappy because they do not live in Soviet Russia where, they say, there is a classless society and everything is better than it is here. But it seems that it is not very much fun to live in Russia, not only from the material point of view, but from the point of view of individual freedom. If you ask, "How is it possible that people say everything is wonderful in a country, Russia, in which everything is probably not very wonderful," then we must answer, "Because our last three generations were unable to explode the contradictions and the failures of this philosophy of dialectic materialism."

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The greatest philosophy in the world today is that of dialectical materialism--the idea that it is inevitable that we are being carried toward socialism. The books that have been written up to now have not succeeded in countering this thesis. You must write new books. You must think of these problems. It is ideas that distinguish men from animals. This is the human quality of man. But according to the ideas of the socialists the opportunity to have ideas should be reserved to the Politburo only; all the other people should only carry out what the Politburo tells them to do.

It is impossible to defeat a philosophy if you do not fight in the philosophical field. One of the great deficiencies of American thinking--and America is the most important country in the world because it is here, not in Moscow, that this problem will be decided--the greatest shortcoming, is that people think all these philosophies and everything that is written in books is of minor importance, that it doesn't count. Therefore they underrate the importance and the power of ideas. Yet there is nothing more important in the world than ideas. Ideas and nothing else will determine the outcome of this great struggle. It is a great mistake to believe that the outcome of the battle will be determined by things other than ideas.

Russian Marxists, like all other Marxists, had the idea that they wanted to nationalize agriculture. That is, the theorists wanted to--the individual worker did not want to nationalize the farms; they wanted to take the big farms, break them up, and distribute the land among the small farmers. This has been called "agrarian reform." The social revolutionaries wanted to distribute the farms to the poor peasants. In 1917, Lenin coined a new slogan, "You make revolution with the slogan of the day." Therefore, they accepted something that was against Marxism. Later they started the nationalization of farm lands. Then they adopted this idea in the new countries they took over; they told every man that he would get his own farm.

They started this program in China. In China they took the big farms and abolished the rights of mortgage banks and landlords and freed the tenants from making any payments to the landlords. Therefore, it was not philosophy that made the Chinese peasants communistic, but the promise of a better life; people thought they would improve their conditions if they could get some farm land owned up to then by wealthier people. But this is not the solution for the Chinese problem. The advocates of this program were called agricultural reformers; they were not Marxians. The idea of land distribution is entirely un-Marxian.

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*[Additional comments by Mises during the question-and-answer period]*

Majorities are also not godlike. “The people’s voice is God’s” is an old German maxim, but it is not true. The basis of the idea of talking about pleasing the majority is that in the long run the majority will not tolerate rule by a minority; if the majority are not pleased there will be a violent revolution to change the government. The system of representative government is not radical; it is precisely a way to make a change of government possible without violence; many think that, with the approval of the people, they can change the government at the next election. Majority rule is not a good system but it is a system that assures peaceful conditions within the country. Newspapers, periodicals, books, and so on, are the opinion-makers.

The great progress of the modern age is that it led to representative government. The great pioneer of this idea was the British philosopher David Hume [1711–1776],<sup>6</sup> who pointed out that in the long run government is not, as people believed, based on military power, but on opinion, on the opinion of the majority. What is needed is to convince the majority. It is not because the majority is always right. On the contrary, I would say the majority is very often wrong. But if you do not want to resort to a violent overthrow of the government, and this is impossible if you are the minority because if you are the minority they will overthrow you, you have only one method—to talk to the people, to write, and to talk again.

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6 [David Hume, “Of the First Principles of Government,” Chapter 4, in Eugene F. Miller, ed., *Essays, Moral, Political, and Literary*, (Indianapolis: Liberty Fund, 1987)—Ed.]

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# The Making of Modern Civilization: Savings, Investment, and Economic Calculation

INSTITUTIONALISM<sup>1</sup> used to ridicule the classical economists because they started with “Crusoe economics.” In the beginning a fisherman got the idea that he could catch more fish one day than he needed and then he could have some leisure time to manufacture fishing nets. These nets and saved fish are “capital goods”; I don’t call them “capital.”

Capital goods are the intermediate factors between the given natural factors of production and consumer goods. Nature—given resources and human labor are the given natural factors. But if they are to produce, they must be guided. The produced, intermediary factors of production—capital goods—are not only tools; they are also all other intermediary goods, half-finished products, and supplies of consumer goods which are used for the support of those who are producing with the aid of capital goods. The production process which we are organizing and operating today started in the early ages of history, in the remotest ages of history. If the children used up the nets and fish produced by their parents, capital accumulation would have had to start all over again. There is a continuous progress from simpler conditions to more refined conditions. It is important to realize this because we must know that, from the early beginnings on, the first step toward this system of producing with the aid of capital goods was saving, and has always been saving.

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1 [A school of thought that stresses the importance of social, historical, and institutional factors within the economic realm rather than individual human action.]

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The concept of “capital” must be distinguished from the concept of “capital goods.” It is impossible to think and to deal with the problems of capital goods without using and referring to the concepts which we have developed in the complicated modern system of capital calculation. Capital goods are something material—something that could be described in terms of physics and chemistry. The concept of “capital” refers to the *valuation* of a supply of these capital goods in terms of money. This valuation of capital goods in terms of money is what marks the beginning of what may be called a new and higher period in human endeavors to improve the external conditions of mankind. The problem is how to maintain or to preserve the amount of capital available and how to avoid consuming the available capital goods without replacing them. The problem is how not to consume more, or if possible, how to consume less, than the amount of newly produced products. It is the problem of capital preservation, maintenance, and of course of increasing the capital available.

Under some circumstances, it is possible to deal with this problem without any special calculation or computation. If a farmer continues to produce in the same way and if the methods of construction and method of living haven’t changed, he can estimate his condition because he can establish comparisons in physical and biological terms—two barns are more than one barn, a dozen head of cattle is more than two cows, and so on. But such simple methods of computation are insufficient in an economic system in which there is change and progress. Replacement may not be in the same form as the factors which are used up. Diesel engines may be substituted for steam engines, and so on. Replacement and maintenance of capital under such conditions require a method of computation and calculation which can only be figured in terms of money. The various physical and external factors of production cannot be compared in any other way than from the point of view of the services they render to men, calculated in terms of money.

It was one of the fundamental errors of Aristotle that he believed that in exchanges the things which were exchanged must have the same value. Since the days of Aristotle, for two or three thousand years, the same error has prevailed again and again, leading great thinkers, as well as simple men, astray. The same error appears in the first pages of Marx’s *Das Kapital*, making everything Marx said about these problems useless. This error was repeated even much later in the writings of Henri Bergson [1859–1941], the eminent French philosopher.

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There is no equivalence in exchange. On the contrary, it is differences that bring about exchange. You cannot reduce the terms of exchange and of trade to equivalence; you can only reduce them to differences in evaluation. The buyer values what he gets more highly than what he gives away; the seller values what he gives less highly than what he gets. Therefore, the equivalence that we use in determining the importance the various capital goods have in our lives can only be expressed in terms of prices. In calculating in terms of prices you can establish a system of prices, and determine whether or not a price has increased or decreased—that is, in terms of money. Without a price system there cannot be any calculation. In the socialist system, which cannot have a price system as we have it in the market system, there cannot be established calculation and computation.

In the system of economic calculation, we have the terms “capital” and “income”—terms and notions that cannot be thought of outside this system. “Capital” is the sum of the prices that can be obtained on the market for a definite given supply of capital goods. The businessman employs economic calculation in a specific way; he could not operate without this system of economic calculation. At the beginning of his enterprise he establishes a total value of all the capital goods at his disposal and calls it his “capital,” or the “capital” of his firm or corporation. Periodically, he compares the value of the prices of all the capital goods available in the firm with the prices of these capital goods at the beginning. If there is an increase he calls it “profit.” If there is a decrease, he calls it “loss.” No other system would make it possible to establish whether what has been done has increased the capital available, improved it, or decreased it. From another point of view, the total surplus that he calls “profit” can also be called “income,” insofar as it makes it possible for the owner—corporation or individual—to consume this amount without reducing the amount of capital available and without, therefore, living at the expense of the future. Thus the concepts of “capital” and “income” developed only within this system of economic calculation.

If the total amount of “income” is consumed, then there is no change in the amount of capital available for the enterprise. If a part is saved, i.e., not consumed but reinvested—that is, if it is used to expand the stock of capital goods working in the enterprise—then we can say additional capital has been accumulated; the enterprise has earned some “income.” If the contrary is the case, if the amount consumed by the owner exceeds the income, then we have capital consumption, or capital

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decumulation, and there will be less available in the future for the production of consumer goods.

I don't want to enter into how much knowledge the ancient Greeks and Romans had of these ideas. They had some knowledge at least, but by the Middle Ages it had entirely disappeared. Under the conditions of the Middle Ages, there was no need for such calculation. It developed slowly, step by step in the latter part of the Middle Ages in the countries in which at that time economic progress was much better than other countries, in Italy, for instance. As a result, some of the fundamental terms of accountancy preserve their Italian origin, for instance the word "capital" itself.

In the beginning, the terms of accountancy were not very clear. People were not very good at arithmetic, and we discover very bad errors simply in arithmetical problems even in the books of big fifteenth-century firms. Gradually these ideas developed more and more until the system of double-entry bookkeeping was developed. Our whole thinking is now influenced by these ideas, even the ideas of those who know nothing of the problems of accountancy and who are not in a position to read and interpret the balance sheet of a corporation. Accountants and bookkeepers are only the handymen in this fundamental way of dealing with all material and external problems. However, these problems concern others than accountants and bookkeepers. Goethe, who was a great poet, scientist, and a precursor of the science of evolution, described a merchant's double-entry accounting system as "one of the most marvelous inventions of the human spirit." Goethe realized these ideas were fundamental to the modern system of producing and acting and that these concepts were a kind of practical mathematics and logic in the way people deal with all these problems.

In our age, public opinion and legislation have completely lost all understanding of these problems. This is due to modern income-tax legislation. First of all, in the legislation concerning income taxes, the law-giver calls salaries and wages "income" or "earned income." However, the main characteristic of "income" in the economic sense is that it is that surplus over a businessman's costs that may be consumed without reducing capital, i.e., without living at the expense of the future. You cannot consume "income" without deteriorating your opportunities for future production. The concepts of "capital" and "income" developed only within the system of economic calculation.

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These income-tax laws also deal with “profits” as if they were salaries. The income-tax authors are very astonished if a firm doesn’t have a profit every year. They don’t realize that there are good years and bad years for an enterprise. One consequence was that during the depression in the early 1930s people used to say, “How unjust that a man who owns a big factory doesn’t have to pay any income tax this year, while a man who makes only \$300 a month has to pay.” It was not unjust from the point of view of the law; that year the big factory owner had no “income.”

The authors in promulgating these income-tax laws had not the slightest idea of what “capital” and “income” in the economic system really meant. What they didn’t see was that the greater part of the great profits and great incomes wasn’t spent by the businessmen, but reinvested in capital goods and plowed back into the enterprise to increase production. This was precisely the way in which economic progress, improvement in material conditions, took place. Fortunately I do not have to deal with the income-tax laws, nor with the mentality that led to these laws. It is enough to say that, from the point of view of the individual worker, it would be much more reasonable to tax only income spent, *not* income saved and reinvested.

In many cases, it is difficult for a man in the late years of his life to make a living, or at least to earn as much as he had earned in his prime. To make it simple, take the situation of singers whose years of big earning are definitely limited.

What I want to deal with is the idea that saving in general, or that saving under special circumstances, is supposedly bad from the point of view of the welfare of the commonwealth and, therefore, that something should be done to restrict saving or to direct it into special channels. In fact, we may say, and nobody can deny it, that all material progress, everything that distinguishes our conditions from those of earlier ages, is that more has been saved and accumulated as capital goods. This also distinguishes the United States from, let us say, India or China. The most important difference is only a difference in time. It is not too late for them. We just started earlier to save some of the excess of production over consumption.

The most important institutional factor in the development of nations was the establishment of a system of government and of legislation that made large-scale saving possible. Large-scale saving was impossible and still is impossible today in all those countries in which the governments believe that when one man has more it must necessarily be the cause of other

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people's distress. This was once the idea of all people. And it is today the idea of the people in many countries outside the countries of Western civilization. It is the idea that is now jeopardizing Western civilization by introducing different methods of government into the constitutions which made possible the development of Western civilization. It was also the idea prevailing in most European countries until the rise of modern capitalism, that is, until the age very inappropriately called the "Industrial Revolution."

To show how strong this idea was, I quote from Immanuel Kant [1724–1804], one of the most important philosophers—but he lived in the east, in Kaliningrad, then called Königsberg: "If one man has more than necessary, another man has less." This is mathematically perfectly true, of course, but mathematics and economics are two different things. The fact is that in all those countries in which people believed in this dictum and in which governments believed that the best way to improve conditions was to confiscate the wealth of successful businessmen—it was not necessary to confiscate the wealth of those who were unsuccessful—in all those countries, it was not possible to save and invest.

If someone asked me why the ancient Greeks did not have railroads, I would answer, "Because there was a tendency in those days to confiscate wealth. Why should people then invest?" The Greek philosopher Isocrates [436–438 BC] made some speeches which are still available to us. He said if a wealthy citizen stood trial in Athens he had no chance to win because the judges wanted to confiscate his wealth, expecting this would improve their situation. Under such conditions there couldn't be any question of large-scale savings.

Large-scale savings developed only from the eighteenth century on. And from that time on there developed also those institutions which made saving and investment possible, not only by the well-to-do, but also of small sums by the poor man. In the early days the poor man could save only by hoarding coins. But coins don't bear any interest, and the advantage he got from his savings was not very great. Moreover, it was dangerous to have such small hoards in his regular home; they could be stolen easily and they didn't earn anything. From the beginning of the nineteenth century on, we had a large-scale development that made saving possible for the broad masses.

One of the characteristic differences between a capitalistic and a pre-capitalistic system is that in the capitalistic system even those who are not very well off are owners of savings and have small investments. Many

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people do not recognize this difference. Still today, in dealing with the problem of interest, statesmen, or politicians, as well as public opinion, believe that creditors are the rich and the debtors are the poor. Therefore, they think that a policy of easy money, a policy of lowering interest rates artificially by government interference, is in favor of the poor and against the rich. In fact, the poor and the less well-to-do own deposits with savings banks, have bonds, insurance policies, and are entitled to pensions. According to a newspaper account today, there are 6½ million owners of bonds (promises to pay) in this country. I don't know whether or not this figure is accurate. But nevertheless these bonds are widely distributed, and so this means that the majority are not debtors but creditors. All these people are creditors. On the other hand, the owners of the common stock of a corporation that has issued bonds, or is indebted to banks, are not creditors, but debtors. Similarly the big real estate operator who has a big mortgage is also a debtor. Therefore, it is no longer true to say that the rich are creditors and the poor are debtors. Conditions in this regard have changed considerably.

One of Hitler's great rallying cries was: "Do away with interest slavery. Long live the debtor; perish the creditor." But one German newspaper recognized the error in this and wrote an article with the headline, "DO YOU KNOW THAT YOU YOURSELF ARE A CREDITOR?" I cannot say that this article was appreciated by Hitler.

There developed some years ago a hostility to saving and capital accumulation. This opposition to saving can't be attributed to Marx, because Marx didn't understand how capital was accumulated. Karl Marx didn't foresee the development of large corporations and ownership by many small savers. A Russian economist who was influenced by Marx declared years ago that the whole economic system of capitalism was self-contradictory. Instead of consuming everything that was produced, a great part of the things produced is saved and accumulated as additional capital. There will be more and more for coming generations. What is the sense of this? For whom do they accumulate all this? Like a miser they accumulate, but who will enjoy what the saver earns? It is ridiculous; it is bad; something should be done about it.

John Maynard Keynes [1883–1946] succeeded with his anti-saving program. According to him, there is danger in over-saving. He believed, and many people accepted his view, that opportunities for investment were limited. There may not be sufficient investment opportunities to absorb all the income that is set aside as savings. Business will become bad because there is too much savings. Therefore, it was possible to save too much.

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The same doctrine from another point of view had been prevalent for a very long time. People believed that a new invention—a labor-saving device—would produce what was called “technological unemployment.” This was the idea that led the early unions to destroy machines. Present-day unions still have the same idea, but they are not so unsophisticated as to destroy the machines—they have more refined methods.

As far as we can see, human wants are practically unlimited. What we need to fulfill satisfactions is more accumulation of capital goods. The only reason we don’t have a higher standard of living in this country is that we don’t have enough capital goods to produce all the things that people would like to have. I don’t want to say that people always make the best use of economic improvements. But whatever it is that you want, it requires more investment and more manpower to satisfy it. We could improve conditions, we could think of more ways to employ capital, even in the wealthiest parts of the United States, even in California. There will always be plenty of room for investment as long as there is scarcity of the material factors of production. We cannot imagine a state of affairs without this scarcity. We cannot imagine life in a “Land of Cockaigne,” where people have only to open their mouths and let food enter and where everything else people wanted was available.

Scarcity of the factors of production means a scarcity of capital goods. Therefore, the whole idea that we must stop saving and start spending is fantastic. In 1931 or 1932, Lord Keynes and a number of his friends published a declaration in which they stated there was only one means to avoid catastrophe and to improve economic conditions immediately—that was to spend, spend more, and still more. Economically we must realize that spending in this sense does not create jobs that investment wouldn’t have created just as much. It doesn’t matter whether you use your money for the purchase of a new machine or you spend it in a night club. According to Keynes’s theory the man who spends the money on a better life creates jobs, while the man who buys a machine and improves production is withholding something from the public.

It is not true that when Keynes wrote his book conditions in Great Britain justified his theory of government spending to create full employment. What created the unfavorable situation in Great Britain was that British industries after World War I did not have the means required to improve the material equipment in their factories. Therefore, the British machines were inefficient when compared with the machines in some other countries, especially in the United States. As a result, the marginal productivity of labor was lower in Britain. But as the unions would not

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tolerate any significant reduction of wage rates to make British industry more competitive, the result was unemployment. What Great Britain needed was more investment to improve the productivity of the factors of production, just as they need to do the same today.

Lord Keynes was very peculiar about this idea. An American friend published an article dealing with his personal friendship with Lord Keynes. He tells a story about visiting Keynes in a Washington hotel. In washing his hands, the friend was very careful not to soil more than a single towel. Keynes then crumpled all of the towels and said in that way he was making more jobs for American chambermaids. From this point of view, the best way to increase employment would be to destroy as much as possible. I would have thought that idea had been demolished once and for all by Frédéric Bastiat [1801–1850] in his broken window story.<sup>2</sup> But evidently Keynes didn't understand this tale of Bastiat's.

The fallacy that labor-saving machines create technological unemployment has not only been disproved by theoretical examination but also by the fact that the whole history of mankind consists precisely of the introduction of more and more labor-saving machines. Today we produce a greater amount of various amenities with a smaller amount of human labor. Yet there are more people and more employment. Therefore, it is not true that people are deprived of their jobs because some new machines are invented.

It is no less a fable, and it is also a very bad fable, that the accumulation of capital hurts the workers. The more capital goods available, the higher the marginal productivity of labor—other things being equal. If an employer considers the hiring of an additional worker or the firing of an additional worker, he asks himself what the employment of this man adds to the value of his products. If the employment of one worker more adds something to the quantities produced, the employer's problem is, does his employment cost more than it brings from the sale of his production? The same problem arises when the employment of an additional amount of capital goods is considered. The greater amount of capital available per head of the worker, the greater the marginal

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2 [See "What Is Seen and What Is Not Seen," an excerpt from the first chapter of Bastiat's *Selected Essays on Political Economy*, translated by Seymour Cain and edited by George B. de Huszar (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1995 [1964]), reprinted in *The Freeman: Ideas on Liberty*, June 2001.—Ed.]

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productivity of the worker and consequently the higher the wages the employer can pay. The more capital accumulated—other things being equal—the more workers can be employed at the same rates, or at higher rates.

Two businessmen—J. Howard Pew [1882–1971] of Sunoco, and Irving Olds [1887–1963] of U. S. Steel—have tried, without too much success, to explain to other businessmen the effect of inflation on their capital accumulation, inventories, depreciation, and so forth. Inflation raises the businessmen's selling prices, creating the illusion that they are making profits. The government then taxes and uses for current expenses these apparent "profits" which would otherwise have been used for investment or set aside for depreciation and replacement.

If an individual takes out a policy with a private insurance company, the insurance company invests this money. Later, of course, when the insurance has to be paid out, it has to disinvest. Individuals come to the point where they must disinvest, but insurance companies expand from year to year, and as there is capital accumulation taking place in the whole country, the insurance companies as a whole do not have to disinvest.

It is different with the Social Security system. The government talks about actuarial statistics but this does not mean what it means to an insurance company. What the individual pays, the government spends for current expenses. The government then gives to the "Social Security Fund" an IOU which it calls a "bond." Thus the government "invests" in government bonds. When the government collects "Social Security" taxes, it says, "give me your money to spend and in return I promise that in 30 or 40 years the taxpayers will be willing to pay back the debt which we have incurred today." Therefore the Social Security system is something very different from private insurance. It doesn't mean something has been saved. On the contrary, the savings of individuals are collected by government for "social security" but they are used for current expenses. I am fully convinced the government will pay, but the question is, in what kind of dollars? The whole thing depends on the readiness of future Congresses and the future public to pay in good money. If people don't like the paper money, they won't use it. For instance, California stayed on hard currency during the Civil War era of the greenbacks.

Bismarck's idea of social security was that he wanted everybody to receive something from the government. He compared the situation with that of the French, many of whom owned government bonds and received interest. He thought that was why the French were so patriotic; they

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were receiving something from the government. Bismarck wanted the individual German, too, to depend on the government. So he started an additional government bonus of 50 Marks to every old-age pensioner. This was called the *Reichszuschuss* [governmental supplementary allowance].

The problems of capital are problems of economic calculation. You cannot increase “capital goods” by inflation, although you can *seemingly* increase “capital.” The result is a discrepancy between capital goods and capital, as is pointed out by economic calculation.



7TH LECTURE

# Money, Interest, and the Business Cycle

THERE ARE TWO PURELY THEORETICAL PROBLEMS which have had serious influences and serious consequences that cannot be exaggerated.

The first of these two problems relates to the taking of interest. This leads us back to Aristotle and his famous dictum, “Money cannot beget money.” Aristotle found interest a very difficult problem. He was responsible for the error that interest was paid for the *use of money*. For many centuries, for two thousand years, this was the theoretical basis of the legal prohibition of interest-taking on loans. People saw only the interest on loans; they didn’t see that interest stemmed from a general category of human action, that it arose out of the fact that all people by necessity, without any exception, valued present goods higher than future goods. Therefore, this meant that the discounted values and discounted prices of future goods as against present goods could not be eliminated simply by a government fiat, rule, or command. When the Roman Empire’s “capitalism” broke down and the highly developed Roman economic system was supplanted by the economy of the invading tribes—an economy that was purely agricultural and based on the self-sufficiency of every householder’s farm—the general prohibition against the taking of interest was increasingly enforced.

In many parts of Europe there was a struggle against the taking of interest. At the head of this struggle was the Church. For a thousand years, the councils of the Church repeated the unconditional prohibition of interest. But in order to find a theoretical basis for this prohibition they

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could not use the Gospels and the New Testament—they had to go back to the law of Moses. There they found a passage referring to the taking of interest on loans lent to Jews and not to Gentiles. Later at the beginning of the twelfth century the theologians found a passage in the Gospels<sup>1</sup> which could also be interpreted as being against interest taking. This, however, did not refer specifically to interest taking; it said, “lend, hoping for nothing again.” I think that translation is correct. This raised a problem which we needn’t go into, but which was contested by theologians and historians of law.

There was on the one hand the prohibition of the Church—the Canon Law—which the Church was very eager to enforce—but there was on the other hand reality, the practice of the people. Loans were needed. In the countries under the power of the Church, both religious and secular, modern banking was slowly developing. Theologians began to study the question of interest to determine whether or not there were reasons to justify the taking of interest. These studies were the beginning of economic law versus canonistic doctrine. They discussed many issues, and at least eliminated the erroneous belief that the lender extracts something unjust from the borrower by earning interest on money that is lent. Nevertheless that idea is still found in many American textbooks.

There was, however, another question and that question was this: If you increase the supply of money that is available for lending, then you bring about on the money market (the market for short-term loans) a tendency toward a drop in the rate of interest. If interest is not the reward for giving a man the use of a certain sum of money but in fact depends on the discount of present goods against future goods (and is independent of whether the supply of money is greater or smaller), how, then, and why does the initial drop in the rate of interest, caused by an increase in the supply of money, get reversed? In other words, notwithstanding this increased supply of money, what is the process that re-establishes a rate of interest that reflects people’s evaluations concerning the discount of future against present goods? Some people denied the existence of this phenomenon. Some people simply declared that if you increase the amount of money or money substitutes you can bring about a progressive tendency toward a further and further drop in the rate of interest until

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1 [Luke VI, 35, King James Version: “But love ye your enemies, and do good, and lend, hoping for nothing again.”—Ed.]

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interest finally disappears completely. There are actually socialist authors who believe this is the right way to bring about abundance, to create plenty for all, and make everybody rich.

We must draw a sharp distinction between two types of bank transactions. The classical old definition of a banker, the businessman's and economist's definition, was that a banker was a man who loaned other people's money. (A man who lends only his own money is a money-lender.) The banker is a person who gets deposits from people, who takes other people's money, and lends this money to still other people. His business gains are derived from a difference in the rate of interest he pays to his depositors and the rate of interest he gets from those to whom he lends money. This is the genuine business of banking, of a banker.

The situation that came about in the nineteenth century with the development of modern methods of banking, with the issue of banknotes and of deposits subject to check, led to two serious problems: fiduciary media and credit expansion.

It was a historical evolution that took place first in Great Britain, and then also in other countries. People deposited money for safekeeping with persons whom they later called bankers—earlier these persons were the goldsmiths of London. From these goldsmiths the depositors got receipts for their money which they used in making payments. Today, we would call these receipts “banknotes.” When the goldsmith concerned enjoyed favorable good will, there was no reason for another person not to accept such a receipt in payment of money due him. The goldsmiths and the early bankers very soon discovered that it was not necessary to keep as reserves in their vaults funds amounting to the total amount of the receipts they issued—they could issue more receipts, more banknotes, than they really had ready in their cash holdings. They discovered that they could lend a part of their reserves, that it was possible to give more credit by means of banking operations than the amount of money actually deposited with them would have permitted. Thus they discovered what we would call “fiduciary media.”

The second very questionable business consists of the institution of credit expansion, which may be called the most important economic problem of our age. This means that the banker lends more money to people than he receives from his depositors. This surplus of banknotes issued by the banker, or of deposits subject to check which he opens for his customers, is credit expansion. The question is, “What are the consequences of such operations?” At the beginning, credit expansion of

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this type was not very critical, not very dangerous, because it was done by individual bankers who had a good standing in the city and their notes could be taken by people, or they could be refused. You could go to the banker and receive from him a loan made up completely of additional banknotes, fiduciary media, made up completely of credit expansion. *But* then the question was, would your customers and your creditors really be ready to accept as payment the banknotes issued by this banker? We may assume that a creditor who has a questionable deal would answer, "It is better to take these notes than to wait any longer for payment." But then, he would have gone immediately to the banker who issued the notes and would have redeemed them, thus reducing the number of surplus banknotes outstanding. Therefore, the dangers of credit expansion were not very great as long as the credit expansion was the business of private banks and private businesses subject to commercial laws. As long as the surplus banknotes could be returned to the bank of issue for redemption, there was a check on credit expansion, and there couldn't be credit expansion of any considerable extent.

But very soon governments invaded this field of action. They invaded it under the erroneous idea that by issuing circulation credit, additional credit, fiduciary media, by issuing more money than they had received from the public, the banks were in a position, precisely on account of this credit expansion, to reduce the height of the rate of interest.

I pointed out before that a great mistake concerning interest was inherited from earlier ages. It was a correct description of the conditions in ancient times to say that the wealthy were the creditors and the poor were the debtors. And as a result of this, the idea prevailed that a high interest rate was bad. People were not prepared to accept the rate of interest as a market phenomenon that could not be influenced by the government. They considered the interest rate merely as an obstacle to economic development and progress. Many even believed that the rate of interest was something produced by the greed of selfish money-lenders and that it was the duty of the government to fight against it. The development of modern capitalism was due to the fact that governments, after centuries and centuries of making mistakes, finally abandoned the idea that they should interfere with market prices, wage rates, and so on. Capitalism wouldn't have developed if government interference with prices and wages had not been abandoned in the eighteenth century. This development laid the way for the economic improvements of our age. However, it did not succeed completely with regard to the rate of interest.

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It is true that the older government decrees fixing maximum rates of interest were abolished in the age of liberalism and capitalism. But they were abolished only because governments thought they had discovered a new means of making credit cheaper, i.e., through credit expansion by the banks. In the process, private bankers disappeared completely from this business. Governments gave privileges to governmental banks that had the monopoly of the issuance of fiduciary media. It was not easy for them to do this, because there was some resistance. Twice in the United States, the efforts to establish a United States bank of issue were thwarted by the majority of the population.

What the governments did was to introduce a very weak “middle of the road” procedure for dealing with the problem. A consistent supporter of this system of credit expansion would have said, “If you can reduce the interest rate by credit expansion, why should you not finally abolish it altogether and make the rate of interest disappear and give everybody loans without charging them any rate of interest at all? This would be a solution to the social problem of poverty—you could give to everybody. Why not?” But the governments did not believe they could abolish the rates of interest altogether.

There was a famous exchange of letters between the French socialist Pierre-Joseph Proudhon [1809–1865] and Frédéric Bastiat. Proudhon was an opponent of Bastiat. Proudhon maintained that if we established such credit-issuing banks, then we could make the rate of interest disappear completely. Bastiat disagreed, but he didn’t find precisely the correct position; he endorsed a “middle of the road” solution, namely that interest rates should be allowed to go up to certain points but that they should not be “too high.” This middle-of-the-road position became later the generally accepted doctrine of the world. Those who still maintained that it was possible to create riches for all by credit measures aimed at lowering or eliminating interest rates altogether were called “monetary cranks.” There was no reason to call them monetary cranks; they were only more consistent than those who advocated the official middle-of-the-road policy. Some of the advocates of lowering interest rates drastically were very eminent men, eminent in other fields. There was Ernest Solvay [1838–1922], a Belgian who was successful as a businessman and as a chemist, but who believed that it was possible to make all people happy by establishing *comptabilisme social* [compatibilism]. In Canada, there was the Alberta Experiment, the program of an Englishman, Major Clifford H. Douglas [1879–1952]. Douglas called it “social credit.”

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How could people be so mistaken as to assume that there were no consequences from this credit expansion? A special doctrine was developed for this purpose. It was said that within the economic system there is a natural limit to credit expansion. The amount of money required for business transactions, they said, was determined by the “needs of business,” and if the banks did not expand credit more than called for by these “needs of business,” then no harm can be done. Their idea was this: The producer of raw materials sells raw materials to a manufacturer and issues a bill of exchange to him; the businessman who buys the raw materials takes the bill of exchange to the bank; the bank discounts it and gives him credit to pay for these raw materials; after three months the manufacturer has produced a finished product out of these raw materials; he sells the product and pays back the loan granted to him. Therefore, the proponents of this system say, there is no danger if the bank merely provides credit enabling the businessman to buy these raw materials. If the bank limits itself to granting credit to such business already transacted, they say, then the amount of credit asked from the bank for such purposes is limited by the “needs of business”—by the exact and real amount of business transacted in the country. Therefore, it doesn’t mean an increase in the supply of credit, because the increase in the supply of credit corresponds exactly to the increase in the demand for credit transactions based on real transactions on the part of business.

But what this doctrine did not see was that these “needs of business” depend on the amount of credit given by the bank. And the amount of credit it gives out depends on the interest rate it asks from borrowers. The higher the interest rate, the fewer borrowers will want loans; the lower the interest rate, the more borrowers will ask for credit.

Every businessman calculates the expected outgo and income of his projects. If his calculations show that the transaction, given the costs, *including, of course, the cost of interest*, will not pay, then the project is not undertaken. But if the bank of issue appears on the scene and creates additional circulation credit to give out for such purposes, thereby lowering the rate of interest below what it would have been in the absence of this new credit, even if only by a quarter or a fifth of one percent, a number of projects which would not have been undertaken at the higher rate of interest would now be done. The credit expansion of the bank creates its own demand; it gives the impression that more savings, more capital goods, are available than actually is the case. In fact what has been increased is only the amount of credit.

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If the bank does not expand credit, if it does not give out new circulation credit for this purpose, that is, if it lends only money from someone's savings, the consequence would be that the bank would have to charge a higher rate of interest than if it did create new credit. Then many transactions would not be conducted, precisely on account of the fact that the rate of interest was a little bit higher. However, if the bank gives out new credit, additional money, it must reduce the interest rate to attract new borrowers, as all available funds were already loaned out at the prevailing market rate of interest.

The banks very often expand credit for political reasons. There is an old saying that if prices are rising, if business is booming, the party in power has a better chance to succeed in an election campaign than it would otherwise. Thus the decision to expand credit is very often influenced by the government that wants to have "prosperity." Therefore, governments all over the world are in favor of such a credit-expansion policy.

On the market, credit expansion creates the impression that more capital and savings are available than actually are, and that projects which yesterday were not practical because of the higher interest rate are feasible today because conditions have changed. Businessmen assume that the lower interest rate signals the availability of sufficient capital goods. This means that credit expansion falsifies the businessman's economic calculations; it gives the impression to him, to the nation, and to the world, that there are more capital goods than there really are. By credit expansion, you can increase the accounting concept of "capital"; what you cannot do is create more real capital goods. As production is necessarily always limited by the amount of capital goods available, the result of credit expansion is to make businessmen believe that projects are feasible which actually cannot be executed on account of the existing scarcity of capital goods. Thus credit expansion misleads businessmen, results in distorting production and causes economic "malinvestment." When the credit expansion causes businessmen to undertake such projects, the result is called a "boom."

We must not overlook the fact that all during the nineteenth and twentieth centuries there was always an obsession, unfortunately not against credit expansion, but at least against giving the government too much power in matters of credit expansion. The main object was to limit the government's influence with regard to the central banks.

In the course of history, governments have used the central banks again and again for borrowing money. The government can borrow money from

the public. For instance, a person who has saved one hundred dollars could hold them as dollars or invest them. But instead of doing either of these things he can buy a new government bond; this purchase doesn't change the amount of money in existence; the money he pays for the bond passes from his hands to those of the government. But if the government goes to the central bank to borrow the money, the bank can buy government bonds and lend money to the government simply by expanding credit, in effect creating new money. Governments have a lot of good ideas as to how to carry out this borrowing.

There has always been a struggle between parliaments and the executive concerning the government's influence on the central banks. Most of the European legislatures said very clearly that their central banks must be separate from the government, that they must be independent. And in this country, you know there is a continual conflict between the Federal Reserve Board and the U.S. Treasury. This is a natural situation caused by economic laws and government legislation. Some governments have found it very easy to violate the legislation without violating the letter of the law. The German government, for instance, borrowed from the public during World War I because the Reichsbank had promised to give it loans. Private individuals who bought German government bonds needed to pay out only 17 percent of the amount of the bond, and this 17 percent gave them a yield of 6 or 7 percent. Hence, 83 percent of the price of the bond was supplied by the Bank. This meant that when the government borrowed from the public, it was actually borrowing indirectly from the German Reichsbank. The result was that in Germany the U. S. dollar went from 4.20 Marks pre-World War I, to 4.2 billion Marks by the end of 1923.<sup>2</sup>

There has always been resistance to giving power to the central banks, but in the last decades this resistance has been by and large completely defeated in all countries of the world. The U. S. government has used the power of the central bank, the Federal Reserve, to borrow from it to obtain a considerable part of the money it needs to fund its expenditures. The consequences have been inflation and a tendency for prices and wage rates to rise.

There is no doubt that the credit expansion brings about a drop in the rate of interest. Why then does this not mean that the rate of interest can always remain low and that interest could really disappear completely? If it is true that the rate of interest is not a monetary phenomenon but a general

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2 [See Ludwig von Mises, "Business Under German Inflation," *The Freeman*, November 2003.—Ed.]

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phenomenon of the market, which reflects the fact that future goods are traded at a discount as compared with present goods, we must ask ourselves, “What is the nature of the process which, after the initial drop of the interest rate due to credit expansion, finally brings about step by step a return of the rate of interest to that level which reflects market conditions and the general state of affairs?” That is, if the rate of interest is a general category of human action, and yet if an increased supply of money and bank credit can bring about a temporary drop in the rate of interest, how does the interest rate return once more to the rate that reflects the discount of future goods over present goods?

In answering this question, we are also answering a question that has occupied people for decades, even centuries in some countries that have had central banks and a system of credit expansion. This is the problem of the trade cycle—the regular return of periods of economic depression. In Great Britain from the end of the eighteenth century on, and later in those countries of the world that entered step by step into the system of modern capitalism and modern banking methods, we could observe from time to time an almost regular occurrence of events, i.e., the emergence of periods of economic depression, economic crises. We do not mean economic crises brought about by some obvious event that makes it possible to explain the emergence of this crisis. For instance, in the early 1860s the American Civil War made it impossible to ship cotton from the United States to Europe; and the U. S. Southern states were at that time the only suppliers of cotton to Europe. There was a very bad economic crisis, starting in the cotton-goods industries in Europe and as a consequence other industries suffered also. But everyone realized what was causing this crisis—it was the American Civil War and the stoppage of shipments of cotton to Europe. We do not deal with such crises due to a definite identifiable situation. We deal with a genuine crisis in all branches of business—although it is sometimes worse in some branches than in others—a crisis for which people couldn’t see any special reason.

From the beginning of the nineteenth century on, people began to consider these periodic crises as one of the most important problems of economic research. In the 1830s and 1840s British economists answered this question by saying, “What we have to study is not the economic depression. This depression is always the consequence of a preceding boom. We must ask ourselves not ‘What is the cause of the crisis?’—we must ask ‘What is the cause of the preceding boom?’ And we must ask ourselves what is the reason why the unquestionable and certain

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development of economic conditions that takes place in all countries with capitalism does not proceed steadily upward, but follows a wave-like movement, a movement in which there are repeated boom periods that always are followed by periods of depression.” In this way the crisis problem was transformed into the problem of the trade cycle. And for the problem of the trade cycle many more or less wrong explanations were offered.

I want to mention only one. This was the doctrine of an otherwise famous economist, William Stanley Jevons [1835–1882]. His doctrine acquired some fame. He attributed economic crises to sunspots. He said that sunspots bring about bad harvests, and this means bad business. If this was so, why then didn’t business adjust to this natural phenomenon as it learned to adjust to other natural phenomena?

If there is credit expansion, it must necessarily lower the rate of interest. If the banks are to find borrowers for additional credit, they must lower the rate of interest or lower the credit qualifications of would-be borrowers. Because all those who wanted loans at the previous rate of interest had gotten them, the banks must either offer loans at a lower interest rate or include in the class of businesses to whom loans are granted at the previous rate less-promising businesses, people of lower credit quality.

When individuals consume less than they produce, the surplus production is set aside as savings. Thus when the money given out in loans comes from savers, it represents actual goods which are available for further production. But when the loans are granted out of credit expansion, businessmen are misled; there are no goods standing behind them, only newly created credit. This leads to a falsification of economic calculation. Credit expansion brings about a systematic falsification—it gives to the individual businessman the impression that a project that couldn’t be executed yesterday because there were not enough capital goods, can now be executed on account of the credit expansion. As a result, there is an intensification of business activity, which means that higher prices are offered for the factors of production. But there has been no increase in the quantity of capital goods. Therefore the intensification of business activity means an artificial boom. Producers of factors of production are happy when they see that the prices they are getting are higher than they were yesterday. But this cannot go on forever, because no more material factors of production have been produced. The prices of these factors of production are going up more and more as borrowers of the new credit compete and bid up their prices. Then finally two alternatives are possible.

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Business is asking for more and more credit. Either (1) the banks grant this demand by creating more and more credit (this happened in Germany in 1923, when it led to a complete breakdown of the currency). Or (2) one day, because they realize for some reason or other that they must stop credit expansion, the banks *do* stop creating new credit to lend. Then the firms that have expanded cannot get credit to pay for the factors of production necessary for the completion of the investment projects which they have already committed themselves. Because they cannot pay their bills, they sell off their inventories cheap. Then comes the panic, the breakdown. And the depression starts.

On account of the credit expansion the whole economic system of the country or of the world is in the situation of a man who has a limited supply of building materials available and wants to construct a home. But being poor in technological calculations, he makes some mistakes. He thinks he can build a bigger house out of his limited supply of building materials than he really can. Therefore, he starts by constructing too large a foundation. Only later does he discover that he has made a mistake and that he cannot finish the house in the way he had intended. Then he must either abandon the whole project, or use the materials still available to build a smaller house, leaving part of the foundation unused. This is the situation in which a country or in which the world finds itself at the end of a crisis caused by credit expansion. Because of the easy credit businessmen make mistakes in their economic calculations and find themselves with over-ambitious plans which cannot be completed because of insufficient factors of production.

In every boom period that precedes a crisis, in Great Britain and then later in other parts of the world, indeed, in every country in the world which has experienced credit expansion, you always find people who have said, "This is not a boom that will be followed by a crisis; only people who do not know what is going on can say such a thing. This is the final prosperity—an everlasting prosperity. We will never again have such a crisis." The more people believe in this slogan of everlasting prosperity, the more desperate they become when they discover that the "everlasting" prosperity doesn't last forever.

One thing that made matters worse following 1929, than in preceding periods of depression, was that the American unions were really very powerful and they would not tolerate that the crisis should bring about those results which were the consequence of earlier crises in this country and in other countries—i.e., they would not tolerate a considerable drop

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in money wage rates. In some branches of business, money wages went a little bit down. But by and large the unions were successful in maintaining the wage rates which had been developed artificially during the boom. Therefore, the number of unemployed remained considerable, and unemployment continued for a very long time. On the other hand, those workers who did not lose their jobs enjoyed a situation in which their wages did not drop to the same extent as commodity prices. The living conditions of some groups of labor even improved.<sup>3</sup>

This was the same situation that led to the conditions in England in the latter part of the 1920s, which were important in bringing about the doctrines of Lord Keynes and the ideas of credit expansion that have been practiced in recent years. The British government made a very serious mistake in the 1920s. It was necessary for Great Britain to stabilize the currency. But they did not simply stabilize. In 1925, they returned to the pre-war gold value of the pound. That meant that the pound was a heavier pound afterwards and had a greater purchasing power than the pound, of let us say, 1920. A country like Great Britain that imports raw materials and foodstuffs and exports manufactures should not have made the pound more expensive. As Hitler expressed it, “They must either export or starve.” In such a country, in which the unions did not tolerate a drop in wage rates, it meant that the costs in pounds of manufacturing British products were increased in relation to production costs in countries which had not made a similar return to the gold standard. With higher costs, you must ask higher prices to stay in business. So you can sell fewer units and must cut production. Therefore, unemployment increased, and there was permanent mass unemployment.

Because it was impossible to deal with the unions concerning this problem, the government proceeded in 1931 to devalue the pound much more than it had been revalued in 1925, in order, they said, to encourage export trade. Other countries did the same. Czechoslovakia did it twice. The United States followed in 1933. The countries of the French standard (France, Switzerland) followed in 1936. I mention this because it is necessary to realize why the crisis of 1929—it was merely a crisis of credit

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3 [See Ludwig von Mises, “The Causes of the Economic Crisis” (1931) in Percy L. Greaves, Jr., ed., *On the Manipulation of Money and Credit: Essays of Ludwig von Mises* (Dobbs Ferry, N.Y.: Free Market Books, 1978), pp. 173–203, esp. pp. 186–92.—Ed.]

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expansion—had much longer and more serious consequences than those crises in preceding times. Of course, the Marxians say, every crisis must be worse and worse; the Russians, they say, have no trade cycle. Of course the Russians don't; they have a depression all the time.

We must realize the tremendous “psychological” importance, the enormous importance of the fact that in the history of the nineteenth and twentieth centuries, credit expansion was limited. Nevertheless, it was the general opinion of businessmen, economists, statesmen, and the people, that bank credit expansion was necessary, that the rate of interest was an obstacle to prosperity, and that an “easy money” policy was a good policy to have. Everyone, businessmen as well as economists, considered credit expansion necessary and they became very angry if somebody tried to say that it might have some drawbacks. At the end of the nineteenth century, it was considered practically indecent to support the British Currency School, which was opposed to credit expansion.

When I started to study the theory of money and credit I found in the whole world of literature only one living author, a Swedish economist, Knut Wicksell [1851–1926], who really saw the problems in credit expansion.<sup>4</sup> The idea prevails even today that we cannot do without credit expansion. It will be impossible, without a very serious struggle which really has to be fought, to defeat all those ideological forces that are operating in favor of credit expansion. Most people, of course, don't give any thought to credit expansion. But the governments have a very clear idea about it—they say, “We can't do without it.”

Credit expansion is fundamentally really a problem of civil rights. Representative government is based on the principle that the citizens need to pay to the government only those taxes that have been legally promulgated in a constitutional way: “No taxation without representation.” However, governments believe they cannot ask their citizens to pay as much in taxes as is needed to cover the whole of government expenditures. When governments cannot cover their expenses out of legally enacted taxes, they borrow from the commercial banks and so expand credit. Therefore, representative government can actually be the instigator of credit expansion and inflation.

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4 [Knut Wicksell, *Interest and Prices* (New York: Macmillan, [1898] 1936).—Ed.]

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If the institution of credit expansion and other types of government inflation had been invented in the seventeenth century the history of the struggle of the Stuarts with the British Parliament would have been very different. Charles I [1600–1649] wouldn't have had any problems in getting the money he needed if he could simply have ordered the Bank of England, which didn't exist in his time, to grant him credit. He would then have been in a position to organize an army of the King and to defeat Parliament. This is only one aspect.

The second aspect—I don't believe that this country could stand psychologically a recurrence of a crisis like that of 1929. And the only way to avoid such a crisis is by preventing the boom. We are already very far along in this boom, but we could still stop it in time. However, there is a great danger. While capital goods are limited in amount and are scarce and would, therefore, limit those projects which can be executed and make many projects appear impossible for the time being, credit expansion can hide by the illusion of an increase in the capital reported in dollars on the books. Credit expansion creates the illusion of available capital, while in fact there is not.

The fundamental problem of the nineteenth century was that people didn't realize these things. As a result, capitalism was very much discredited, for people believed that the almost periodic occurrence of depressions was a phenomenon of capitalism. Marx and his followers expected the depressions to get progressively worse, and Stalin still says openly every day: "We have only to wait. There will be a very bad crisis in the capitalist countries." If we want to thwart these plans we must realize that sound credit policies acknowledge the fact that there is a scarcity of capital goods, that capital cannot simply be increased by credit expansion. This must come to be recognized by our businessmen and politicians.

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*[Additional comments by Mises during the question-and-answer period.]*

What happened in the past with credit expansion has been, by and large, absorbed and adjusted to by the market. I would say, take as "given" the conditions as they have happened in the past, and say only that for the future there should be *no more credit expansion*. In the future no additional banknotes should be issued, no additional credit should be entered on a bank account subject to check, *unless there is 100 percent coverage in money*. This is the 100-percent plan. With respect to today's

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situation, we should leave everything that has happened in the past alone—we should not attempt to reverse it because that would be deflationary. Deflation is not as dangerous, not as bad, as inflation. Deflation is expensive for the government, while inflation is profitable for the government. But deflation, too, must be avoided.

If there hadn't been any privileged banks and if government had not forced citizens to take the banknotes by making them "legal tender," banknotes would never have become popular. The average citizen today in every country of the world, with the exception of the most backward countries, considers as money every scrap of paper upon which the government or an institution privileged by the government has printed the magic words "legal tender." But it was different in the past. It was not easy to make people accept banknotes. They took them because the banknotes were better than nothing. If a person didn't want the banknotes he could take them back to the bank that issued them; and if the bank couldn't redeem them the bank went broke. The "wonderful" thing about government-issued banknotes, from the point of view of the government and the banks, is that the bank is not required to redeem them, except perhaps in legal tender money, which is again banknotes.

If the governments had never interfered with money and banking, it would be possible to leave every citizen free to issue his own banknotes. I want to give everybody the right to issue his own banknotes. The problem then would be to get other men to accept such private banknotes; maybe nobody will take them. I am not against banknotes as such; I am only against banknotes that are protected by some government privilege. I want the banknotes issued in the past to retain their privilege, *but no more legal tender banknotes and no more credit expansion!*

If I say that the return to the gold standard is necessary it is because it makes inflation impossible. Under the gold standard the amount of money depends on geological factors that cannot be controlled by the government. It is not an unreasonable standard because it is the only alternative to making money completely dependent on the government. If King Charles I [1600–1649] had had the power to print paper money he would probably have been in a much better position in his fight against the government.

Under the gold standard, the supply of money is independent of the changing whims and political programs of governments and political parties. For centuries there were struggles on the part of the predecessors

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of our parliamentary bodies against the princes who wanted to debase the currency. The princes said, “What counts is only the name which I give to money.” But their silver money got a “red face” when the princes adulterated it with copper, all the while declaring that their new alloyed money, which contained less silver than the old money, still had the same purchasing power and the same legal tender power as the old money. If the government is in a position to provide for some of its expenditures by creating money, it no longer needs to depend, let us say, on Congress. Historically and politically the gold standard is an implement in the system of legislation that limits the power of government and makes government dependent on the will of the people.



8TH LECTURE

# Profit and Loss, Private Property, and the Achievements of Capitalism

IN DEALING WITH ALL MATTERS CONCERNING CAPITALISM, it is fundamental never to forget the difference between “capital goods” and “capital.” “Capital goods” are physical things. The concept of “capital” is purely a theoretical concept within the framework of a definite method of calculation and computation. The evolution of this concept of capital finally resulted in including in the accountant’s concept of capital, the auditor’s concept, and also those things that are not capital goods.

The system of accountancy started, of course, with businessmen. Anxious to know what the results of their transactions were they developed this method of accounting—double-entry bookkeeping and so on. The concept of capital that they applied referred to, and included, only those funds that they had diverted to the development of business. It did not include real estate or the private property of the head of the enterprise, of his family, and so on. You can still read in legal treatises and papers essays debating whether or not the private capital of the owner should be included in the balance sheet of a firm. According to the methods in practice in accountancy, the concept of capital as used today includes the real estate and all rights owned by the enterprise.

Agriculturists also began to pay attention to these problems, but only much later. In the beginning they developed methods of accounting which were limited to the operation of the farm only, without including the whole property of the owner. I mention these facts because if you look into the balance sheet of an enterprise there is room for the building, the

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real estate, owned by the enterprise. The concept of capital as used today includes more than capital goods; it includes all the things owned by the enterprise.

From this point of view we must raise the question also of whether or not there are other distinctions which may have greater importance for the practical problems of capital. If we speak of capital we discover that we have in mind all the total material factors of production as far as they may be used for production purposes.

If we talk about the decisions to be made concerning the employment of capital, we must take into account the fact that the greater part of the capital available is embodied in nonconvertible or not perfectly convertible goods. Capital goods are intermediary factors between the natural goods and the final consumer's goods. In a changing world, in which the productive processes and other things are constantly changing, the question is whether we can use these intermediary products, which were originally designed for a specific end use, for any other end. Is it possible, even after a change in plans and intentions, to use for other purposes capital accumulated or produced in the past with different plans and different intentions in mind? This is the problem of the convertibility of capital goods.

For more than one hundred years, a movement popular in the whole world, today especially in California, is represented by a group of reformers who call themselves "technocrats." Technocrats criticize the fact that we have still going on side by side with the most modern methods of production, processes of production of an outdated character. And they are not the only ones to criticize this fact. They point out how wonderful it would be if all that they call "economic backwardness" were eliminated, if we had all the factories located in the best places, and if all the factories were equipped with the most modern equipment. Then there wouldn't be any backwardness, nor any machines and methods of production being used which are no longer up to date. There was a German, or a Russian—I had better say a Baltic—socialist who pointed out, for instance, how backward German agriculture was. He would abandon or diminish all existing farms and machines, substitute the most modern achievements of agriculture, and then it would be possible to produce everything cheaper.

The weak point of these plans is that the capital accumulated in the past was in the form of capital goods that represented the technical wisdom of the ages in which it was accumulated. Although the factories are out of date it does not necessarily mean that the old machines have to

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be sold as scrap iron and new machines substituted. It depends upon the superiority of the new machines. Unless it is impossible for the old factory to make any surplus over current expenses, it would be a waste, not only both from the point of view of the individual factory owner but also from the point of view of a socialistic system that had to deal with the same thing. The problem is similar to that of a man who must choose between buying a new typewriter or a new television set because better ones have now been invented, or buying something else that he doesn't have at all. Just as not everybody will throw away his old typewriter or his car when a new model appears, so will a businessman have to make similar decisions in business. While in the household precise calculations are not needed, in business these decisions are made on the basis of more careful calculations.

The capital equipment that makes up the wealth of our age and that also makes one country richer as against poorer countries is embodied in capital goods created in the past by our ancestors, or created by ourselves under different technical conditions and for different purposes. If we want to use this old capital equipment in the future, too, in spite of the fact that it does not render as much service as new equipment, we do so because we consider the service it renders worth more than what we can gain by throwing away the old machines and replacing them with new machines.

The settlement of the world was done in other ages under other assumptions and other conditions with other technical knowledge. If we were to come to earth from another planet with perfect knowledge of today's geographical conditions, we would settle the world with the use of that other knowledge, knowledge very different from that which was responsible for our present capital equipment. In the past our wealth consisted to a great extent of capital goods adjusted to conditions which are different from our conditions. Decisions of the past were based on conditions at that time. The fact that our ancestors made the decisions they did helps to influence us to keep things as they are; it wouldn't be worthwhile to abandon the investments of the past. In every individual case we have to make a decision between continuing in the old ways, in spite of the fact that we now know better, or renouncing the old ways for some other employment of additional capital goods which we now consider more important.

In answer to the technocrats, we say we are not rich enough to scrap everything that was built in the past. Perhaps it would be better to have the industrial centers somewhere else than where they were built in the past. But this transfer, this shifting, is a very slow process. It depends on the

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superiority of the new sites. This is a refutation of the famous infant-industry argument, which says that the new industries must be protected against the old industries. In this case too—in the case of shifting industries from physically less favorable to more favorable sites—the decision must depend on the degree of superiority of the new sites. If the superiority of the new sites is sufficient the industries will move without any outside assistance at all. If it is not sufficient, it is a waste to assist industries to make such a move. (For instance, the textile industries developed in New England even though the cotton was grown in the south. More lately the textile mills have been shifting to the south, again without any outside assistance.) If the advantage to be derived from the abandonment of capital goods is great enough, the change will be made.

Technical backwardness is not the same as economic backwardness. If capital needed for eliminating this technical backwardness, from our point of view or from the point of view of the buying public, has a more urgent employment somewhere else, then it would be economically a very serious mistake to employ it in making changes to new equipment simply because there are already better machines.

Capital goods are scarce. The economic problem consists precisely in the fact that consumers seek to employ them for the satisfaction of their most urgent not-yet-satisfied demands. The economic problem is not to employ capital goods for producing something which is less important than another product, which cannot be started precisely on account of the fact that these capital goods are being employed in the production of the less important product. This is what unprofitability means. A businessman says, "This is unprofitable. The project could be undertaken but it would be unprofitable. Therefore, we do not want to start it." What the socialists say is, "But businessmen are greedy; they want to produce only those things which are profitable, not those which are unprofitable." However, what makes an enterprise unprofitable is that, given the prices of the factors of production and the rate of interest, the anticipated proceeds would lag behind the expenditures.

What does it mean if the price of copper is higher than it used to be? It means that consumers are ready to pay a higher price for the copper that goes into the making of other products; they are not ready to pay the higher price for copper in its present uses. They make some prices high enough to make the production of other products profitable. On the other hand, if there is an increase in the supply of copper, or if some branches of business which used to employ copper until now use something else

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instead of copper in production, then copper becomes more readily available, the price of copper drops, and it now becomes profitable to use copper to produce some things that yesterday were unprofitable. Ultimately it is the consumers, in their buying, who determine what should be produced and what should not be produced.

When aluminum was first introduced, many things could not be produced from aluminum because its price was very high. Napoleon III [1808–1873] immediately had the idea to give to his cavalry armor of aluminum, but it was so expensive then that it would have been cheaper to give them armor made of silver. When I was a child, aluminum was used for children's toys, but the really serious industrial use of aluminum was then more or less out of the question. Slowly the production of aluminum improved and the use of aluminum for many articles became possible. Years ago, it was as unprofitable to use aluminum as it is today to use some high-grade metals for certain commercial purposes.

The slogan “Production for use and not for profit” is meaningless. A businessman produces for profit. But he can make profits only because consumers want to use the things he produces, because they want to use them more urgently than other things.

In the absence of profits and losses there wouldn't be any guides for production. It is profits or losses that show the businessmen what the consumers are asking for most urgently, in what qualities and in what quantities. In a system in which there were no profits or losses, the businessman would not know what the wishes of the consumers were, and he wouldn't be able to arrange his production processes according to the wishes of the consumers.

Besides this function of profit or loss there is the role they play in shifting ownership of the means of production into the hands of those who knew—in the past, of course, i.e., until yesterday—how best to employ them for the needs of the consumers. This is no guarantee that the means of production will be used in the best way tomorrow. But if they aren't, the owners will suffer losses. And if they do not change their methods of production, they will lose their property and will be thrown out of their eminent position as the owners of factors of production. But this is something given, and it cannot be changed. Every judgment about people refers to the past. A candidate in an election can only be judged by what he has done in the past. The same applies also to the choice of a doctor, a shop, and so on, and also to producers. It is always good will referring to the past.

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Past profits shift the ownership of the means of production from the hands of those who were less efficient in using them in the eyes of the public into the hands of those who are expected to be more efficient. Therefore, the meaning of ownership of the means of production is very different in a system based on the division of labor from its meaning in a feudal system. In a feudal system, private ownership was acquired by conquest or by the arbitrary appropriation of pieces of land. The proprietor was the conqueror; the supreme conqueror was the head of the army, the king, the “Führer.” Other people acquired private property as gifts from the supreme lord. There was a whole hierarchy—kings, dukes, knights, and so on, and at the bottom were the people with no property. The dukes and knights could lose their property by being deprived of their “gift” by the higher authority—the king—revoking his gift; or they might be defeated by a successful conqueror. This system prevailed until capitalism replaced it to varying degrees in many countries.

If you study the history of private ownership in land you can, of course, go back either to conquest or to appropriation of ownerless property by somebody. From this point of view, the older critics of private ownership said property does not have a legal origin; it was acquired by might, by conquest, without any legal basis. Hence, they say they want to take it away from the current private owners and give it to everybody. Whether the origin described here is right or wrong is one question. Another question is what to do now that property is privately owned.

The socialists took over this critique of the origin of property without realizing the enormous difference that existed between then and now. If you say that in the old days the owners of land did not depend on the market, that is true; there was no market; there was only an insignificant amount of trade. The feudal lord had only one real way to spend his great income in the products of the earth—to retain a great retinue of armed men in order to fight his battles. The court of a feudal lord consisted of an enormous household in which many people lived (boarders I would say), supported by the great estate. In Brandenburg in Berlin, for instance, there was one case of a councilor in the sixteenth century who was living in the king’s household. This is very different from the conditions in the market economy.

In the market economy, private ownership is, as it were, a social function because it can be retained and enlarged only by serving customers in the cheapest and best possible way. Those who do not know how to serve consumers in the cheapest and best possible way suffer losses. If they

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do not change their methods of production in time they are thrown out of their positions as owners, entrepreneurs, capitalists, and shifted to positions in which they no longer have entrepreneurial and capitalistic functions. Therefore, the meaning of private ownership in the capitalistic system is entirely different from the meaning of private ownership in the feudal system.

Critics of private ownership are still living mentally in the Middle Ages (like critics of interest and creditors). They don't realize that the market determines every day who should own what and how much he should own. The market gives ownership to those people who are best fitted to use the means of production for the best possible satisfaction of the needs of the consumers. Therefore it is not correct to criticize the institutions of private property by citing conditions as they existed in the early days under feudal conditions, under absolute kings.

As President Franklin Roosevelt [1882–1945] said, capitalism has never been really tried.<sup>1</sup> There always remains something from the old days. But it is absolutely useless to tell us today, “Look how the wealth of many aristocratic families originated in the seventeenth century.” Some modern wealthy people may be descendants of wealthy aristocratic families, but what has that to do with the situation today? The Prussian *Junkers* were still privileged in the nineteenth century and early twentieth century; they could retain their property only because the whole apparatus of the imperial government was glad to preserve them, to protect them, and to prevent consumers from putting persons in their places who were better equipped to serve consumers.

We must realize that every governmental measure that lowers the amount of profit successful enterprises can make or which taxes away their profits is a measure that weakens the influence of the consumers over producers. For example, the great industrial fortunes of the nineteenth century were acquired by successful innovators in their business. Henry Ford [1863–1947] started with almost nothing; he made enormous profits which were plowed back in his enterprise; in this way over a comparatively short time he developed one of the biggest fortunes of the United States. The result was that something quite new happened, mass production of

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<sup>1</sup> [“A program whose basic thesis is, not that the system of free enterprise for profit has failed in this generation, but that it has not yet been tried.” F. D. Roosevelt, as quoted in Chapter 1, Friedrich A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944), p. 10.—Ed.]

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automobiles for the masses. At the beginning of the twentieth century there were some successful motor cars. The French Renault cost about \$10,000 in gold; it was a luxury car for a few very rich men. The activities of Ford and of some other people made the motor car something for everybody. In this way great fortunes were developed. The great department stores and the great factories developed in this way. But now this cannot happen. If a man starts a small enterprise and makes huge profits, the greater part of this profit is absorbed by taxes. However, there are still some loopholes. If you have a good accountant you may avoid being expropriated 90 percent and may be expropriated only 70 percent. But the greater part of the profits which would have been reinvested are taken by the government and spent for current expenses.

In the case of department stores, formerly an old store had to compete for potential new consumers with new competitors. Today this is no longer the case. The small man will never develop into a big store because his profits are taken away by the government. It is true that the old and new stores operate under the same laws; the large old store also has to pay high income taxes. But the old store has already accumulated the capital needed for a big business, while the new man is prevented from accumulating the capital needed to expand into a big-scale enterprise. The consequence, therefore, is that the competitive spirit could easily disappear from the management of the big store. Without any danger to the old store in the conduct of its affairs, the old store may sometimes become "lazy."

There are people who say capitalism is dying because the spirit of competition no longer exists as it used to and because great enterprises become bureaucratic. But capitalism is not dying; people are murdering it. There is a difference between dying by a disease that finally results in death and dying as a result of assault and assassination. It is fantastic to use as an argument against capitalism the fact that the competitive spirit in business is weakening and that businesses sometimes become bureaucratic. This is precisely due to the fact that people are fighting against the capitalistic system and don't want to tolerate the institutions that are essential for its existence. Therefore, I must say something about the difference between profit and loss under business management on the one hand, and bureaucratic management on the other hand.

Profit-and-loss management is the sign of an enterprise, of an outfit, that is subject to the supremacy of the market, i.e., the supremacy of consumers. In such an outfit the determining factor is "Is it profitable or not?" This yardstick is applied not only to the whole enterprise but to

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every portion of the enterprise. This is the method of double-entry accounting which Goethe characterized in such a wonderful way by saying that it makes it possible for the man at the head of an organization to control every aspect of a business without becoming enmeshed in too much detail work.

Under such an accounting system you can establish whether or not any special department or branch pays. For instance, an enterprise in New York has a branch store in San Francisco. There is only one standard the head of the company in New York need apply: is it profitable? He has a special balance sheet for the store in San Francisco. He assigns to this branch on his books the necessary capital, compares the costs and the prices of this branch, and on this basis judges whether or not it is useful, whether or not it is profitable, for the total enterprise to continue this branch office in San Francisco. He can leave all the details to the head of the branch office in San Francisco because this man always knows that he is responsible. It is not necessary that the branch manager get a share of the profits. He knows very well that if the branch does not pay it will be discontinued and he will lose his job; his future depends on this branch. Therefore, the man in New York does not have to say to this branch manager in San Francisco anything more than, "Make profits!" The head in New York doesn't interfere because if he does and the branch office has losses, the branch manager will be able to say it was because "You ordered me to do so and so."

The consumers are supreme. The consumers are not always intelligent—not at all—but the consumers are sovereign. They can be stupid and they may change their minds, but we must accept the fact that they are sovereign. Businessmen are subject to the supremacy of the consumers. The same is, of course, true for the whole business establishment; the decisive voice is the voice of the consumers. It is not the problem of the producers or manufacturers to criticize consumers, to say, "These people have bad tastes—I recommend they buy something else." This is the task of philosophers and artists. A great painter, a great leader, a man who wants to play a role in history must not yield to the bad taste of consumers. However, businessmen are subject to profit-and-loss management and are directed in every detail by the wishes of the consumers. The consumers are supreme; they are buying the product and this is justification for the producer. If it is not weakened by government interference, this is profit-and-loss management, production for consumers.

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Now what is bureaucratic management? People often confuse bigness with bureaucracy. Even such an eminent man as Max Weber [1864–1920] thought that the essential factor of a bureaucracy was that people sat at desks and had a lot of paperwork to do. But this is not the essential feature of a bureaucracy. The characteristic of a bureaucracy is that it deals with things which are necessary but which cannot be sold and that do not have a price on the market. Such a thing, for instance, is the protection of individuals against gangsters and other criminals. This is the job of the police department. It is very important, indispensable. But the services of the police department cannot be sold on the market. Therefore, you cannot judge the results of these police operations in the same way as you can judge the operations of a shoe factory. The shoe factory can say, “The public approves of our operations because we make profits.” The police department can only say the public approves through the actions of its town council, congress, parliament, and so on. Therefore, the system of management which must be used for a police system is the bureaucratic system.

The nation, or the citizenry, elects parliamentary bodies and these parliamentary bodies determine how much should be spent for the various functions of the government, including the police department. You cannot evaluate in dollars and pennies the results of a police department. And, therefore, you cannot have bookkeeping and auditing of a police department in the same way you do in private businesses. In private businesses, the expenses are measured in terms of dollars against the proceeds. In the police department you cannot measure the expenses against the proceeds. The police department has only expenses. The “proceeds” of a police department are, for instance, the fact that you can walk safely through the town, even after midnight. Such proceeds cannot be evaluated in terms of money.

The parliaments set the budget for the police department; they determine the amount of money to be spent. They must also tell the police department what services they should perform. The FBI could no doubt be improved by increasing its appropriations, but it is the will of the people that it not go any further; the head of the Department of Justice tells the FBI what to do and what not to do; the Department of Justice head cannot leave these decisions to the “branch managers.” Therefore, the manager of a bureaucratic operation issues instructions on many things which appear unnecessary to the businessman—how often to clean the offices, how many telephones to have, how many men to watch a certain building, and

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so forth. These detailed instructions are necessary because in a bureaucracy what has to be done and what has *not* to be done must be determined by such rules. Otherwise the man on the spot would spend money without giving heed to the total budget. If there is a limited budget you must tell the employees what they can and what they cannot do. This refers to all branches of government administration.

This is bureaucracy, and in these areas it is indispensable. You cannot leave it to the individual employee; you cannot tell a man, "Here is a big hospital. Do what you want with it." A limit is drawn by the parliament, the state, or the union and, therefore, it is necessary to limit the money spent in each department. This bureaucratic method of management does not apply under profit management. But, of course, if you weaken the profit motive of private businesses, bureaucratic ideas and bureaucratic management creeps in.

Given the present-day excess-profits tax, corporation taxes, and individual taxes on corporation shareholders, many enterprises say when calculating a new expenditure, "It means an expenditure of \$100 more, of course. But considering the 82 percent tax I must pay on the firm's earnings, it will cost much less. If I don't spend this \$100 on business, I will still have to pay a tax of \$82. Therefore, spending this \$100 will cost the firm only \$18." People calculating this way no longer compare the total expenditure with the advantages to be derived from it on the market; they compare only that part of the expenditures which affects their own income. In other words, in spending \$100 on its business, the company could afford to be lavish, wasteful, or extravagant; it would no longer consider consumer wishes primarily.

If this tax system is continued, it could lead finally to complete government control. For instance, if government takes 100 percent of a company's income, its business expenses would all be deductible and chargeable to the government. The company wouldn't need to worry then about consumer sovereignty, about whether consumers would be willing to pay enough for their product to cover costs; it wouldn't need to worry about keeping expenses down. But then the government couldn't allow the business to do as it wished; the government would have to control all aspects of the business's operations. Therefore, if you hear that business is becoming bureaucratic and wasteful, it is not the consequence of big business, of capitalism, of an unhampered market system; it is the consequence of government taxation and government interference with these things.

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9TH LECTURE

# Foreign Investments and the Spirit of Capitalism

THREE HUNDRED YEARS AGO, economic conditions in the world were more uniform than at present. There were some savage tribes, of course, but except for them the greater part of the world by and large had reached the same level of technological development and civilization. Then there came a radical change in some countries. Capitalism developed in the West; there was an accumulation and investment of capital; tools were perfected; Western civilization developed. Today there is an immense difference between Western civilization in the “advanced” countries of the world and conditions in the “backward” countries.

This distinction was even somewhat sharper in the early and middle part of the nineteenth century. A man who visited England and Romania in 1700 would not have seen any remarkable differences in the methods of production. By the year 1850, these differences were enormous. These differences were then so considerable that one could say, and some people believed, that the disparities would never disappear, that they would remain forever.

These differences consisted in the fact that there was greater capital investment, very much greater capital investment, in the West. But this capital investment, these capital goods are nothing but intermediate products. The head start these countries had attained over the “backward” countries consisted only in the matter of time. The Western nations had started earlier on the road toward improving economic conditions. The “backward” countries had still to begin. But there was time. It would have been a slow process. However, these backward nations would have found

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enterprise much easier, for there was no need for them to make experiments with unsuccessful methods of production. They didn't have to make the inventions anew; they could simply take them over from the Western countries. In time, this would have reduced the discrepancy in economic levels, but some difference would have remained.

There was no secrecy about the technological inventions of Western civilization. The most intelligent young men in the "backward" countries went to schools in the West to learn all they could about methods of production. Then they could bring Western technology to their own countries. But technology was not the only thing. What was lacking in the "backward" countries was the mentality that had produced capitalism in the West and the institutions brought about by that mentality.

Capitalism couldn't develop in the "backward" nations because the people didn't like capitalism, and because businessmen there were exposed to dangers which didn't exist in the West where there was the Rule of Law. The important thing for these "backward" nations, which were mostly in the East, was to change radically their mentality, their idea of economics. They had to recognize that the greater the number of rich there are, the better it is for the poor, that the presence of rich people is necessary for the abolition of the poverty of the masses. But this idea didn't enter into the minds of these people. The farther they were from Europe, the less they realized that the essence of capitalistic development was not the technological knowledge and capital goods but the mentality which had made it possible to accumulate large-scale capital and capital goods.

The people in the "backward" nations, especially those in Asia, saw only their technological backwardness. If these countries had powerful governments, powerful in dominating their own country, what they wanted first of all, what they envied most of all, was the better weaponry produced by the West. These kings of the East were interested first of all in getting better guns; they were little interested in other things. But the patriots who did not consider war as the most important manifestation of the human mind were interested in technology. So they sent their sons to technological universities in the West and invited professors and industrialists from the West to come to their countries. But they didn't grasp the real difference between the East and the West, the difference in ideas.

If the people in the "backward" nations had been left alone, they would probably never have improved conditions in their own countries; they probably wouldn't have adopted the ideologies necessary to transform

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their countries into “modern” countries. Even if they had done this, it would have been a very slow process. It would have been necessary for them to start from the grass roots. First, they would have had to accumulate capital to construct, let us say, equipment for the mines, in order to produce ore and from this ore to produce metals, and then the railroads. It would have been a very long, slow process.

But what really happened was a phenomenon that nobody in the eighteenth century had considered. What developed was foreign investment. Considered from the point of view of world history, foreign investment was a most important phenomenon. Foreign investment meant that the capitalists in the West provided the capital required for the transformation of a part of the economic system of the “backward” countries into a modern society. This was something entirely new, something unknown in earlier ages. In 1817, when Ricardo wrote his book *On the Principles of Political Economy and Taxation*, he simply assumed as a fact that there was no capital investment abroad.

The capital investment that developed in the nineteenth century was very different from what had taken place under the old colonial system as it developed from the fifteenth century on. Then it had been a search for agricultural materials, natural resources, and products that could not be obtained in Europe. A silly explanation of their desire to trade was that the colonial powers were interested in getting foreign markets for their production. Actually the colonial powers exploited the colonies in order to get materials; they were very happy when they didn’t have to give anything for the resources they wanted, when they could get the foreign products for nothing. These early colonists were more often pirates and robbers than tradesmen. They considered selling abroad only as a sort of emergency measure if they couldn’t get what they wanted without paying for it. They really had very little interest in investing—they only wanted the raw materials.

Of course, they couldn’t prevent some citizens from their own countries from settling in these colonies and starting agricultural production. As a by-product of these colonial ventures of the fifteenth–eighteenth centuries, some important colonies developed overseas. The most important, of course, was the United States, and secondly the Latin American countries. But from the point of view of the European merchants and tradesmen, there was little interest in the fact that some members of the lower classes migrated and settled in the United States. For a long time they probably considered the islands in the Caribbean more

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important because there they could produce something they wanted—sugar. The settlements in America were not a part of the old colonial policy; they developed in spite of the ideas of the government, at least not because of them.

In the eighteenth century there was already some investment in the North American colonies, but it was not yet a phenomenon of great historical importance. The real foreign investment started in the nineteenth century. This foreign investment was different from the earlier colonial investment insofar as it took place in territories owned and ruled by *foreign* governments.

This foreign investment was developed in two different ways. One development was the investment in colonies owned by the several colonial powers, i.e., in countries dependent on European nations, for instance, the British investments in India. But still more important were the investments in countries that were politically independent and some of which were highly developed, such as the United States. The American railroads, for instance, were built to a great extent with the aid of European capital. Investments in the United States, Canada, and Australia were different from investments in other foreign countries because those three countries were not “backward” in the sense that they lacked the business mentality. These investments had a very different history because they were really used in the best possible way, and also because they were later completely paid back. In the 1860s and 1870s one of the most important investment opportunities for Europeans was to invest in the United States.

Capital investment in a country means, of course, what is called an “unfavorable balance of trade.” The United States imported capital in the nineteenth century. Therefore, in the nineteenth century there was an excess, by and large, of imports to the United States over exports from the United States. But then from the last decade of the nineteenth century on, the United States began to pay back the investments the Europeans had made. Then there was an excess of exports over imports; the balance of trade became, therefore, “active.” The difference was paid for by the purchases by U.S. citizens of American shares and bonds that before had been sold to Europeans. This went on until after World War I. The United States then became the greatest money lender and investor in the world.

The capital from Europe, and later from North America, that came to these countries made it possible for European and North American countries to expand their economic systems. One result of these foreign investments was that certain branches of production were developed in

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countries where they wouldn't have been developed at all, or where they would have been developed only much later and certainly not in the way in which they were actually developed. The consequences undoubtedly benefited both the countries that invested and the countries in which the investments had been made.

Very soon an attitude hostile to foreign investors and foreign creditors developed in many of the countries which had benefited from this foreign investment. Such things even happened to some extent in the United States. One reason why the Confederate States didn't get more than one small loan from Europe during the Civil War was that in their files Jefferson Davis [1808–1889] had a black mark against him. Before he became president of the Confederacy, Davis had worked to repudiate a state loan in Mississippi, and the European bankers at that time had a good memory. However, such things happened more often in other countries than they did in the United States.

On the one hand some countries had a specific idea about how foreign investors and foreign creditors should be treated. On the other hand there were European governments waiting to intervene when such conflicts became acute, to protect the "rights" as they said, of their citizens. As a matter of fact, these European governments were not very much interested in the "rights" of their citizens. What they wanted was a pretext for colonial conquest. After the Congress of Vienna [1814–1815], it was a very disagreeable situation to be an army officer in Europe which was, by and large, at peace. The governments, and especially their armies and navies, were anxious to gain success abroad. They wanted victories, and some governments believed that public opinion expected such victories. If they went to war, they might be defeated and their prestige would suffer. This led some of them to seek colonial exploitation. For instance, the government of Napoleon III, which suffered from really bad treatment of French investors in the Republic of Mexico, embarked in the 1860s on a great adventure in Mexico. In the beginning, it brought some success to the French army, but it did not end as the French had hoped.

The countries which had been benefited from foreign investment misunderstood the meaning and advantages of foreign investment. There was a popular movement against foreign investors. Throughout the world, the principle of national sovereignty became accepted; it was maintained that an outside nation does not have the right to interfere if the rights of its citizens in another country are being violated. This was called the sovereignty doctrine. We are not interested in the legal excuses for placing

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obstacles in the path of foreign investors. But the result of the whole movement was that foreign investments and foreign loans granted to a country were completely at the mercy of every sovereign nation. These countries declared the foreigners to be exploiters and they tried to demonstrate the presence of exploitation by various theories which are not worth mentioning.

The Marxians provided several doctrines which related foreign investment to imperialism. They maintained imperialism is bad and must be abolished at any cost. These Marxian doctrines, especially those of Rosa Luxemburg [1871–1919], cannot be explained without entering into the whole value theory of Karl Marx. These Marxian doctrines of imperialism declared that foreign investment is both detrimental to the country from which capital is exported and detrimental to the country to which it is imported. Foreign investment is imperialism—imperialism means war—and therefore foreign countries are conquerors. The naïve reader of a newspaper is very astonished to learn that the United States, which is today practically the only country that can make foreign investments, is an imperialistic power and that a loan granted by the United States to another country means aggression against that country. This is a consequence of these ideas. But are they true? Did the capitalists of one country go into foreign countries, as this doctrine declares, in order to withhold capital and the advantages of additional capital investment from their own citizens?

Let us look at the motives of an individual capitalist entrepreneur. Why did he not invest at home? Because he believed that investing abroad was more profitable than investing at home. Why was this the case? Because the consumers on the domestic market were asking more urgently for products which could be produced only with the aid of foreign resources than they were asking for products which could have been produced by an expansion of domestic industries. For example, until a short time ago Europe had practically no oil production. Except for a very small quantity of inferior quality oil in Rumania and in a part of the Austro-Hungarian Empire that later became a part of Poland one could produce practically no oil in Europe. Therefore, instead of expanding European industries when consumers began to ask for more oil products, it became profitable to go to foreign countries and invest there in order to produce oil. The same was true of many other articles. For instance, the greater part of the cooking fats and soaps produced in Europe were made from plants that couldn't be grown in Europe. A great part of European consumption was consumption of things produced from raw materials that couldn't be

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produced in Europe at all, or that could be produced there only at a much higher cost.

At the beginning of the nineteenth century, when the question was protectionism against free trade, the slogan of the free traders in Britain was the simple Englishman's breakfast table for which all the products were either directly or indirectly imported from abroad. Even if some of them were produced at home, it was with the aid of fertilizer or fodder from abroad. In order to develop the products for the Englishman's breakfast, European investors went abroad and in the process they developed a demand for the products of English manufacturers. They also had to establish transport systems, harbors, and so on. Therefore, it is simply not true that European consumers and then later American consumers were hurt by capital exports; the capital was exported to invest in the production of things that European and American consumers wanted. The domestic resources of the European nations were lamentably insufficient; it would have been impossible for them to feed and clothe their populations out of domestic resources. In spite of the fact that there are now seven times more people in England than at the start of the Industrial Revolution,<sup>1</sup> the standard of living is incomparably higher. This was possible only because capital had been invested and large-scale production had been started in England and abroad—railroads, mines, and so on.

On the eve of the Second World War, the economic structure of British life was characterized by the fact that Great Britain imported about £400,000,000 more than it exported. 50 percent of this surplus was paid for by the dividends and profits of British-owned enterprises abroad and by the interest on bonds of foreign countries owned by the British. The standard of living of Great Britain was determined by this fact. During World War II, a part of these British investments abroad were sold, mostly to the United States, in order to pay for the war and for the surplus of imports the British needed before Lend-Lease started.<sup>2</sup> Then after the war, when Lend-Lease came to an end, the British government declared that it

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1 [The population of England was 41,147,938 (1952 World Almanac), as compared with an estimated 6 million in 1750.—Ed.]

2 [The U.S. Lend-Lease Act of March 11, 1941, permitted the President of the United States to "sell, transfer title to, exchange, lease, lend, or otherwise dispose of, to any such government [whose defense the President deems vital to the defense of the United States] any defense article," including weapons, munitions, aircraft and seagoing vessels, machinery, raw materials, and certain agricultural commodities. The United States thus could support the Allied nations' war effort while remaining a neutral country.—Ed.]

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was no longer possible to feed their people without the aid of an American loan which was, in fact, an American gift. But even this was not enough. The Argentine government expropriated the shares of the British-owned railroad and paid for these expropriations in British currency. The British government then taxed the money away from the people who got this indemnity from Argentina, and used this money to pay for wheat, meat, and other foodstuffs bought from Argentina. This is a typical case of capital consumption. Savings of the past which had been accumulated in the form of railroads were sold in order to get food (current consumption). This is very characteristic; it shows how these foreign investments were consumed.

But the greater part of European foreign investments, including British investments abroad, were simply expropriated. For the United States these expropriations and repudiations didn't mean so much, because the United States is comparatively very rich and these investments didn't play such a great role in the economy. Also, in my opinion, the United States is still accumulating additional capital. But for Great Britain, Germany, Switzerland, France, and other countries, this meant a considerable reduction in their wealth; they had invested abroad, not because they wanted to give away their wealth, but because they wanted income from the investments.

There are many different methods of expropriation.

1. *The communistic method:* If the country goes communistic, the government simply declares that there is no longer any private property; it takes and it doesn't pay for what it takes. Sometimes they say they will pay, but in fact they find some excuse not to make this indemnification.

2. *Confiscatory taxation:* Of course, there are in some trade agreements provisions prohibiting any discrimination against foreigners and this includes discrimination by taxation. But laws can be written so as not to appear to be against foreigners.

3. *Foreign-exchange control:* This is the most popular method. The foreign corporation makes a profit in its dealings in a country but the foreign-exchange control laws prevent it from transferring these profits into another country. As an example, let us consider Hungary. There were foreigners who owned small or greater amounts of bonds and common stocks in Hungary. The Hungarian government said, "Of course, you are perfectly free. You have the right to receive your interest and dividends. *But* we have a law, not only for foreigners, also for Hungarians. The law says that the transfer of funds out of the country is forbidden. Come to

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Hungary and live here, and you can get your money.” Often a country with foreign-exchange controls does not even let a man spend all his money earned in a short period of time—it is portioned out in monthly payments. In effect, this means expropriation. What they really want is for the producer, if he should actually come to the country, to spend not only the money earned in the country but also his own money which he brings to the country. This practically means an end to foreign investment. In the past if people were willing to invest capital in foreign countries they expected an improvement in conditions. But now this is no longer the case.

In the Middle Ages, the wealthy kings and rulers traveled around their empires. They said they were judges and had to keep an eye on the country. But the real economic reason for their travels was that the prince, the German Kaiser, for instance, owned big estates in various parts of the country. They traveled with their retinue to consume what was produced there. It was easier to move the men to the commodities than to move the commodities to the prince’s palace. This is the same right that exchange controls give—to consume goods in the region of their origin.

The Chinese governments were very clever. They did not expropriate the British. First, they prohibited them from exporting profits. Then they forced them to operate in such a way that there was no profit. Then they asked for taxes also, so that the British had to send additional money to China. Finally they made the British realize that you cannot do business with the communists, you especially cannot invest with them.

The expropriation of the Mexican oil fields was accomplished by repudiation, by the nonpayment of bonds.

The story of foreign investment can be told in a few words. Investments went out but only the glory, or the fame of this glory, remains. The result is that today there is very little readiness of people to invest abroad.

It was amazing that during the interval between the first and second World Wars there were still investments in countries that had repudiated foreign investors openly or indirectly. American investors lost a lot of money when the German mark collapsed because the German bonds were Mark bonds, not gold bonds. Nevertheless, during this period there were many German municipalities that succeeded in getting loans from American investors. Sometimes these American investors were simply “babes in the woods”; they didn’t know what they were doing.

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The Swedish government issued a gold dollar bond. They were paid for these bonds in gold dollars and promised to repay the loan in American gold dollars, defined as the American McKinley gold dollar. Then in 1933, the United States went off the gold standard. The provision in the Swedish loan had been formulated precisely for the unlikely event of a change in the American currency. But then the Swedish government declared, "We will repay the loan in new American dollars, Roosevelt dollars, not in McKinley dollars as specified in the bond." Given such a situation it is very difficult to get foreign investment.

In some Latin American countries there is no market for government bonds. These countries got private loans in the United States. But they will no longer get such loans. What has been substituted for this system of private investment was, first, Lend-Lease and, now, foreign aid. That means the American taxpayer is making gifts, not loans, to these countries.

Institutions have been established, especially the International World Bank, for the purpose of giving loans, but under a guarantee. In the long run such a system is self-defeating. If the United States issues bonds at a definite rate, let us say 3 percent, then the United States is standing behind the bond. If a foreign government issues such a bond under the guarantee of the United States, then again the United States is behind this bond. If the United States will not pay, then this foreign government will certainly not pay either. Now if this foreign loan is at a higher rate, let us say 4 percent, then the American government competes with its own bonds. The American government will not be in a position to sell its own bonds at 3 percent if the foreign bond has an advantage over the American bonds—not only a higher interest rate but the guarantee of the American government besides. Therefore, such a system cannot prevail in the long run. The result of the whole thing is that there is no longer any private investment.

Public investment abroad means something quite different from private investment. When the Argentine railroads were owned by private individuals of Great Britain, there was no infringement on the sovereignty of the government of Argentina. But if the railroads or harbors, for instance, are owned by a foreign government, this means something entirely different. And it means political problems become more important than economic problems.

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Point Four is a very lame attempt to do away with the disastrous consequences of the absence of foreign investment.<sup>3</sup> Behind it is the idea of teaching these backward nations “know-how.” But in the United States, there are many gifted engineers with “know-how” who could be offered positions abroad where they could use the knowledge and experience they have acquired in this country. Therefore, Point Four is not necessary for that reason. Also, there are hundreds and even thousands of foreign citizens in the United States and in Western universities who learn all these things. The art of printing was invented 500 years ago, and there are now printed textbooks. For those who cannot read English there are translations of these books. There are many clever Chinese. If a factory in China is backward, it is not due to the inability to acquire “know-how,” but because it doesn’t have the capital required.

In 1948, there was a meeting of the World Council of Churches in Amsterdam. They issued a statement saying that it was unfair and unjust that only the countries of the West enjoyed the advantages of machines, while in Asia and Africa the methods of production were backward. If, on the eighth day of Creation, the Lord had made a limited amount of machines and hospitals to be distributed equally and the West had appropriated more than its share, then one could have said that the situation was unfair. But the capitalist countries actually gave very valuable equipment and machines as gifts to these “backward” countries and the “backward” countries simply expropriated them. These countries didn’t understand what capitalism means. They thought the machines and the hospitals were capitalism. But capitalism is the mentality from which the institutions could emerge making it possible for capital to develop in the West and then to construct all these things. It could be said that the West developed its method of production from capital it made at home. Capitalism is not things; it is a mentality.

Nehru [Jawaharlal Nehru, 1889–1964] has been quoted as saying: “We want to give every encouragement to private industry. We won’t expropriate private businesses for at least ten years—perhaps not even that soon.” You cannot expect people to invest if you tell them that you will

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3 [A U.S. government foreign-aid program, announced January 20, 1949, by President Harry Truman, “for the improvement and growth of under-developed areas.” See Henry Hazlitt, *Illusions of Point Four* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1950).—Ed.]

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expropriate them at some time in the future. Therefore, conditions in India are much worse now than when the British were there. Then you could still hope that the British would remain and that they would not expropriate your business. The conditions are again similar to those that prevailed before the British came to India. If an Indian has some savings, he invests in the precious metals or still better in jewels. First of all these cannot be confiscated so easily and you can try to hide them. If necessary, you can even swallow a diamond to keep it safe for some time. You can't hide a railroad or a mine. And this is the catastrophe of the "backward" nations; people invest their savings in such things rather than in capital goods.

This situation has been made much worse because the Europeans brought to these countries modern medicines and modern methods of treating contagious diseases. In spite of the conditions that still prevail in China, and India especially, infant mortality figures have dropped considerably. As a result, these countries have an increasing population and a decreasing capital investment. The per capita capital is dropping instead of increasing. The Russian system also does not produce capital accumulation, i.e., it has insufficient capital accumulation. Thus, we have a situation in which the greater part of mankind in the world is living under conditions which mean a lowering of the standard of living. It is terrible to say this, but it is true; it would have been better for these people if the methods of fighting contagious diseases had not been imported for them.

I want to stress again that capitalism, modern machine production, and so on, is not something material! The tools and machines are the material results attained by a certain spiritual mentality, by a certain ideology. Capitalism or modern conditions, modern standards of living, are not simply the outcome of technology. They are the outcomes of certain ideas about social organization and about the cooperation of men under the division of labor and private ownership of the means of production. These ideas must be adopted in these "backward" countries if they want to change conditions.

I do not want to deal with happiness and other connected problems. I don't want to say that the Africans are happy without machines, without clothes, and with very different methods of feeding. But certainly they are not enthusiastic about the various diseases that plague them and which they can fight only with the methods of modern capitalism. It is wonderful that Dr. Albert Schweitzer [1875–1965] went to the center of Africa to work for the improvement of conditions. But Dr. Schweitzer has had only

a very limited effect compared to the effects of capitalism which made possible the modern means of production that provided all the things necessary to maintain a hospital in the middle of Africa. If you want to help the millions in Asia and Africa, then what is needed is capitalistic methods of production and capitalistic ideas. And they cannot be developed by the means which are today being applied in those countries.

It was the introduction of foreign investment in the nineteenth century that helped to make war and conquest superfluous. The situation which people had to face at that time, and are facing again today, was that there are countries in the world which nature has endowed with natural resources that are not available in other countries. From the point of view of natural resources, Europe is very poorly endowed by nature; Asia is much better endowed. If, on the one hand, the countries which have rich natural resources are so backward and so poor in capital that they cannot produce from these resources, and if, on the other hand, they do not permit foreigners to invest capital there and take advantage of the existence of these resources, both for their own and for the natives' advantage, can anyone expect that the people of the civilized countries will forever tolerate this state of affairs? Do the inhabitants of a country, just because their ancestors, conquered the country 500 or 600 years ago, have a right to prevent the improvement of conditions and peace in the world?

We are going back to the situation when you couldn't get these products without conquest, the situation which made the colonial system necessary. The nineteenth century developed a method which made it unnecessary. But now we have a state of affairs again in which these countries are preventing access by trade to raw materials. We can't know but some day a new technological method may be discovered that depends on raw materials which are available only in very backward countries. The people will say, "We could improve our standard of living and that of all other countries if we had access to these raw materials; they are completely useless to the Dalai Lama of Tibet." It was precisely foreign investment—the possibility of making use of all natural resources without political interference—that made war unnecessary. That doesn't hurt the countries involved. The foreign investments really cooperated in the country's development without hurting the country in any way. The peace of the world depends on this.

The disappearance of foreign investment is a very serious problem. What is most visible today is only the bad consequences, the bad standards

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of living, in India and China and some other countries. But this is not all; the whole system of world policies and international policies will be affected. And then if such real conflicts really arise, even the Boy Scouts of the United Nations will not prove any better than did the statutes of the League of Nations, the UN's predecessor.

I thank you for the patience with which you have endured my lectures.

★ ★ ★ ★

*[Additional comments by Mises during the question-and-answer period.]*

Lenin tried to get foreign capital to invest in Russia, during the NEP period, but it didn't amount to much.

Reciprocity in trade agreements is one method to destroy the market economy. The principle of buying only from those who buy from you ignores the existence of money. The idea of money, the use of money, the whole monetary system, is precisely for the purpose of making it unnecessary for you to buy only from those who buy from you. Triangular trade means trade with the aid of money. You buy from people who have bought from others. Not a single branch of business in this country could exist if this principle were to be applied here.

Frontiers don't exist in nature or in economy; frontiers are government-made obstacles. Governments create these differences.

Capitalism is not the ideas of the capitalist; it is an economic system. The ideas of the individual capitalist may be contrary in many regards to the principles of the market economy. There have always been businessmen who ask for privileges, protection, and so on, and as public opinion was favorable to these things they got them. It was not the fault of the lobbyists. As there are always lobbyists in favor of some things, there are also always lobbyists against other things. It is not even necessary to protect infant industries; there are shifts in American industry without such protection. If some get privileges, those who do not get any privileges are jeopardized. If the non-privileged are asking for privileges also, it is easy to understand. The duty to make such a system of privileges disappear does not rest with the businessman but with public opinion, with the ideologists, statesmen, politicians, and political campaigns. If there are privileges, then everybody tries to get privileges.

The advantages of capitalism are not for the benefit and advantage of the capitalists, but for the benefit of the masses. Capitalism is primarily production, large-scale production, for the masses. The customer, who is

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always right, benefits from capitalism. The institution of capitalism is not a reward for good children; it is an institution for the benefit of nations and of the people. If an individual capitalist is bad, you should not punish him by abolishing capitalism. Therefore, all the writers and authors of the fictional stories, literature, and plays that give us pictures of very bad capitalists, and say capitalism should be abolished, miss the point.

I am not in favor of the market economy and against socialism because capitalists are very nice people. Some are; some are not. In that way they are no different from other people. I am for capitalism because it benefits mankind. I am not against socialism because socialists are bad people, but because it brings about a complete decline in everyone's standard of living and destroys freedom.



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