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Source: *The American Journal of Economics and Sociology*, Vol. 3, No. 3, Essays in Memory of Franz Oppenheimer, 1864-1943 (Apr., 1944), pp. 435-442

Published by: American Journal of Economics and Sociology, Inc.

Stable URL: <https://www.jstor.org/stable/3483784>

Accessed: 25-02-2023 18:51 UTC

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# The Future of Free Enterprise

By EDUARD HEIMANN

FREE ENTERPRISE has built America; it has become the focal point of the American tradition. Critics too easily forget how much the system of political liberty owes to free enterprise. It is free enterprise which pushes back political tyranny by exempting one most important section of human activities from the jurisdiction of government. Political liberty is a product of the bourgeois world, and it is not by mere chance that the present grave danger to political liberty all over the world coincides with a parallel danger to the system of free enterprise. Truthfulness and fairness demand that this be emphatically stated by way of introduction to considerations of a much more critical nature.<sup>1</sup>

It is no less true, however, that free enterprise also destroys liberty. For the unrestrained liberty of the strong cannot fail to violate the liberty of the weak, both of weaker competitors and of dependent employees. The defenselessness of the weaker competitors ultimately makes them dependent employees. This is the social problem of capitalism, and it is not simply solved, as too many advocates of free enterprise would have it, by larger outputs. Justice is not a mere by-product of efficiency. It follows that Liberty must not be regarded as the exclusive and supreme value, but must be subordinated to Justice. There can be no Justice without Liberty, for man is entitled to his freedom; but Justice must also delimit Liberty in order to preserve it as freedom for all.

<sup>1</sup> The wisdom of Franz Oppenheimer's heroic struggle, not only against the distortion of free enterprise by feudal landed property, but also for free enterprise against all forms of State socialism, can be much better appreciated today than a generation ago, when the State was invoked as the guarantor of economic liberty against economic tyranny. We do not infer that the State should be kept out of the economic field altogether but we do infer that we should honor and heed Oppenheimer's critical attitude toward the State, particularly when we appeal for its help. This point is developed further in my article, "Franz Oppenheimer's Economic Ideas," *Social Research*, February, 1944.

With all these grave defects in the system of free enterprise, the principal objection to the system, nevertheless, arises from its technical malfunctioning. The social difficulty, some advocates of the system feel, is something one has to take into the bargain as the price of its many great achievements; but the economic crisis means that the system does not live up to its own standards. It is generally agreed that the system will be able to survive only if it can provide the people with reasonably full employment. An evaluation of the future prospects of the economy in the light of this condition is the concern of the present inquiry.

It is a commonplace to say that the system of free enterprise is dynamic. The center of its dynamic power is in the heavy industries, and in them the crisis centers, too. It is they which have to turn out the means of growth to be used in all expanding branches of production. Such growth takes the two forms of expansion, to cover wider areas, and of intensification, to equip the workers with more powerful machinery per head. More machines are the means of expansion, more complicated machines the means of intensification.

Machines, and the buildings to house them, are durable goods. This year's machine does not replace last year's machine but is added on top of it. That is why a point of saturation is reached sooner or later, and why the production of all durable goods is liable to violent fluctuations. In a period of rapid growth the machine-building industries are fully utilized; once the new demand has been met, the best they can hope for is orders for the annual replacement quota. If their size is geared to the pace of rapid expansion and intensification of the industrial system, any slackening of that pace spells unemployment to them; they can prosper only with an undiminished rate of growth of the system.

Whether the machine-building industries can hope for such a rate of further growth is our problem. It is to be discussed

under its longer range aspect, one that looks beyond the first post-war boom which will be dominated by the huge amounts of stored-up money.

Our analysis will proceed in terms of the saving-investment doctrine. Those engaged in the building of machines and houses, as of other investment goods, thereby acquire a title to consumption goods embodied in their incomes from their jobs; they expect to spend their incomes for such goods. But they do not produce such goods, while those who do also want to consume them. Any investment, and industrial growth in particular, thus produces an excess demand for consumption goods. On the other hand, not all the income that gives a title to consumption goods is employed to buy such goods. Part of the income is saved, where saving means non-consumption; and the savings quota becomes larger as people become richer. So for steady employment, (intended) investment should at least be equal to (intended) saving. The question as to whether it is likely to be so is the technical form of the problem of the future of free enterprise.

Three factors are likely to determine that future.

The first is the wave of technological innovations now under way in aviation, refrigeration, plastics, etc. Innovation always is the strongest incentive to investment; no one can afford to lag behind. The period between the Napoleonic Wars and the First World War, the century of the incredible development of capitalism, was also a period of most rapid technological development in several fields. Canals, railroads, electricity, chemistry, and finally automobiles have initiated the successive prosperity and boom periods of capitalism. Likewise a new industrial revolution may give a new impetus to free enterprise.

The critics of free enterprise cannot have it both ways. They freely predict a wave of monopolization as the conse-

quence of the new technological developments inaugurated by the exigencies of the war. This obviously presupposes such capital requirements for the new technology that only the biggest firms will be in a position to meet them. Should this prediction materialize, then we would have plenty of worries about the middle classes, about labor, about democratic government, but none whatever about employment. For such a wave of innovations would mean additional investments on a very large scale.

It is true that the TNEC, when it investigated the nature of modern inventions a few years ago, came to the conclusion that these are, to a large extent, of the capital-saving type, meaning that the new machines cost less capital than their predecessors did. If so, the conclusion runs, this new industrial revolution, contrary to the old one, will not increase total investment at all; the new machines will simply be ordered as the depreciation funds allow. But this conclusion is rash. Cheaper production through cheaper machines, instead of through costlier machines, may become so attractive that, while the individual machine is cheaper than its predecessor, the total of the machine orders may still exceed the total value of the fewer costlier machines of the preceding type. Whether this occurs depends on the degree of the expansion. Total investment may still grow.

The second factor to be considered is the development of the population curve, or more specifically, the downward trend of the birth rate. The growth of the population, for several generations, has depended on the decline in the birth rate being offset by a declining death rate. Since this cannot continue forever, the growth of the population will stop or be reversed.

Professor Hans Neisser has effectively blasted one pessimistic argument that used to be associated with the decline

of the total population.<sup>2</sup> The argument ran that a stable population would save more than a growing one. Neisser shows that the dissaving (spending out of savings), which has to be deducted from the savings in order to arrive at the figure of the net savings, will be larger in a stable than in a growing population. For in the former the ratio of old to young people is larger, it is an aging structure; and the old are likely to dissave the amounts they saved in their younger years for the very purpose of spending these sums after their retirement. In a growing structure, contrariwise, the statistical superiority of the younger strata over the old, and of the new saving over the dissaving, is likely to be stronger. This is convincing reasoning.

It does not fully invalidate, however, the pessimistic argument from the declining total population, in my opinion. This argument rests primarily on the changing directions in the demand for goods as the population declines. A growing population has an increasing demand for dwelling space, and buildings happen to be the most capital-intensive of all goods, the ones whose production involves the largest investment. Every major boom in the historical development of capitalism was accompanied by, or rather inaugurated by, a housing boom, and in the absence of a housing boom the upswing always remains half-hearted. When Professor Joseph Schumpeter objects<sup>3</sup> that a stationary population would replace more houses by more luxuries, he seems to miss the point; not every demand is as good as any other demand, and the production of personal services or many luxury articles would not be equivalent in invested capital to the production of housing. It is a well-known argument in business cycle studies that a mere shift in demand from such goods as require a capital-intensive production to other goods whose produc-

<sup>2</sup> "The Economics of a Stationary Population," to be published shortly in *Social Research*.

<sup>3</sup> "Capitalism, Socialism, and Democracy," p. 114.

tion is less capital-intensive may lead to a slump, because of the unfavorable effects of that shift on the machine-building industries.

What may be questioned is the presupposition of our reasoning, the decline of the total population. At the moment the figure is upward bound. We do not know, as long as the war is on, whether this is only the short-lived upward movement associated with every war, or a real turn of the tide, a real revival of democratic vitality and morality after the excesses of a Malthusianism which went far beyond the pales of its legitimacy. Should the new trend prove to be permanent, our problem would be solved. But there is, so far, little to support that expectation.

The third factor which must be considered is economic nationalism. Industrialization of pre-industrial structures long seemed to provide the heavy industries of the advanced countries with an insatiable demand for their products. Nay, there was a school of thought which held that only such outlets into pre-industrial structures prolonged the lease of life of the *laissez-faire* system, and that in order to secure those outlets the system was forced into imperialism and wars. Now it is remarkable that the boom of the twenties, a boom that was as violent as any boom has ever been, did not rest on any such expansion, and was even accompanied by the most sensational contraction of the area accessible to the machine-building industries of the Western world, as Russia and, to a minor degree, China, shut themselves off from foreign suppliers. These two countries would have been an immense field for capital imports from the West. But, for reasons of political independence, they chose to modernize themselves by economizing on their own resources despite the appallingly low standard of living of their people. In the twenties the driving power of the boom was such that it dwarfed even that tremendous drain. In assessing the factors that will deter-

mine the prospects of American industry in the future, however, this potential reduction of the field of its operations counts heavily. And no one can say at this juncture to what extent the example of the two may be followed by other "young" countries.

On the other hand, these two major countries, as well as many others, may be forced by the unparalleled ravages of this war to renounce any such nationalistic ambition, however justified it may have appeared under the special circumstances. The reconstruction demand, however financed, may far exceed anything that the most powerful industries of the world can supply for a long time to come, particularly if we include, as we should do for both political and economic reasons, that half of the globe which has not been touched by the war but abides in such a degree of misery and squalor that it appears unable to emerge from its poverty without outside help. A TVA on the Danube, the Congo, the Amazon, and on many other rivers, would be a good thing for us indeed. What one may doubt is that such reconstruction, organized as it would probably be on an international basis, could still be classified as in the free market, since the international flow of purchasing power would be fully planned.

Our survey leads to the conclusion that, while the probable trend of the population development is unfavorable to the prospects of full employment under a system of free enterprise, the technological outlook and that for reconstruction seem to encourage the expectation that the system will survive.

There are two reasons, however, why we would not go as far as that. In the first place, the outlook is much too uncertain to permit the government to adopt an attitude of indifference toward the employment question. The government has to stand by, even if free enterprise is put into control once more, ready to step in at a moment's notice, if needed.



Its intervention would have to assume, as in the past but in a more systematic manner, the form of public investment and building, on the one hand, and of public consumption, on the other hand, to supplement a slackening private investment and demand.

Should this come to pass, we would no longer have a system of free enterprise but a mixed system, consisting of a private sector for liberty and a public sector for full employment and justice. There is no economic reason why such a system should not be perfectly workable. Whether it would work depends on the spokesmen for free enterprise. Their claims should be kept in proportion with the performance of their system; they should claim exclusive control, as far as economic reasoning goes, only if they were sure that they can provide us with full employment.

If they can, in the second place, there would not only be the specter of monopoly with its political implication of irresponsible power. Nay, even in the narrowest technical reasoning, we would be right back where we came from. There is no reason to assume that the force of the boom would not spend itself once more, sooner or later; no mysterious law but the simple logic of durable goods would drive toward the saturation point of the demand. The more the boom would resemble the typical booms of the rising phase of capitalism, the surer it would give way, sooner or later, to a typical depression. We must not forget that no one could blame the depression of 1929 on governmental interference or crushing taxes. And critics may raise the question how often we are to be required to give business the "chance" for which it clamors.

Our result is undecided, but rather favorable for the short run, while highly sceptical about the prospects of the long run.<sup>4</sup>

<sup>4</sup> This paper was read in a symposium with Dr. Beardsley Rumel in the series of Littauer lectures at Hunter College in November, 1943.