

# 2 ESSAYS BY WILHELM ROEPKE

The Problem of  
Economic Order  
Welfare Freedom  
and Inflation

Edited with an Introduction by

**Johannes Overbeek**

UNIVERSITY  
PRESS OF  
AMERICA



LANHAM • NEW YORK • LONDON

Copyright © 1987 by

University Press of America,® Inc.

4720 Boston Way  
Lanham, MD 20706

3 Henrietta Street  
London WC2E 8LU England

All rights reserved

Printed in the United States of America

British Cataloging in Publication Information Available

**Library of Congress Cataloging-in-Publication Data**

Röpke, Wilhelm, 1899-1966.  
2 essays.

Essays originally published in 1951 and 1957.

Contents: The problem of economic order—Welfare, freedom, and inflation.

1. Economic policy. 2. Inflation (Finance).

3. Welfare economics. I. Overbeek, Johannes.

II. Röpke, Wilhelm, 1899-1966. Welfare, freedom, and inflation. 1987. III. Title. IV. Title:

Two essays. V. Title: Problem of economic order.

VI. Title: Welfare, freedom, and inflation.

HD82.R682 1987 338.9 86-33982

ISBN 0-8191-6125-X (alk. paper)

ISBN 0-8191-6126-8 (pbk. : alk. paper)

All University Press of America books are produced on acid-free paper which exceeds the minimum standards set by the National Historical Publication and Records Commission.



## CONTENTS

### I. THE PROBLEM OF ECONOMIC ORDER

First Lecture	1
Second Lecture; The First Stage of the Discussion: The Nature of the Problem	12
The Second Stage of the Discussion: The Different Solutions of the Problem	18
Third Lecture; The Third Stage of the Discussion: The Choice Between the two Possible Solutions	24
The Issue of Liberty	25
The Issue of the Control of Power	28
The Issue of Economy Efficiency	30
Fourth Lecture; The Third Stage of the Discussion: The Choice Between Two Possible Solutions (Again)	35
The Issue of Efficiency (Continued): The Problem of Inflation	35
The Issue of International Integration	41
The Fourth Stage of the Discussion: The "Third Way"	44

### II. Welfare, Freedom and Inflation

Facing the Future	49
Reflections on the Welfare State	69
Keeping Money Honest	83
Creeping Inflation: The Managerial Disease of the Public Economy	93



## PREFACE

This book presents two essays by the late Professor Wilhelm Roepke published in 1951 and 1957. The justification for republishing them lies in the fact that they are still very relevant, especially now that the prevailing drift of academic opinion has changed at the expense of Keynesian economics and democratic socialism.

The first part of this work consists of four scholarly lectures on the problem of economic order delivered in Cairo. The achievements of socialist systems are compared with those of the market economy. They were published by the National Bank of Egypt. The second part of this volume is made up of four compositions - two on the welfare state and two on inflation. This section has more the character of a tract stating the case against the welfare state. These pieces were written with a British audience in mind. The two parts of this publication are coherent but they were not written as a consistent whole. Therefore some overlap is inevitable.

As the editor I have limited myself mostly to the writing of an introduction and the usual editorial changes including the correction of obvious printing errors, an occasional footnote or clarification, as well as translations of quotations in foreign languages. During this undertaking I have remained attentive to the needs of the American reader which also made me revise a few unclear statements. However, nothing essential was altered.

Thanks are due to the University of the Virgin Islands which supported this project by providing secretarial assistance. Grateful acknowledgement is made to the son of Professor Roepke, Mr. Barthold Roepke, for his permission to reprint these essays.



## INTRODUCTION

The following two essays by Professor Wilhelm Roepke published in 1951 and 1957 are of more than historical interest. The writing on economic order contains an illuminating analysis of the various types of socialism and their impact on human freedom, the distribution of power, economic efficiency and international integration. Both pieces include a powerful warning against the long-term effects of the welfare state which, as we have learned in recent times, amounts to chronic inflation, low productivity, slow economic growth, a punitive and confiscatory tax system, economic strangulation by state regulatory activity, a gradual erosion of individual freedom and self-determination and finally the loss of the true spirit of individual responsibility without which the free society cannot function. Yet, in many nations there still exists a widespread popular support for the welfare state which suggest that only too few people have learned from the experience of recent decades in such countries as England and the Scandinavian states.

Wilhelm Roepke was born in Schwarmstedt (Germany) on October 10, 1899. His father was a physician. He participated in the first world war and as he himself put it in the preface of his book "International Order and Economic Integration", he had to come face to face with the terrible crisis in the history of human society which the first world war signified.

Once the war was over, he studied economics at the University of Marburg (Germany). In 1923 he married Eva Fincke with whom he had three children. His first academic appointment was obtained in 1924 at the University of Jena. From there he moved to the University of Graz and in 1929 he went to the University of Marburg as a full professor. At that time Roepke was one of the few German economists who did not endorse the teachings of the all-powerful German Historical School and the so-called "Academic Socialists" with their neglect of analytical economic theory and their approval of far-reaching government intervention. In the mean time (1927-'28) he visited

the United States as a scholar sponsored by the Rockefeller Foundation which allowed him to familiarize himself with American farm problems. He left Marburg in 1933 after Hitler seized power. About a week after that event, Roepke delivered a speech in Frankfurt/Main which was very critical of the Nazis. Then he voluntarily exiled himself and his family.

From 1933 to 1937 he taught at the University of Istanbul (Turkey) which gave him the opportunity to work and live in a non-Western environment. In his courses and seminars at the Graduate Institute in Geneva, he often told his students that he had been deeply influenced by this experience. Here in Turkey, he said, he was forced to realize that he was not only a German but before all a European and a product of Western civilization.

In 1937 Roepke accepted an appointment as professor of international economics at the Graduate Institute of International Studies of the University of Geneva, in Geneva, Switzerland where he stayed until his untimely death in 1966. Until the outbreak of World War II, he was always in close contact with Ludwig Von Mises who taught at the same establishment between 1934 and 1940. In fact, throughout his career, Roepke was one of the few German economists who maintained a close intellectual link to the Austrian school of economics.

After 1945 Roepke became closely associated with the economic and monetary policies carried out by his friend Dr. Ludwig Erhard who became known as the architect of the German "Economic Miracle". As Erhard's economic advisor, the latter's neo-liberal economic policies clearly bore Roepke's stamp. As is well-known these policies produced an unexpectedly rapid economic recovery in a country ruined by totalitarian economic policies and war. Roepke used to tell his students that the German economic miracle was no miracle at all but simply the predictable result of the application of sound economic policies.

Another major post-war event was the foundation of the Mont Pelerin Society in 1947. At the suggestion of F.A. Hayek and W. Roepke, an informal meeting of a group of European and American scholars was organized

near Vevey (Switzerland). All participants were strong believers in political, economic and moral freedom and after 10 days of discussions it was decided that the group should convert itself into a permanent association. The Mont Pelerin society has grown in status and membership to the present day and continues to organize annual meetings.

Roepke's scholarly publications are too numerous to be stated here but his research program can perhaps be divided into three major phases. During the first period of his career which lasted until about 1937, Roepke was mainly an economic theorist with the theory of the trade cycle as his area of concentration. Thus, he published "Crisis and Cycles" in 1936 and an introductory text in 1937 entitled: "Economics of the Free Society".

During the second interval which lasted from 1938 to the early post-war period Roepke turned to the subject of international economic relations. This stage of his research produced such works as "International Economic Disintegration" (1942) and "International Order and Economic Integration" (1959).

The last and third phase was characterized by the growing conviction that many pressing social issues required research beyond the scope of technical economic theory. Thus, like Von Mises, Hayek and others, Roepke moved into the direction of intellectual history and political and social philosophy. This period which roughly lasted ~~from the post-war period to his death in 1966~~ produced such contributions as "Civitas Humana" (1944), "The Social Crisis of Our Time" (1950), "The Problem of Economic Order" (1951), "Welfare Freedom and Inflation" (1957) and "A Humane Economy: The Social Framework of the Free Market" which first appeared in a German edition in 1958. The latter works devoted a great deal of attention to the study of the political and social environment in which economic systems operate. During the late 1950's and the early 1960's Roepke regularly lectured on the topic of economic systems. Had he been able to live and publish for many more years, he probably would have expanded his research in this direction.

For a number of reasons both essays reproduced here-below retain a strong contemporary relevance.

They obviously contain elements of what is now known as public choice economics as well as components of Austrian economics, contemporary monetarism and supply-side economics. At the time of their writing, Roepke clearly appreciated the general principle which in more recent years has become the heart of supply-side economics. The basic philosophy of supply side economics recognizes that human beings act and react knowingly and respond to incentives. People will change their behavior when incentives such as tax rules are modified. High taxes tend to distort individual choice with negative effects on the supply of productive inputs. In "The Problem of Economic Order" Roepke subscribes to the idea that a highly progressive income tax "profoundly changes the motives and incentives of the economic process".(1) Under a system of confiscatory taxation, writes Roepke, "people will tend to prefer leisure to work, safety to risk, routine to initiative and consumption to saving.(2) Comparable observations appear in "Welfare, Freedom and Inflation".(3)

Thus it seems clear that some important ideas proposed by contemporary supply siders can also be found in earlier works of such economists as Roepke. A close look at his writings even reveals that long before it happened, Roepke predicted that misguided government intervention in the economic process would inevitably lead to the stagflation problem which plagued the U.S. and some other industrial economies during the 1970's and beyond.

---

(1) W. Roepke, The Problem of Economic Order, Cairo: National Bank of Egypt, 1957, p. 7.

(2) Ibid. p. 8.

(3) W. Roepke, Welfare, Freedom and Inflation, London: Pall Mall Press, 1957, p. 45.

**The Problem of Economic Order**



## FIRST LECTURE

If I were asked to say what appeared to me as one of the gravest features of our time I would answer: One of the worst things is that people do not seem to stop and think and to ask themselves quietly what exactly they are doing. "We must do something, no matter what" seems to be the unspoken motto of our age which prompts people to rush from one thing to another. In this hectic activity, we are apt to take fiction for reality, to fool ourselves and others with catch-phrases and make-beliefs, to be afraid to be alone with our own mind and to go to the real roots of the matter at hand, to act instead feverishly, to ask one question after another without staying for an answer like Pilate or to answer questions which are put in the wrong way. We live from hand to mouth, in our ideas as well as in our actions. More and more people no longer know what it means to put first things first and to think in terms of the principles involved. Consequently, only very few still have a real philosophy which separates the essential from the accidental and which puts everything in its place. We lose sight of the real ends while becoming entangled in the means. We do not know any longer what we really want or should reasonably want, or we want at the same time things which are utterly incompatible with each other, like collectivist planning and liberty under the law, like federalism and socialism, like international integration and national sovereignty enhanced to the nth power by economic administration centralized in the hands of the government, or like inflation and stability. We advertise grandiose plans for the realization of which almost all pre-requisites are missing and which are already obsolete at the moment they are published by the government.

The truth is that at heart, we feel helpless, but, being afraid to admit it, we are organizing committees and sub-committees, we are rushing from one conference to another, and finally we pretend to be satisfied with resolutions which have no meaning or which are a tissue of contradictions like the famous Havana Charter of the International Trade Organization. As Aldous Huxley says in his novel Time must have a Stop, "Ours is the Age, not of any poet or thinker or novelist, but of the Document." Our Representative Man is the traveling newspaper correspondent, who dashes off a best seller between two assignments."

These tendencies are really alarming. They tell the sociologist and philosopher more than anything else about the real drift of our age. They had become noticeable already after the first World War, and we are still suffering from their disastrous consequences. For a while there was real hope that this dire harvest of unthinking haste and self-deceptive superficiality would awaken people to their responsibility. Today we have to admit that so far we have hoped in vain. Confusion, loss of orientation and lack of philosophical insight are worse than ever, and so we are drifting on an uncharted sea. We are running after current events, instead of stopping to reach the solid ground of principles and to ask ourselves seriously what might have been the reasons why so much goodwill, energy, intelligence, time, and money have been wasted or not given the result we had a right to expect. What I said more than fifteen years ago at an international conference at Geneva is unfortunately still true today: We behave like a doctor treating with ointments what he believes to be itching while the sombre truth is that it is syphilis.

The analysis of the mental tendencies of our age shows that we have lost the ~~faculty of thinking in fundamental terms, that we have become unable to see the large and general connections of things, that we fail to distinguish between what is different or what is essential and that our thinking is crumbling into disconnected bits and our policy into a series of stop-gaps, like the policy which goes to day under the phrase of "full employment."~~ Its stupendous intelligence did not prevent our time from becoming alarming unwise.

## 2.

The unfortunate tendency which I have criticized can be observed in almost all fields of human relations. But the economist has perhaps particularly strong reasons to stress it and to draw attention to its disastrous consequences. Seen from his point of view, the present states of world appears largely to be the effect of the confusion of economic thought. I could develop this idea in many directions, but I would like to emphasize two aspects of this grave situation which are closely connected.

The one is the dissolution of the body of

generally accepted economic principles by wellknown scientific trends which recently led a convinced follower of the late Lord Keynes in England to the highly creditable confession "that we should be better off with the old Political Economy."(1) In Economics as almost everywhere else, with all our cleverness, we have become decidedly less wise, while knowing more and more about less and less. We have lost the sense of proportion--so indispensable for every economist--while analysing the curiosities of hypothetical economic situations and forgetting what has a bearing on real economic life. In spinning out the fine threads of the New Economics, we forget the most elementary principles of economics, and while stressing what might happen at best in highly exceptional circumstances we overlook what are almost perennial truths. While proudly parading our elaborate equations we unlearned that simple common sense which consists in reckoning with human reactions and institutions as they really are. While studying the trees we have been all too prone to overlook the forest.

It is impossible indeed not to look with considerable uneasiness at the type of the "modern economist" as he developed after Keynes' revolutionary book, whom Keynes himself regarded with alarm at the end of his days., It is the type of man who is obsessed by one thing, i.e. "effective demand," which he thinks must be kept up at whatever cost, while he forgets the working of the mechanism of prices, wages, interest and exchange rates. Whereas formerly a good economist was a man who knew how to assess the relation of the actual economic forces and whereas formerly judgment, experience, and a sense of proportion were rated higher than the formal skill in handling certain

---

(1) Roy Harrod, Are these Hardships Necessary?, London 1947, p. 58 where he says: "...we have no body of received opinion, fairly widely understood to take the place of the place of the old doctrines, and there is consequently no force strong enough to check the Government in its aberrations. People are quite at loss in these matters... Indeed it might well be argued that we should be better off with the old Political Economy which, with all its shortcomings, succeeded for a long time in retaining its hold upon the mind of the average well-informed citizen."

research techniques introduced illegitimately from the natural sciences into economics--today glory goes to him who knows how to express more or less hypothetical statements in mathematical symbols and curves.

All this leads to another calamity which is threatening the foundations of our civilization. Why is it that the whole West has become so desperately entangled in problems which seem almost insoluble? I believe one of the principal reasons for this is to be sought in the fact that we simply fail to solve the most elementary task of any society which is that of having a workable economic order. We fail in this task because our mental laziness prevents us from seeing even what it is all about. And because we do not see it we throw ourselves into the arms of the State, some out of sheer helplessness, others in rapturous enthusiasm. In this way, by leaving to the State the responsibility for something we no longer understand, we tend to end up in Collectivism and everything that goes with it.

To discuss this cardinal problem of economic order in detail is the subject of these lectures. The first task would be to define precisely the term itself. But before we do so it appears necessary to discuss some preliminary questions.

There is no denying the fact that to deal with the problem of economic order is to tread on a very hot ground indeed where political passions are rife and social disputes are raging. The economist who is bold enough to intrude into this battlefield of present ideologies and social religions must be prepared to be handled rather roughly. He will learn that there is today a "Rabies Economica" which is just as bad if not worse than the old dreaded "Rabies Theologica." What can be done about it and how can the dignity of science be saved under such circumstances?

More than half a century ago, in 1897, a great economist, Maffeo Pantaleoni, gave, in the very city where I come from, an inaugural lecture which was to become famous. Its title was "On the logical nature of the differences in opinion which divide economists" and one of his conclusions was the witty statement that there are only two schools of economists, the school of those who understand economics and the other of those who do not. Of course, Pantaleoni's statement was

always a playful oversimplification if not a mere jest. If it were ever true--even in the field of proper theory of which he was speaking--it certainly has become absolutely erroneous today. We have not only the clash between the Keynesian approach and the conventional economics which splits the happy Pantaleonian One World of Economics almost hopelessly "into two realms of logic"(J.M. Clark). There is something much more dangerous and insidious: the clash of "social religions" penetrating into the science of economics itself.

Let us take as an example the present discussions about the "dollar shortage" and the "balance of payments deficit" as they take place even among professional economists. I know by bitter experience that, even here, it has sometimes become very difficult to reach an understanding. If we show that the term "dollar shortage" has no real meaning except either with regard to a given rate of exchange or with regard to a desirable increase of national consumption or investment, we quickly realize that such sober analyses are profoundly shocking to the well-thought-of of today who do not like them for two reasons: 1) because they do not digest the idea of a balance of payments whose disequilibrium is not a God-ordained calamity needing careful planning but the result of certain national policies which can be changed if one wishes, 2) because they react against the suggestion that "dollar shortages" or deficits of the balance of payments may be the result of policies which are deemed desirable, such as what is called nowadays "full employment."

If that is true already in the field of pure theory, understanding in the field of economic policy has become almost impossible. That is the desperate situation which is a real challenge to the economist and the social philosopher. He must make equally desperate efforts to prevent the discussion from degenerating into mere namecalling. To this laudable end, two maxims seem to be particularly useful.

The first maxim for giving more scientific dignity to our present discussions of the issues of economic policy is to begin always with ascertaining the common ground of general aims and ideals without which no discussion is possible anywhere and which we can use as

the point of ultimate reference and as objective criteria when our views become more and more conflicting in the further course of our discussion. If only we agree on the ultimate ends--on liberty, democratic government, justice, peace, the necessity of protecting the individuals and groups against uncontrolled power, material mass welfare, and so on--it must be possible to reduce our discussion of the issues of economic policy to a debate which is merely one about the best means to achieve those ends. The right procedure, therefore, would be to begin with what is common ground and then to work our way step by step up to more and more debatable ground as we come to matters of detail and concrete decisions on the best possible means. That will also be the procedure to be adopted in the course of these lectures.

For the same purpose of reducing as far as possible the ground of combat, it is further necessary to apply a second maxim. It consists in making distinctions where before there was the habit of lumping different things together. I spoke of the ultimate ends and problems. Now, the important thing is to realize that there are, for economic and social reform, quite different ends and problems and that for these quite different answers must be given.

Consider, in this connection, the case of the ardent socialist. He finds that there is very much wrong with our world, and we all probably agree with him. His enthusiastic conclusion will be that "Capitalism" must be replaced by "Socialism." But it is safe to say that, in most cases, the socialist will find it very hard to define the one as well as the other. The idea uppermost in his mind will be that now there is "anarchy" and "jungle" and that afterwards there will be order, justice, and planning. His opponent, defending not "Capitalism" but the market economy, will explain that both theory and ample experience prove that socialism is most likely to be a bitter disappointment. All the time it is quite probable that they will talk at cross purposes because the socialist has in mind quite different problems to be solved whereas his opponent never meant the market economy to be the answer to all these problems but only to one of them, i.e., our special problem of economic order. He will say with Shaw that "no sane person

refuses to wear spectacles because they do not cure a tooth-ache."

Here is perhaps the point where I should say a few words on what could be usefully understood by "Socialism." Properly speaking, of course, the task of defining it is even more hopeless than that of defining similar terms of our political vocabulary like capitalism, liberalism, or democracy. The word "socialism" has become so much a mere receptacle of vague sentiments, passions, desires, emotions, and ideas that it has lost almost every vestige of ascertainable meaning and therefore almost every value in a scientific discussion. Nevertheless, it may serve a good purpose to do something else and to find out at least the most important meanings of actual socialist movements and policies today. In this respect, I think it is possible to distinguish altogether three main meanings of socialism:

1) Socialism as a policy whose aim it is to bring about a radical change in the distribution of income and property by all the means which make up the modern Welfare State, i.e. generally speaking by taking continuously from the ones and giving to the others.(2) Strictly speaking, such a policy can be pushed quite far without changing what we call the economic order, neither taxes on the one hand nor social services on the other necessarily interfere with the process of the market economy. There is in other words, nothing in the technique of the welfare state which can be called socialist in the sense of something necessarily opposite to the market economy. The interesting question, however, is whether this is not again one of the cases where quantity finally changes to quality. We can no

---

(2) It is important to see all the implications of this definition and to realize that all stress is laid on distributional change brought about by the continuous working of the fiscal machinery of the government. There is another kind of policy combating inequalities which consists in abolishing as far as possible the conditions under which unjust inequalities may arise (monopoly, privileges, feudal landownership, etc.). This policy constitutes, of course, a common ground for socialists and liberals.

longer doubt that once the fiscal system takes more than a certain maximum share of the national income it ceases to be a mere machinery to change the distributional aspect of the market economy. Quite apart from the eventuality that, by price subsidies, modern fiscal policies may entirely falsify the price mechanism, they introduce into the economic system profound changes of various kinds. In the modern welfare state, fiscal policies may indeed be pushed so far that they serve an entirely new ideal which we may call that of the ~~socialization of consumption~~. That is to say: the individual consumer becomes suspect; he is no longer thought fit to decide the use of his income; the government does it for him to an ever larger extent by leaving him the smaller part of his income to be enjoyed within the narrow conditions of some system of "austerity" while using the remainder for the provision of collective goods of every description. Fiscal policy becomes almost a new end in itself, and the larger the quota of the national income claimed the better. This ideal of what might be termed Fiscal Socialism appears all the more progressive as with increased public budgets there is an increasing scope also for using the fiscal policy, by varying the size and the kinds of revenues and public expenses, for what is now called "functional finance," i.e. for policies of "full employment." Within this new framework of policies, public finance ceases to be neutral for the simple reason that, beyond a certain point, reached in more and more countries today, the burden of taxation, particularly that of personal direct taxation and of business taxation, will profoundly change the motives and incentives of the economic process. People will act very much differently than before. As a recent German author (G. Schmoelders) puts it: "The belief is utopian that, in a national economy burdened with such tax rates (60 to 100 percent, or even more), the entrepreneur would still shape his economic actions faithfully after the rules of the individual search for profit which have been valid for 150 years, while profit and income taxation aim either to take away from him the fruits of his work or to give them to others." But people not only will act differently and make business less rational than before. Their incentives to work or to fulfill their functions in the economic process will be considerably weakened, with the consequence that total production may be most unfavourably affected. Under

the crushing burden of taxation as we find it today in so many countries, ~~people will tend to prefer leisure to work, safety to risk, routine to initiative, and consumption to saving.~~ We conclude that evidently, socialism in this first sense of a distributional and fiscal system seems to have little to do with the economic structure as such, ~~but the order of magnitude involved today together with the aims and the technique of this system makes this detached view more and more untenable.~~ It seems, therefore, impossible to discuss today the problem of economic order and its possible changes without due regard to this factor of the changed size and position of public finance which have been brought about by "Fiscal and Distributional Socialism."

2) Socialism as a policy which primarily wants to solve the problem of ~~industrial property and of the position of the worker as it depends on this property.~~ It seems that, not so long ago, it has been possible, at least in a country so little doctrinaire as Great Britain, to pass for a good socialist while championing the solution of this problem of property in our age by the restoration of private property. That, at least, was the stand taken by the Labour leader Ramsay MacDonald who, in 1924, defined the socialist as the best defender of private property "since he considered it a good so great that everybody ought to have some." (3)

Today, such a socialist belief in private property has become as anachronistic as the one in free trade. Not only on the Continent but even more so in Great Britain, the modern socialist recognizes only one solution of the problem of industrial (and even agrarian) property: the change of private into public property by what he calls ~~nationalization~~. In this, he is following particularly ~~Karl Marx~~, whose main concern was precisely this socio-legal aspect of ~~"capitalism"~~ as presented by the private ownership of the means of production while he cared much less for the distributional aspect and neglected entirely the problem of the economic order itself.

---

(3) W.A. Orton, The Liberal Tradition, New Haven, 1945, p. 110.

3) Socialism as a policy which is not so much concerned with the question as to who owns the means of production as with ~~the other question as to how they should be coordinated in the economic process itself,~~ in other words, with the question of economic order. As socialism in the second sense is mainly connected with the name of Karl Marx, socialism in this third sense has been really founded by St. Simon, the ~~spiritual father of planning, interventionism and control, and it is not by accident that this idea which had been developed first by an engineering mind and in the shadow of the Ecole Polytechnique in Paris,~~ should have found so many of its champions among scientists, engineers and industrial organizers among whom not the least important has been Walter Rathenau, who invented the term "planned economy" itself. (4) For to solve the problem of economic order by governmental planning is nothing else than to try to organize the whole national economy on the pattern of a single huge factory and to apply to it the principle of the blue-print. Whereas, in the second case, we recognize socialism as nationalization we encounter it here as planning, centrally administered economy, or Office Economy as I like to call it. What that exactly means will be discussed here in due course. The important thing to realize at this point is that both are essentially different things. It is possible to have, up to a point, socialism as nationalization without socialism as planning, as it is possible to have socialism as planning without socialism as nationalization. To nationalize this or that industry, though changing

---

(4) Henri de Saint-Simon (1760-1825). French socialist philosopher entertained a passionate desire to reform science and society. In such publications as "On the Industrial System" (1821-'22), he set forth a vision of a technocratic state characterized by large-scale industrialization under planned scientific guidance. The future society would be administered by engineers, scientists, industrialists and artists.

Walther Rathenau (1867-1922). German industrialist, public official and economist served as minister of reconstruction and foreign minister during 1921 and 1922. Rathenau wrote extensively on social and economic problems. His work includes several books on economic planning (ed.)

industrial ownership, does not necessarily involve a change in the principles of economic order. It is possible that the economic process as a whole will continue to be mainly determined by prices and competition and not by the plans and orders of the government. There are examples of socialist governments, after the first and also the second World War, which thought that socialism meant primarily nationalization of select industries while they did not seem even to see that, besides that, there was an entirely different and independent problem, i.e. that of economic order as the way of regulating the economic process as such. On the other hand, we have the example of the Nationalsocialist government in Germany which adopted the most thorough system of Saint-Simonian socialism in the sense of the social technique of planning while leaving the problem of industrial property formally untouched. I say "formally": that is to say that while, in this case, the legal title of property remained intact, its substance was gradually emptied once the private entrepreneur became a mere agent of the omnipotent government.

## 3.

This survey of three main meanings of contemporary socialism as a practical policy illustrates what I meant when I said that it is so important to keep the different problems apart and to separate the problem of economic order from others which are perhaps equally important but entirely different. In the course of the present lectures, we may find that there are good reasons to believe that the so-called market economy as a solution of the problem of economic order is vastly superior to the Office Economy. But to say this is not to overlook the fact that there are other problems to be solved and not necessarily being solved simultaneously by the market economy: the problems of distributive justice, of social security, of property, of power, of the human aspects of industrial mass society and so on. I shall have to say more about these other problems at the end of my lectures. Our immediate task, however, is to consider now exclusively the problem of economic order for whose dispassionate discussion the field has been somewhat cleared by this first lecture.

Let me finish today with one last remark. In all these discussions on types of economic policies and

economic systems there is one particular danger of which particularly the man of science has to beware. It is the danger of mere intellectualism by which I mean the failure to translate theoretical blue-prints into reality which is not only economic but also political, sociological and almost everything in addition. When studying so many projects of economic and social reform one has the uneasy feeling that their authors never asked themselves the simple question: Who is to carry through all those fine-spun schemes? What is the state like which is to execute them? Where is the administration efficient and honest enough to put them into daily practice? Where are the men capable, devoted--and healthy enough to assume the direction? In all those projects, and particularly those of a collectivist kind, there is above all the "human bottle-neck" to consider, but it is exactly this which is all too often entirely overlooked.

There is a story told of the well-known Italian Prime Minister Giolitti which illustrates very well this point. When a delegation of professors had explained once more a dazzling reform project Giolitti is said to have answered: "I agree entirely with you and your plan. I only have one objection which is that you only have to write down all those beautiful things while I have to implement them." You will admit that there is wisdom in this reply. There is indeed little use in making blueprints of theoretically perfect machines for the economic process which have the one but capital fault that they do not work because men, governments and societies are as they are,--which reminds us of the saying of Lichtenberg, the great German essayist of the 18th century, that it is a pity that the social philosopher cannot, like the professor of physics, make models of his utopian republics to see that they do not work. We need economic systems and monetary standards which correspond both to the average intelligence and the average morality of man. They have to be fool-proof, and they must suppose neither heroes nor saints nor intellectual giants but men with their average ethics and brains.

## SECOND LECTURE

### 1.

The first stage of the discussion: The nature of the problem

In the first lecture, an attempt was made to clear the ground in various ways. We gave a preliminary idea of the subject and, particularly an effort was made to narrow the controversial ground as far as possible. One of the main results of all these endeavours has been to convince us that it is quite wrong to believe that, in the discussions on the economic order, the dividing line ~~must be necessarily between socialists and non-socialists. The two types of economic order which we have to consider--the market economy and the office economy--are, manifestly hardly more than two~~ opposite social techniques of establishing an economic order which can be combined with quite different general systems of economy, policy, culture, and human relations, although they have themselves far-reaching consequences. Those consequences of the office economy are such that the liberal and democratic socialist should have no less reason to dislike them than the non-socialist while, I repeat, he has enough scope left for reforms in other directions which should fairly satisfy them.

When we now proceed to study those consequences of the two techniques of economic order we remember another maxim mentioned in the first lecture: to go on from the uncontroversial ground cautiously to more and more controversial ground where, increasingly, subjective elements of political valuation are involved. To this end, I suggest that we carry the subsequent discussion through three main stages which can be characterized by the following capital questions.

- (1) What is the problem involved?
- (2) What are the possibilities to solve it?
- (3) Which of these should be preferred?
- (4) If we should find that the liberal solution (market economy) is to be preferred--what are the reforms with which it should be combined in order to be made politically feasible and socially acceptable?

Let me begin then with the first stage of the discussion where we ask for the nature of the problem involved whenever we speak of the "economic order."

What we have in mind speaking of an economic order is precisely the following: For the social economy as a whole the same problem must be solved which is familiar to every farmer who, all the time, has to

decide, carefully and weighing all circumstances, how to use in every detail his land, his capital and his labour resources so as to produce the right things in the right proportions. Given at every moment the scarcity of the productive forces, society has to provide an ever changing answer for the ever changing problem: what use shall we make of these scarce resources? Shall we produce this or rather that, and how much of this and how much of that? That sounds very simple, but probably no one but the trained economist can have a fairly appropriate idea of the immense difficulties which this problem involves. He knows that it is not only a question of simple large groups of commodities like food, clothes, or houses, but one of the boundless varieties within these large groups. All these almost innumerable individual commodities and services, among which we have to make our choice continuously, must be there in the right proportions, at the right place and at the right moment if the economic process is to work in a fairly orderly manner. The initiated is equally aware of the fact that all this implies at the same time the momentous decision as to whether we should produce more for current consumption or for the capital equipment of the community, a decision which means what is technically known as the temporal order of the economic process. The trained economist will also understand at once our hints as to many other choices to be made if there is to be economic order, choices which are as important as they are difficult and which have to be made continuously changing circumstances.

But order in this sense of the right choice, of proportions and harmony, is not all. Like a watch which contains as its vital parts ~~not only a balance but also a spring, a workable economic system not only needs order but also incentives.~~ What matters is not only that, at every minute, we produce the right thing in the right proportions, at the right moment, at the right place, and with the right technique, but also that all this happens on the level of maximum quantity and quality. This level will be reached and maintained if everybody gives his best, and everybody will give his best if the economic process is provided everywhere with the proper incentives corresponding to human nature as it is--neither angel nor beast as Pascal has

said.(5) Society must be so arranged that we find it natural to work hard and conscientiously and to live up to our functions as entrepreneur, merchant, farmer, worker, scientist, inventor or artist as best as we can. At the same time we must feel encouraged to think of the future by saving and investing. All this must happen naturally, smoothly, and spontaneously while we feel at once that something must be fundamentally wrong in a country where the most natural actions of man like working, caring for his family, saving, creating new things or raising children must be instigated by propaganda, radio speechies, medals, moralizing, conferring the distinction of "heroes of work" or theatrical performances. It is the most elementary wisdom to put man under conditions which bring out what is best in him and which make him work, save and invest as natural expressions of his vitality without his being even remotely a saint or a hero. Every economic system which, for its functioning, requires saints or heroes is condemned as utterly unworkable, and only fools and fanatics still refuse to submit to this wisdom which is proved by the experience of all ages. A wise social system is that which releases the full activity of man so natural to him while at the same time, it curbs his hidden tigerish tendencies which, unfortunately, are no less natural to him.

The distinction between the two principal problems to be solved in order to constitute what we call the economic order--that is to say, that of order properly speaking and that of incentives--is of a significance far from being generally understood. The two tasks must be kept strictly apart, and if only one of them is unsolved there is not yet an economic order. That is, among other things, very important for settling a question which has been hotly debated during the discussion on the economic possibilities of socialism. After it had been shown convincingly that the price mechanism of the market economy is indispensable for a rational organization of production and the right

---

(5) Blaise Pascal (1623-1662) was a French religious thinker, mathematician and scientist. He invented the first calculating machine in 1645. His most famous work "Pensees" (Thoughts) contains a set of deeply personal meditations (ed.).

allocation of resources, socialists were at first more or less nonplussed until ingenious plans were presented to overcome his difficulty by building into the socialist economy a sort of synthetic competitive system. There will be a few today who still take this idea seriously, but we can now say exactly what is particularly wrong with it. While it is quite conceivable that, even in a socialist state, competition between persons or departments can be used, under certain conditions, for the purpose of providing incentives it is not thinkable that it could be used also as a means of directing the economic process in the way it is used in the market economy. For either it is the planning authority which directs or it is not. If it is not the planning authority which is directing the economic process but competitive price bidding, then we have no longer a collectivist system but a market economy. "Competition can be used to improve efficiency, but as a mechanism of direction for an important section of the economy it cannot be applied without the abdication of the central authority."(6)

There is another point which ought to be stressed to avoid misunderstanding. When we speak of "incentive" as the second prerequisite of economic order we include a most important function: the willingness of all to reach and to carry through the right decisions which are necessary for an orderly economic process. In order to see what is meant by an "orderly economic process," we must remember that one of the main problems of continuous coordination is to avoid what is nowadays called "bottlenecks" in the economy, i.e. all sorts of disproportionalities and disharmonies which now here, now there may bring the whole economic process standstill. They may appear everywhere, not only in the shape of a shortage of raw materials like coal or tin but also in the insufficient supply of insignificant supplementary goods which suddenly, by their absence, become all-significant, just as the biggest dinner-party can be spoiled by the smallest toothache. As the experience of the National-socialist planning in Germany shows, it may be the

---

(6) W. Eucken, On the Theory of the Centrally Administered Economy: An Analysis of the German Experiment, *Economica*, May 1948, p. 94.

sudden deficiency of wooden cases and other packing materials or nails or a certain kind of screws which brings the flow of production to a stop. Or it may be glassjars for honey or jam or a thousand other small things which play such an inglorious role in the stories we hear from the communist countries behind the Iron Curtain today.

It is quite significant that this phenomenon of bottlenecks has been quite neglected in former discussions about the theory of collectivism, and even today its real importance is far from being generally understood. Here, as at so many other points, former times had been without experience, and it is only now, after collectivism has been made the object of various experiments, that we are wiser and that we discover problems where formerly things had been taken more or less for granted. The point is, of course, that "bottlenecks" in the sense of a situation where certain goods cannot be obtained in the right quantities at current prices were unknown in former times of a fairly working market economy with its free pricing mechanism. They make their appearance only when prices are prevented from bringing about prompt equilibrium, whatever the circumstances. And it is here, of course, where we find also the cause of those disturbances. Bottlenecks are the constant and inevitable result of collectivism, a statement which we must bear in mind when we come to discuss the merits or demerits of the office economy.

Why does collectivism (office economy) invariably produce bottlenecks? To avoid bottlenecks, there must be an efficient regulating agent or, better, a correct indicator of where, in the process of production and consumption, an increase or a decrease of a certain commodity is wanted. But there must be also an efficient force securing a speedy reaction of producers and consumers to this indicator. It is one thing to know where bottlenecks occur or threaten to occur, and to what extent, and to send out directions to the producers and consumers to act accordingly. It is quite another thing to secure prompt obedience to these directions. Prices are orders given by the market to producers and consumers to expand or to restrict. If the market economy is replaced by the office economy these orders in the shape of prices must be replaced by orders literally issued by the political authority. Now, the difference between the two kinds of economic

order is not only that the office economy finds it difficult to provide a substitute for prices as an indicator of where to expand and where to restrict. The difference is also that producers and consumers will react promptly to price changes (the orders of the market) but not to orders of the central authority. In other words: (a) the orders issued by the centre of the office economy are clumsy and wrong, and (b) the reaction to them is slow and uncertain. It is deficient not only as a system of regulation and coordination but also as one of incentives and reactions.

## 2.

The second stage of the discussion: the different solutions of the problem

Order and incentive--they are the two capital problems which must be solved if we want to have a working economic system, now as ever, and they must be solved continuously, noiselessly, and spontaneously. The problem has been solved once we have found a reliable system of regulating and instigating forces. But where is the solution?

If we examine this question thoroughly and if we take into account only the modern world with its highly developed division of labour and its interdependence of producers, we find that, in the last resort, there are only two solutions: coordination or subordination, liberty or command. Coordination (liberty): that means that kind of economic order which is provided by the market, competition and the free price and which, in contrast to vulgar misconceptions, is working, in spite of its many weaknesses, with an astonishing degree of exactness and determinateness which is the very opposite of arbitrariness. Subordination (command): that means that kind of economic order where the decisions which I mentioned are reached and enforced by the government. We call the first system the market economy while the second goes under such names as Planning, Command Economy, centrally directed economy, or Office Economy. This second system is, to all intents and purposes, also tantamount to what we call Collectivism or Socialism in the sense of that social technique which has been mentioned in the first lecture. It goes without saying that people may want

collectivism for very different reasons and combine it with quite different social philosophies.

If we use the term "collectivism" or "socialism" in this precise sense of a definite economic order we must admit that National-socialism as well as Bolshevism are collectivism or socialism; they are even specimens which we may call "beautiful" in the callous way in which doctors speak of a "beautiful .cancer. Moreover, we are entitled to say that, so far, National-socialism has been, besides Bolshevism, the only example of a really comprehensive collectivist system which has been working in peace-time for quite a long while.

If we want to find our way out of the present confusion, it is of the utmost importance to keep clearly in mind this alternative between two systems of order and incentive. We must assume the habit of thinking in terms of "economic orders" and use this as the criterion whenever people try to enlist our sympathy for all sorts of projects of reform.

We must spare no effort to understand the problem and its alternative solutions. To this end, let us take a simple example and remember that there are two ways of building a house. In fact--incredible as this may seem to many people in western countries today--a house may come into existence because of an entrepreneur finding it profitable to risk his capital in this venture, because of workers finding it profitable to work at certain wages, because of people finding it profitable to give up their savings for mortgages at a certain rate of interest, and finally because of still other people finding it profitable to rent rooms at certain rates of rent. On the other hand, a house may be built by order of the government, which "apportions" the necessary raw materials, which gives--in the shape of subsidies or cheap credits--money wrung from the community by taxes, loans, or inflation, which "directs" the necessary labour force, and which finally "distributes" the dwelling space according to some more or less reasonable system of priority. Or to take another example: shall our food be produced and marketed because the farmer finds it profitable, or because a policeman may come and arrest him if he falls short of the ordered amount of deliveries? Let us also visualize the whole atmosphere in which the two

systems are working and their different psychological climates. Then we realize that in the case of the market economy we are "customers" who are being "served," whereas, in the office economy we hear quite a different language. There we see a bureaucracy which "orders," "seizes," "licenses," "allocates," "releases," "distributes," "controls," "blocks," and, above all, "forbids," threatens and punishes. If you seriously disturb and finally destroy the order of the market economy, you must be prepared to go the whole length of the other way of the office economy, and you must be sure that it will work, i.e. that it will solve the double problem of order and incentive.

In this connection, there are some special points which need further elucidation:

(1) When the two types of economic order are confronted, there are many people who still seem to work with the idea that the market economy is the synonym of everything which is unplanned, disorderly, disconnected, anarchical, in short that it is the "jungle" of competition and of unbridled "natural forces," whereas the office economy seems to recommend itself among other things because it makes an end of this mess. Now, it is one of the surest tests of an economic education to know that the price mechanism, far from being "unplanned" and anarchical, really achieves a system of coordination of economic forces which is remarkable and whose description makes up the major part of traditional economics. In recognizing this working of the price mechanism, there should be no difference between socialists and non-socialists. But that is not all. In reality, there is almost no better way to state the difference between the two economic systems than by saying that the outstanding feature of the market economy is, as I remarked, its astonishing precision and the objectively compelling force of the direction which the market economy issues in the shape of prices, whereas it is the office economy which lacks this exactness and this objectively compelling force of its decisions. There is no arguing with a free price, a free stock-exchange quotation, or a free exchange rate. They are the true measure of the scarcities in question relative to the other economic data of the whole economic process at a particular moment. They speak out an objective truth, and as long as there is competition there is no scope for arbitrariness. They

are objective points of reference which can be taken as reliable guide-posts for rational decisions, and, as such, are welcome also to the leaders of an office economy whenever they can find such guide-posts. Contrariwise, the central authority of the office economy is quite at sea in all its decisions. What is the right value of timber at this moment or of any other commodity which corresponds to the whole constellation of economic data? What commodities should be imported and in what quantities? What commodities should be exported and in what quantities? The central authority simply does not know. It guesses or, worse, it reaches snap decisions which are quite arbitrary and which are coloured by some subjective idea of the planners. These decisions will be always biased, and one principal bias of the planner is: Caveat emptor--let the consumer beware! That is to say: the office economy will almost always show a bias toward reaching decisions which favour spectacular construction schemes and other investments while letting the consumer take the consequences in the form of "austerity" and hardships. The office economy tends to become a gigantic machinery for forced saving, but there is no objective criterion whether the particular kind of investment is fairly well chosen. We must remember this character of the office economy as a fumbling economy working with an appalling amount of arbitrariness when we discuss later the question of the economic efficiency of both types of economic order.

(2) A second point is of such importance that it is the real clue to much that will be explained later on in this lecture. It is already implicit in what I have said on the difference between the two types of economic order, but it has to be made as explicit as possible. What I mean is the essentially political character of the office economy. While the market economy separates the two spheres of economic action and political sovereignty (of dominium and imperium) it is the salient point of the office economy that it merges these two spheres. It means the thorough politicalization of economic life. The market economy gives to economic life a position not too dissimilar from that of organized religion in a state which is based on the principle of the separation of state and church. The office economy, however, gives to economic life the position of religion in a state based on the principle of what is called "Caesaro-Papism." It is

"Caesaro Economism." This is the real key to most of the perplexing problems of collectivism as we shall see.

(3) If I said that the alternative between the market economy and the office economy is a strict one, and that it exhausts the possibilities of a solution, I may be misunderstood. It may be objected that it is obviously possible (and certainly also desirable) to have a sort of mixed system where the two types are combined in various manners. That, of course, is a palpable truth, and it would be foolish to deny it. It is precisely the idea of some desirable mixed system which my friends and I have been developing long since under the name of the "Third Way." What I mean here, however, is something quite different; that there are two and only two principles of economic order which can be applied in every individual case. In other words: between the free price and the order of the office there is nothing but anarchy. If it is not the price which is coordinating and stimulating the economic process, it must be the order of the office if the problem of coordination and stimulation is to be solved. Either the one or the other, and both exclude each other. That is so important to grasp because otherwise there is no protection against all sorts of confused ideas. Common to all these ideas is the desire to find some principle of economic order which is neither the price nor the order of the office. But whenever we examine such proposals we shall find that their authors failed to understand the logic of the problem of economic order. All of them are motivated by the wish to avoid both the devil of prices and the deep blue sea of bureaucracy by inventing some sort of what I would like to call Ersatz-Socialism.(7) Its main varieties are:

(a) The so-called "market socialism" (O. Lange, Lerner, and others) i.e. the idea that the recognized advantages of the price mechanism could be used by the office economy. There are, however, only two possibilities. If prices are genuine and free the central authority really capitulates to the market. Or if they are not, they are unable to coordinate and to

---

(7) Counterfeit socialism is perhaps a preferable term (ed.).

regulate the economic process.

(b) Projects of the type of the Tennessee Valley Authority, often presented as the philosopher's stone in this search for something which is neither market economy nor office economy. As a matter of fact, the T.V.A. may be justly regarded as a bold and constructive piece of regional development or industrial decentralization or antimonopoly policy, but it is obvious that it is an integral part of the market economy of the United States where the American price mechanism determines what should be produced and how much of it.

(c) Cooperativism, i.e. the idea that, by developing consumers' and other cooperatives to the extreme, it should be possible to get some sort of "industrial democracy" superseding the market economy without being an office economy either. Cooperatives, to be sure, are a very valuable form of modern economic organization, but it is impossible to understand how the awkward alternative can be avoided. Either the different cooperatives will trade with each other as independent firms--then there will be some sort of a price system though based on the most baffling combination of monopolies with all its indeterminateness of price formation; or the cooperatives are merged into one gigantic concern--then we have necessarily a centrally directed economy which is compelled to achieve coordination and stimulation by orders instead of free prices and competition.

(d) Corporativism or Syndicalism, i.e. the idea that a new economic order being neither market economy nor office economy, can be organized by some sort of industrial self-government based on the cooperation of industrial groups or managed by trade-unions or a combination of trade-unions and employers. The most recent example of this is the drive in Germany for what is called co-determination by which the trade-unions not only want to make the workers responsible and cooperative partners of industry (which is highly desirable), but also aim at a new form of economic order which they call economic democracy. That is a highly confusing mixture of ideas. On the one hand, there is the urgent problem of how to put on a more human basis the relations between employers and workers inside the factory, a problem arising from the peculiar

nature of large-scale production. On the other hand, there is the altogether different problem of what should be the forces of coordination and stimulation for the national economy as a whole. In this respect, there are only two possibilities: (1) The trade-unions and work-councils really succeed in attaining such a position that they control the whole economic process, which means that a minority usurps the power of the state and executes, on their own account, a self-appointed office economy. (2) The trade-unions either do not succeed in attaining the power or refrain from using it, in which case we are thrown back upon the price system, though again of a kind which involves all the inconveniences of monopolistic group control. Thus we arrive at very much the same results as in the case of cooperativism.

### THIRD LECTURE

The third stage of the discussion: the choice between the two possible solutions

Having defined the problem of economic order and described the two principles among which we have to choose in order to solve it, we are now able to tackle the decisive question: which of the two possibilities shall we prefer, free coordination by markets, prices, and competition or compulsory subordination? While we could conduct our discussion so far on neutral ground it now becomes inevitable that the debate implies more and more points where opinions are bound to clash because the ultimate decision must be a political one. There is no denying the fact that, at this point of our discussion, the scientists will find it increasingly difficult to keep it above the level of political passions. Even here, however, we must spare no effort to narrow the field of mere controversy and to appeal to arguments which are based on scientific reasoning.

To this end, it appears convenient to organize the discussion in such a way that we examine the case for or against both principles of economic order from the point of view of altogether four main issues. These are: liberty, control of power, efficiency, and international integration. In all these respects, severe indictments have been pronounced against the collectivist principle of economic order, and it will be our task now to find out whether and how far they

are justified.

### 1. The issue of liberty

We begin with the issue of liberty. The indictment levelled against collectivism under this aspect and the arguments on which it is based will be familiar to everyone now, particularly after Professor Hayek's famous book on "The Road to Serfdom" of which this issue is the main theme. I think, therefore, that I can be rather brief on this point.(8)

The indictment may be stated like this: National-socialism and Communism are both characterized by a definite "social technique" (which I call that of the "office economy") which also "democratic" socialism claims to be the only genuinely "socialist" technique. Here as well as there we find the same "social technique," although it is being made the means for quite different political ends. We all agree that the experiences made so far with "totalitarian" collectivism are most frightful. Is there not a real danger, therefore, that "democratic" collectivism may also lead to rather the same result if not stopped in time? Is there any guarantee that the same "social technique" may in the end not bring about the same loss of freedom, no matter how respectable the intentions were at the beginning?

More and more economists and sociologists of our time are inclined to give a pessimistic answer to these questions. They say: the tyranny of totalitarian socialism is no mere accident. Totalitarianism and socialism are, in the last resort, only two aspects of the same system which subjects man in all his activities to the omnipotent state with its all embracing bureaucracy. The totalitarian state must be socialist because it needs a social technique which subjects to the government the whole economic life of the nation. Vice versa, a government which uses this

---

(8) See also: M. Friedman, Capitalism and Freedom, Chicago: The University of Chicago Press, 1962 (ed.).

technique, while trying to remain a free democracy, must become totalitarian sooner or later because this technique supposes, with relentless logic, a totalitarian state with its centralized power and omnipotent bureaucracy.

Are these economists and sociologists right? I am afraid they are. The social technique, which we call "socialist," means a comprehensive Planned Economy (office economy). The economy of what plan? Who is its author? Central planning involves a certain allocation of productive forces, determining what to produce and how much of each product. In the market economy, as we saw, this question is being settled by those whose business it is: the consumers. The process of the market economy is like an uninterrupted referendum on what use should be made (at every minute), of the productive resources of the community. In this continuous plebiscite, every piece of money is a voting bulletin. The socialist office economy means that this "democracy of the consumers" is abolished (curiously enough in the name of what many socialists call "economic democracy") and replaced by the allocation of productive forces planned and enforced by the government. The allocation is transferred from the market to the government office, and the population now has to accept that use of the productive resources which the government thinks best. "Does anyone--so I wrote ten years ago in my book on "The Social Crisis of Our Time"--seriously believe that not only the election of this planning team but also the millions of individual decisions which it has to make every day can be based on democratic principles and that the sphere of individual liberty can still be safeguarded?"

While, for the full development of my arguments, I may be permitted to refer to my book on "The Social Crisis of Our Time" (Chicago University Press) which I just mentioned, I want to add some important qualifications. When we maintain that it will be impossible to preserve, under collectivism, an essentially free society with the rule of law, civic rights and parliamentary control, we really mean that it is "extremely unlikely under normal circumstances." That is equivalent to saying that, under highly abnormal circumstances, it might be possible to have temporarily a good deal of collectivist planning without totalitarian tyranny. That is the case of war

collectivism, and with a temperament like the British it might be feasible to extend such a system far into peacetime without mortal danger to liberal democracy.

Here we come to the momentous problem of "democratic" socialism on which I want to make the following remarks: (1) It is, of course, an insult to lump together democratic socialists ("social-democrats" of continental Europe or "labour socialists" in England) with Nationalsocialists and Communists. We have no right to doubt the sincere humanitarian and democratic ideals of most democratic socialists and their excellent intentions. But intentions may be quite immaterial for the ultimate outcome. It is quite arguable that the difference between totalitarian and democratic socialism may be merely that between wilful murder (of liberty and civic rights) and homicide by negligence. It is inexcusable to associate democratic socialists with totalitarian murderers. But liberty may be killed just the same, and one must be afraid that, for the victims, there is no appreciable difference. (2) It is true that, in the case of Great Britain and even of Norway, democracy has remained essentially intact, in spite of serious inroads. To reconcile this with the theory of the "Road to Serfdom," we have, first, to remember that all it wants to do is to point to a danger which may be greater or smaller according to the degree in which the collectivist principle is put into practice. If it is being realized only gradually we are also threatened only by degrees.

(3) In this respect, it is important to note that, in Great Britain, democracy and liberty continue to live (though somewhat precariously) because socialist planning does not live. Anybody knowing England could always be sure that, if she really had to face the grim alternative between socialism and liberty, she would choose liberty. The capital issue is here the direction of labour which is indispensable for any effective central planning. Although the British government has been equipped with this power, the idea has been so unpopular that compulsory direction of labour has never been practised on any significant scale. What that means, however has been expressed by a competent British observer (Professor J. Jewkes, *The Twilight of Planning in Great Britain*, "Farmand," Oslo, 1951, No. 7) in the momentous statement that "Planning

in any real sense has been virtually abandoned." A recent official paper on the "Plan for Coal" illustrates this by the remark that "the estimates of future performance are not forecasts, still less targets." Whereupon Professor Jewkes asks quite properly: "If these Plans are not forecasts and not targets, what are they?" No one seems to know really. Here we get a glimpse of that "muddled economy" whose main feature, as we shall see, is everywhere at least one thing: constant inflationary pressure.

(4) Even for this hybrid economy we do well, however, to remember what A. de Tocqueville has said on such a system one hundred years ago. "The monarch extends over the surface of society a web of insignificant orderly, meticulous and complicated rules which prevent even the most imaginative minds and the most vigorous souls to reveal themselves and overshadow the masses. He does not crush people's will but he softens and bends it while ruling their lives. He rarely compels individuals to undertake something but he persistently opposes their action, he does not destroy, but he prevents projects from coming into existence, he does not tyrannize, he hampers, he obstructs, he irritates and stupefies. Eventually he reduces the nation to a flock of timid and industrious animals with the government as their shepherd. I have always believed that this kind of organized sweet and peaceful serfdom can, much easier than people imagine, be combined with some superficial appearances of freedom." (Alexis de Toqueville, Democracy in America).

## 2. The issue of the control of power

Closely connected with the issue of liberty is that of the control of power in society. One of the most weighty criticisms to be made of our entire economic and social system refers, indeed, to the disquieting concentration of economic and social power in the form of monopoly, privileges, giant corporations, pressure groups, monster associations, including the trade-unions, and other organisations. Almost everywhere, modern development favours an excessive accumulation of power of men over men, and since

it is in the very nature of power to be abused--"Power tends to corrupt, and absolute power corrupts absolutely" (Lord Acton)--the problem of how to control such excess of power is one of the most important in our society. To the socialist the idea which suggests itself to solve this problem is to abolish the system ("Capitalism") in the midst of which the concentration of power developed and which--very unjustly--is made responsible for it. That, however, is a tragic mistake because, in this way, we are bound to make things immeasurably worse. There is no getting away from the fact that collectivism involves the maximum centralization of the economic process in the hands of the government and the entire politicalization of economic life, together with the corresponding immense increase of the concentration of power.

If the problem of our time is "concentration," collectivism means that we want to cure it by hyper-concentration. At present, monopoly is bad enough. But present monopolies under "capitalism" are scattered, limited and largely offsetting each other, always subject to the constant pressure of potential competition, suspiciously watched by public opinion, and confined to the strictly economic sphere. Collectivism, however, would mean that we get one big and all-comprising monopoly of the state. This colossal monopoly of the collectivist state would not only be incomparably bigger than the most frightful private monopoly but it would also represent something entirely different, because it would be no longer confined to the economic sphere. This colossal monopoly would be at the same time the absolute master of our entire life. Collectivism promises to achieve a Super-Monopoly which would be the "perfect monopoly" of the theoretical models of economic science, but at the same time it would bless us with an all-embracing monopoly from which there is no escape.

We heartily agree with the socialists in seeing in the concentration of power and in monopoly one of the capital problems of our age. But socialism offers not only no solution to the problem but promises a state of things which would make it immensely worse. One cannot cure the evil of concentration by more concentration. The only cure is decentralisation of which the restoration of an essentially competitive market economy is one of the most important aspects.

That is also the reason why "socialization" (Socialism No. 2, as I called it in the first of these lectures) is no solution of the problem of big industrial property and its corresponding concentration of power. Here the same reasoning holds true: it is absurd to solve the problem of concentration by hyper-concentration. By concentrating industrial property in the hands of a new owner, the State--that is what "socialization" means--we only carry the process of concentration of property to its ultimate end. And what makes this even more absurd is the fact that this new owner is at the same time our political sovereign. He is identical with the government, the administration, the law-courts, the police, the army. Neither will be a solution of the human problem of the big factory and of industrial property be found on this road of "socialization." How to persuade the British coal miner that he "owns" the coal mines or the railway clerk that he "owns" the railways? How far does "socialization" mean any change for them? They will feel even more than before to be mere cogs in the wheels of big industry, and the more the government becomes the sole owner of the means of production the more the worker will be deprived even of the important possibility of choosing among several employers. By voting for socialism, he will have enslaved himself to an anonymous and all-powerful bureaucracy. On the other hand, we have to remember that, as far as the human problem of property is concerned, the biggest public park is a poor substitute for the smallest private garden.

### 3. The issue of economic efficiency

The third issue to which we turn is that of economic efficiency. It is a scientifically established fact that the market economy ("capitalism" in vulgar phraseology) has proved to be a highly efficient system of order and incentives, and no lesser man than Karl Marx has told us in dithyrambic terms in his "Communist Manifesto" how great this efficiency has been. Can the office economy provide a system of order and incentives which is at least of equal economic efficiency? There were always strong reasons why this question should be answered in the negative, and the evidence of recent experience seems to affirm this view.

Those reasons have been for the most part already explained in the second of these lectures when we compared the two types of economic order. There are two principal points. First: how should it be possible to solve, in every detail, the gigantic problem of directing the economic process of a modern industrial nation according to a pre-conceived plan? Second: how is the office economy to find working substitutes for the intellectual and moral incentives of the market economy?

As a matter of fact, collectivism will be largely deprived of precisely those incentives which, in the average, are the most powerful, i.e. those arising from the desire of man to improve his own economic position and that of his family. Given the dangerous but most efficient natural force of individualism, how is it possible to harness this torrent of self-interest and to conduct it over the turbines of production? The market economy shows how it can be done. By frankly appealing to private initiative, it makes individual success dependent on a corresponding productive performance, provided that markets are competitive. Contrariwise, it is the enormous drawback of the office economy that, instead of harnessing this force and using it, it has to fight against it and to replace the natural incentives of the market economy by fear, artificial emulation, hysteria, and propaganda. Whenever a government turns to the office economy it enters a struggle against human nature which, except in war-time with its feverish patriotism, will bog down the economic process in red-tape, police measures, and controls and compel the government to use all its power to enforce its orders. But there will always be the legal jurisdiction of the official plans and the reality of black markets and passive resistance.

What may be the ultimate consequences of collectivism has been shown, in the most impressive way, by the example of Germany where this policy has been pursued for more than ten years until the reform of the summer of 1948 restored, in large parts of the German economy, the market economy, with the astounding results which are generally known. Everybody should study, very carefully and with an open mind, this German experience in order to understand the process which slowly but inevitably dissolves and paralyzes the national economy wherever the German example of

planning, collectivism, and "repressed inflation" has been followed.

The story of German collectivism is that of the prolonged and obstinate attempt of the government to take care of the economic functions which prices, costs, and exchange rates can no longer perform once they are prevented by the government from following the laws of supply and demand. With relentless logic, the German experience has established the proof that, in the long run, this attempt is bound to fail, because the task is impossible. Sooner or later, all values become wrong because they no longer register relative scarcity as they must if there is to be order. Consequently, there is disorder, arbitrariness, and waste on an appalling scale. At the same time, the incentives to work, to save, to invest, and to show initiative are progressively destroyed. Too little is produced, and this little is largely not what should be reasonably produced or at least not in these quantities, and this little which is being produced in the wrong way is, to a large extent, also being used in the wrong way. In the end, there are chaos, paralysis and controlled misery insufficiently camouflaged by misleading production statistics. In Germany, this collectivist system has broken down completely amidst absurdities to which only the pen of a Swift could have done justice. Germany has thus become the principal country where no serious and honest observer can hold the view that bureaucracy is a better planner than the market. Here only the wilfully blind can deny that the government is not only a complete failure as a planner but also incapable of replacing the incentives of the market economy, unless it is prepared to follow the example of totalitarianism which shows that fear and hysteria, for some time and to some extent, might be used as substitutes for the incentives of the free man.

When describing this German experience I mentioned the word "repressed inflation." This is a hint to a most important aspect of collectivism of which I have said so far very little. In fact, the economic significance of collectivism cannot be grasped if we do not realize that it is invariably bound up with inflationary pressure. The connection is a twofold one. One is now quite familiar to a wider public. It is now generally understood how and why inflationary pressure, whatever its origin, leads in our time to

what we call "repressed inflation." In contrast to the "open inflation" after the first world war, almost every government now will do its utmost to curb the effects of inflation on prices, wages, or exchange rates by collectivist controls which prevent those values from reaching their natural level where supply and demand will be in equilibrium. Since I may refer to my own analysis of this phenomenon of repressed inflation (Kyklos, vol. 1, 1947, no. 1, and vol. 1, 1947, no. 3) I will be excused from stating explicitly and at greater length what would be only a repetition of what I have written in those studies. It will be sufficient here to say that what repressed inflation amounts to is a system of fictitious values compulsorily enforced. The longer it lasts the more fictitious such values tend to become, both in the sense that they correspond ever less truly to the real scarcities and in the other sense that, for this reason, ever less economic transactions are being made on the basis of such fictitious values. The distortion of all value relations, the increasing importance of illegal dealings at the cost of the shrinking "official sector" and the ever greater conflict between the impulses of the market and the administration struggling desperately to maintain its authority--all this may lead finally to that extreme disorder and paralysis of which post-war Germany will forever remain the classical example. Since, in this system of repressed inflation, prices will be kept down in the degree in which a commodity is deemed essential, its ultimate effect will be that a premium will be set on the non-production of the most needed goods whereas the production of non-essentials which can be bought freely will flourish. At the end of repressed inflation in Germany things had reached that absurd stage where the official price of one metric ton of wheat was approximately equal to what one had to pay for a lady's hat. Whenever you wanted to buy something beyond the allotted rations of essential goods you had to fall back on more or less artistic ash-trays, hair-oil or perfumes of dubious quality or other fancy goods--unless you went to the black markets. It paid to produce those goods but it was heroism to produce wheat or shoes. The economic system which developed under such circumstances could be called an "artistic ash-tray economy." In such an economy, there may be "full employment" warming the heart of Sir William Beveridge, but it will be one combined with an appalling degree of

general misery which is all the less bearable as it is increasing rather than diminishing.(9) In the end, money not only loses--as it does in the final stages of an open inflation--its function to serve as the normal medium of exchange and the measure of value but, on top of this, it ceases to give the necessary impulses to production, until people come to the conclusion (as they did in Germany in the years 1946 and 1947) that you had to make up your mind whether you wanted to work or to earn money. Open inflation is bad enough because it is the cause of crying injustices, waste and unbalanced production. Repressed inflation is, if anything, somewhat worse because it adds paralysis to unbalanced production and unjust distribution.

So much on the one sort of connection between inflation and collectivism. It is somewhat less generally understood that the connection also works the other way around. In the case of repressed inflation, it is inflation which leads to collectivist controls and planning. But it is no less true that it is collectivism which leads to inflation. It is of the greatest importance to realize that, just as collectivism nowadays follows inflation, inflation follows collectivism, for reasons which make inflation actually a regular counterpart of collectivism. In other words: collectivism serves just as well for an attempt to mitigate the open harms of inflation as inflation serves for an attempt to mitigate the open harms of collectivism.

---

(9) William Henry Beveridge (1879-1963) British political official and economist was most influential in the creation of Britain's post World-War II social security system. In a document entitled "Social Insurance and Allied Services" (1942) he recommended a compulsory insurance scheme "from the cradle to the grave" to be administered by the state. In a subsequent work named "Full Employment in a Free Society" (1944) he defined full employment as a situation in which the amount of vacant jobs would always exceed the number demanded. He advocated large-scale public spending to reach and maintain such full employment (ed.).

This second connection, while not yet familiar to wider circles, is so important that I propose to reserve some more remarks to this subject in the beginning of my fourth and last lecture.

#### FOURTH LECTURE

The third stage of the discussion: the choice between the two possible solutions (Again).

### 3. The issue of efficiency (continued): the problem of inflation

At the end of the preceding lecture, I stated that there is a two-way connection between collectivism and inflation: collectivism added to inflation in order to repress it (repressed inflation) on the one hand and inflation added to collectivism on the other. After having explained the first connection, I promised to say a few words on the latter.

Regarding this connection, we have to realize that it is still a rather obscure field of scientific inquiry which stands badly in need of being explored more fully. But so much is already clear both on the basis of experience and reasoning that collectivism seems to be necessarily accompanied by inflationary pressure. For this various reasons are given.

The first reason is that the Office Economy naturally comprises full and discretionary control of money and credit without having at its disposal alarm signals which are objective, promptly working and efficient. Groping more or less in the dark, it follows, for comprehensible reasons, the course of inflation as that of the least resistance which, if it is an error, always seems immensely preferable to what is vaguely dreaded as "deflation."

The second reason is that the Office Economy needs constant inflationary pressure which is to compensate for the paralyzing effects of central planning and encumbering controls. Here is to be found the solution of the mystery why the machinery of the national economy goes on at all under central planning. The truth is that the inefficiency of the collectivist system is largely concealed by the effects of inflation.

A third reason is that, under a collectivist system, the claims on the public budget will be such that the budget deficit tends to become a chronic ailment or that, if a balance is achieved for some time, it is largely based on an inflated national income which makes an otherwise unbearable tax burden just bearable. Following the interesting suggestions which have been made by Colin Clark, we may consider it almost an axiom that if the quota of the national income claimed by the state reaches 25% (as it does today in Great Britain and many other countries) the tax burden involved cannot be supported, in the long run, without the value of money giving way under such a strain.<sup>(10)</sup> In other words: such tax burdens generate inflationary pressure.

The most disquieting aspect of this inflationary pressure is that it tends to be constant, perpetuating thereby also the policy of repressing this inflation by collectivist controls. Since it is collectivism itself which is the main reason for this constant inflationary pressure the vicious circle is thus complete.

Here we have to remember a particular reason of this constant inflationary pressure under collectivism. It is the wellknown fact that all these more or less collectivist systems are committed to that definite policy which is called "full employment." In this as in all other aspects, they follow the example of National-socialist Germany where "full employment" had been the main agent in making the economic system ever more collectivist. It seems indispensable, at this juncture, to say a few words on this concept and the policies inspired by it. As those will know who ever came across my own writings of the early thirties (my book "Crises and Cycles," my contribution to the Cassel-Festschrift and my article in the "Economic Journal," September, 1933), I have been one of those

---

(10) Colin Clark, Public Finance and Changes in Value of Money, Economic Journal, December, 1945, and his recent article "Is Britain Heading for a Big Inflation?," The Manchester Guardian, September 18, 1951. Roepke's "quota" is more commonly referred to as "government spending as a percentage of the national income" (ed.).

who at the very depth of the Great Depression, advocated a bold policy of credit expansion in order to overcome what I then proposed to call the "secondary depression" with its mass unemployment and its downward spiral of prices, wages, and production. But to work with the concept of "full employment" now and as something of permanent value seems to me a gross and extremely dangerous misunderstanding, and it is most unfortunate that, some time ago, the Secretariat of the United Nations lent its authority (whatever this is) to the report of so-called experts on "Full Employment" which is so full of fantastic ideas and recommendations as to sound at times almost like a parody. The simple starting point of "full employment" policies today is the idea that practically every kind of unemployment is caused by what is called a lack of "effective demand" so that all we have to do is to fill this gap all the time by additional money and credit, either for investments or for consumption or for both. This is not the moment to analyze this post-Keynesian doctrine in all its aspects and to expose its fallacies. The main point is: It is simply not true that every unemployment is caused by a general disturbance of the monetary circulation (deflation) and therefore capable of being cured by filling the gap. This occurs much more rarely than we think after the experience of the Great Depression. There will always be some amount of unemployment due to causes which have nothing to do with money: people doing the wrong things, or working with the wrong methods or at the wrong places, or people being unemployed as a consequence of wage policies by which organized labour "prices itself out of the market" or as the effect of international disturbances and what not. It is quite true that, in the short run, practically every unemployment, however caused, can be removed by increasing "effective demand," but--except in periods of prolonged depression with a general high degree of "unused capacities"--to do this means simply inflation. To recommend this "full employment at whatever cost" is exactly what the Keynesian doctrine has degenerated to nowadays. And the policy to which so many countries are now committed corresponds to this simple theory. But a policy which sees in any amount of unemployment a sufficient reason for increasing "effective demand" is necessarily tantamount to a policy of constant inflationary pressure. And since now most governments have learnt from Hitler how to repress inflation by collectivist

controls, "full employment" is responsible for most of the collectivist policies today--with the consequences for international trade which I still have to consider.

The present policy of "full employment" as one of constant inflationary pressure cannot be quite understood without reference to the pressure of the trade-unions for ever higher wages which are not justified by a corresponding increase of productivity. That was also the way in which the late Professor Schumpeter saw the problem as he explained it in his paper "The March into Socialism" (American Economic Review, May, 1950) which he wrote towards the end of his days and which I recommend very highly in this connection. The disquieting fact is, indeed, that the trade-union pressure for excessive wages tends to create unemployment even in times of prosperity, but since the governments in question are committed to "full employment" there is a parallel continuous tendency to remove this unemployment by monetary measures. The entire economic policy of such countries threatens more and more to develop into a continuous competition between a wage policy which seeks to push up wages above the equilibrium of the labour market (and which, because of "full employment" conditions, is bound to be successful) and a credit policy which, to counteract the effects of this wage policy, seeks to increase employment. Once more, then, we face the prospect of constant inflationary pressure which gives rise to corresponding collectivist repression.

This danger appears so great that it seems highly appropriate to mobilize all available counter-forces and to remember that it is time-honoured wisdom to put all possible brakes on the money-issuing power of governments. It is high time to correct a wrong perspective in this matter. Indeed, the memory of the disastrous deflation of the early thirties still makes many people incapable of seeing things in their right proportions. The shock of that distant experience has been so great that they still fail to realize that, throughout history, the danger of inflation has always been infinitely greater than that of deflation. Inflation is an ever present temptation and, under all circumstances, the line of least resistance. There is no organized lobby to oppose it. Its beginnings produce agreeable effects while it takes a long time until everybody recognizes it as a social catastrophe,

whereas deflation is a bitter experience from the very beginning. A government resourceful and unscrupulous enough to make, by appropriate theories, inflation fairly acceptable and to dispel possible fears will rarely be unpopular. As far as I know, all statesmen responsible for a major inflation have peacefully died in their beds whereas, in our times, there is at least one (Rassin in Czechoslovakia after the first World War) who has been murdered because he was held responsible for a policy of deflation. Even when finally the evil consequences of inflation--the drug which is so stimulating in the beginning--become apparent the government will always be able to postpone the day of reckoning by finding pretexts and scapegoats like "profiteers," "speculators" or people unpatriotic enough to withdraw their capital from such a country, and it will be quick to learn from totalitarian governments the trick of "repressed inflation."

The secular trend is indeed towards inflation and not towards deflation. During the last centuries, there never was a safer bet than this that, a generation hence, a gold piece would preserve its purchasing power while a note would have lost a considerable part of it. ~~Never has a government enjoyed unlimited power over money without misusing it for the purpose of inflation.~~ To deprive governments of this power and to make money independent of their arbitrary decisions or lack of insight has been one of the main functions of the gold standard, its other function being to make possible--by the same "depolitization" of money--a truly international monetary system. Never was this "depolitization" of money more essential than in our age of mass democracy which, with all its sociological forces and ideologies, may be called a vast machinery for producing inflation.

After the universal downfall of the gold standard, there has been left in many countries a last strong counterweight against the unlimited power of governments over money. It was the--more or less relative--independence of central banks. Even this last obstacle against the unlimited power of governments over money, however, seems to be doomed in our time because it is regarded as an intolerable infringement of democracy. Independent central banks appear to our modern Jacobins as so many Bastilles which must be razed to the ground.

That leads us to the most important point I have to make in this context. If inflation is always a lurking danger it is so especially in our time of collectivist and inflationist ideologies and policies. For more than twenty years now, we have been discussing everywhere the general issues of the free economy and of collectivism, and this discussion will go on as fiercely as ever. There is one point, however, which now may be regarded as being fairly settled by experience. It is now obvious--and that was also the opinion of Professor Schumpeter--that the final results of all these policies of "full employment," of "planning," of "cheap money," of the "welfare state," of "functional finance," of the "maximum pressure of taxation" and so on has been a steadily progressing inflation which has been interrupted only by occasional recessions, partial adjustments--and unjustified warnings against deflation.

We had better face, indeed, the hard fact that the whole world is saddled with a chronic problem of inflation. After the outbreak of the Korean crisis, it has only taken on an acute and particularly dangerous form, seemingly rebellious to milder treatments, now that on the previous and chronic "democratic and social" inflation there has been grafted a dose of oldfashioned "military" inflation. It was the combination of both which made the hitherto concealed danger open to all eyes.

To see this is a very important point in the general debate for and against the free economy (market economy). For we recognize now that to fight for a free market economy not only means to fight for the freedom of markets, but also against chronic inflation and the erosion of the purchasing-power of money which it involves. Until quite recently, I fear, the strong but subtle reasons were hardly understood which explain why the collectivist destruction of the market economy in our time is necessarily connected with a process of constant inflationary pressure. Today, the fact itself at least should be obvious to every one. The advocates of the market economy cannot be fully understood if it is overlooked that their determined resistance to collectivism comprises an equally determined resistance to inflationism. The one resistance is as determined as the other because the one danger is as great as the other. That, however, is so because the source of the danger is the same here as well as there.

Inflation is as old as the power of governments over money, and as old as inflation are also the patched-up theories whose aim it is to conceal or to justify it. But there is something new in our age. Formerly, inflation was at least something which was done with a bad conscience, and the theories with which it was draped were, after all, like hypocrisy, the proverbial tribute which vice pays to virtue. All that has been changed now. The governments and social groups which now cooperate to bring about the "perpetual inflationary pressure" (of which Professor Schumpeter spoke) are able to work with theories of academic respectability which not only give them back their good conscience but seem to turn sin into positive virtue. As a last line of resistance and as a sort of reassurance against the final consequences of monetary and fiscal recklessness governments bent upon inflation can always fall back on the device of "repressed inflation" with its collectivist controls. As long as possible, inflation will be denied as an optical illusion and the very term will be named inappropriate. But when this line can no longer be taken because the inflationary pressure has become too obvious there is always time to apply the panacea of repressed inflation. In other words: in the field of theory, inflation will be argued away and in practice forbidden.

#### 4. The issue of international integration

After having considered the problem of the two types of economic order under the various aspects of liberty, dispersal of social power, and efficiency (including that of monetary order), we arrive finally at the issue of international integration which, curiously enough, is both the least explored and yet as important as any. If the collectivist order is not compatible with liberty, if it leads to an intolerable concentration of power, and if it sadly lacks in efficiency--is it an agent of international integration

or disintegration.(11)

Here again, we are able to begin with stating something which is hardly controversial any longer. It is both obvious and proved by experience that even a mild and incomplete collectivist system, provided that it is organized on a national scale and within the borders of a single national state, must inevitably lead to international economic disintegration in the strictly technical sense of dissolution of the international economic order by inconvertibility of currencies and bilateralism. National collectivism makes it indispensable to supplement the internal system of planning by all those well-known measures of external control which culminate in exchange control. Exchange control is not a sufficient but a necessary condition of collectivism; it is its real key-stone without which the whole structure is bound to collapse. There is no measure, however, which interferes more radically with international economic integration than exchange control. It is the real Pandora's box from which come all the calamities of international economic disorder of today.

No doubt, then, that national collectivism (in all its grades and varieties) has proved to be real dynamite for international trade, and nowhere is its effect more devastating than in Europe. As far as I see, few socialists still deny that collectivism as carried through on the national scale has led us into an impasse. Where is the way out?

There are only two possibilities. Either we overcome national collectivism by organizing collectivism on an international scale--or we restore the market economy.

---

(11) For a fuller explanation of my views, I refer to my articles: "The Economic Integration of Europe," Measures (Chicago), 1950, no. 4, and "European Economic Integration," Time & Tide (London), 2 and 9 June, 1951.

A well-known publication in this field is: L. Robbins, Economic Planning and International Order, London: MacMillan, 1937 (ed.).

Now the important point is that international collectivism is neither practicable nor desirable. To understand this we must first remember that to replace the market economy and the price mechanism by planning means to make the economic process government-controlled like the army. It involves the thorough "politicalization" of economic life which now becomes entirely dependent on the administration which gives its orders and enforces them by its penal sanctions. International collectivism (planning), therefore, supposes an international State equipped with all the prerogatives and sovereign powers of the national States which it supersedes. To merge national systems of planning is to merge the Governments on which they were depending into an international super-State.

European economic integration--to take the most important example--by ~~the collectivist method of planning, therefore, requires~~ a real European Government which does with the Europeans, whatever their nationality, exactly what the national planning administrations have been doing so far with their respective subjects. To visualize such a political union would be difficult at any time. What makes the prospect cloud-cuckooland in our case, however, is the very fact that this super-State would be equipped with the same degree of power and the centralization which a planned economic system requires. It is, to say the least, most unlikely that, short of impending or actual war, such a State will ever come into existence as a voluntary act of free nations.

That this reasoning is correct is implicitly admitted by all Socialists who champion a European Federation as the only feasible form of European Government. ~~At the same time, they cannot be unaware of the fact (which is obvious, at least, to most subjects of the Swiss Federation) that collectivist planning and federalism are incompatible with each other.~~ We conclude then: the very fact which would make a European super-State strictly necessary--a policy of international planning--makes it nothing short of chimerical. That is what the Marshall Plan administration found out by experiment and it would be easy to show that the never ending difficulties of Benelux tell very much the same story.

But even if the task were less impracticable we

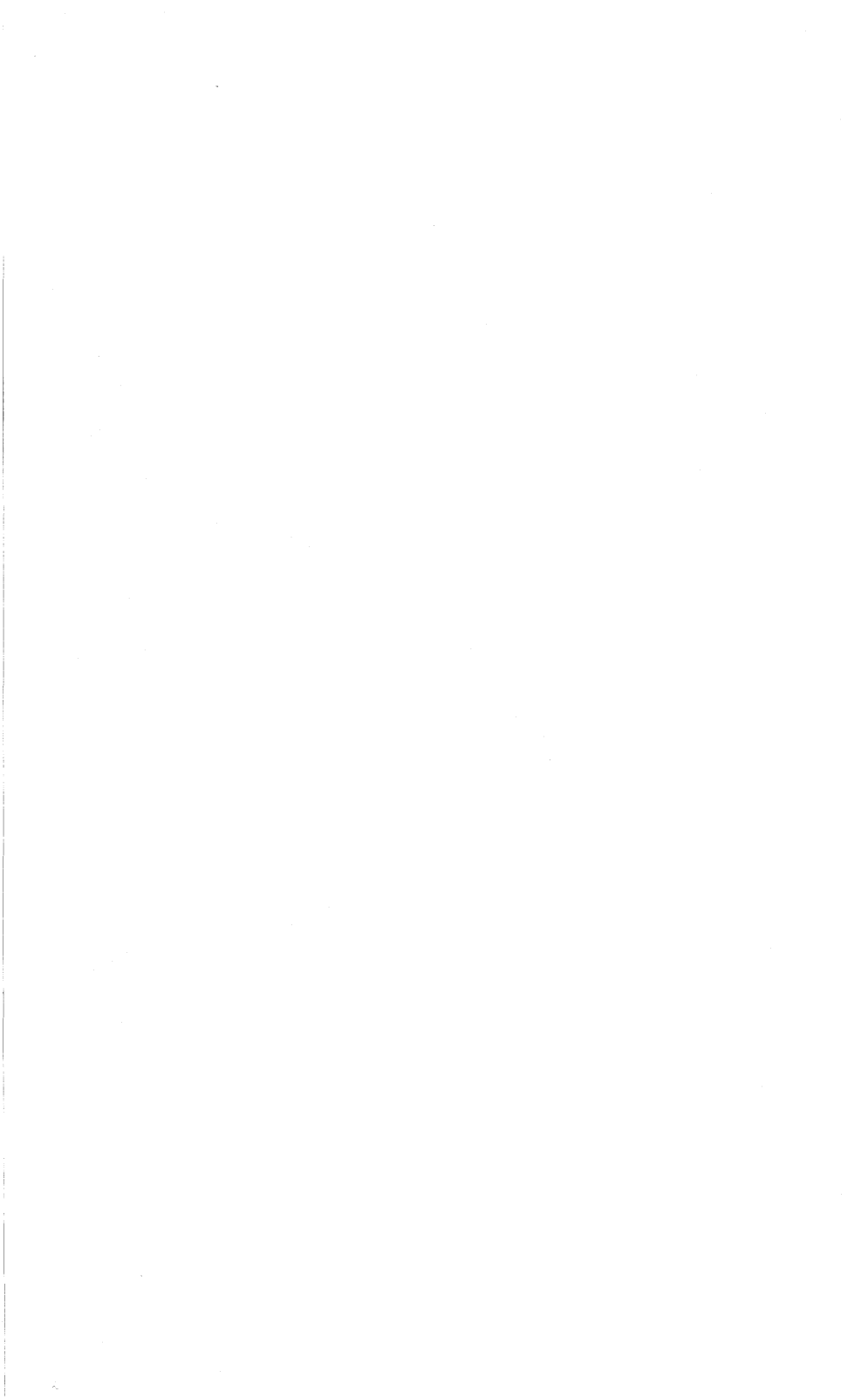
should realize that the collectivist method of bringing about the economic integration of (let us say) Europe would not be desirable. Besides the general inconveniences of collectivism, we must realize that collectivist integration of Europe would be entirely different from liberal integration, because it would be bought at the cost of less integration with the rest of the world. It is only logical to expect that all the consequences of national collectivism--isolation, dislocation of trade channels, autarkic tendencies, disequilibrium, disorder of international payments--would re-appear then in the relations between Europe and the rest of the world. If there is general agreement that national planning causes the gravest disturbances of international trade and international payments, Continental planning would mean that those disturbances would only be repeated on a higher geographical level. And every step in this direction would be tantamount to adding one further stone to the construction of a European "Grossraum" (superexpanse) in the sinister sense of the term.

There is, then, no getting away from the fact that the impasse brought about by national collectivism with its waste, autarky, and international disintegration cannot be overcome by making collectivism international. There only remains, therefore, the other course which means to dismantle the national systems of planning, autarky and inflationary pressure and to restore, in their essentials, the market economy and the working of the price mechanism, nationally as well as internationally.

The fourth stage of the discussion: The "Third Way."

We are now at the end of our discussion of the rival systems of economic order under the aspect of the four capital issues of liberty, dispersal of power, efficiency and international integration. Although the final decision as to what system we should prefer will be a political one, our analysis has at least the merit of enabling us to make this choice as rational as possible and to see clearly what is involved. But, for this final judgment, a vital element would be lacking without a full discussion of the imperfections of the market economy itself and the possibilities to correct them within the framework of this system.

This question of the reform of the market economy is the subject of a vast and wide-ranged discussion which has developed during the last twenty years between economists and sociologists of various countries, and this discussion still goes on. The aim of these endeavours is to elaborate a well-balanced and undogmatic but humane programme of economic and social reform which reconciles the immense advantages of the free market economy with the claims of social justice, stability, dispersal of power, fairness and the conditions of life and work which are proper to Man. In the course of this discussion, the old controversy between Socialism and "Capitalism" has lost most of its meaning. The real issue now is whether it may be possible to preserve (or to restore) a society of Free Men by developing, in the West, a workable type of market economy which is acceptable and politically possible because it gives a fairly satisfactory answer to the challenging problem of the fate of man in our proletarianized, urbanized, industrialized and highly centralized society. It is this vast programme which my friends and I have in mind when we speak of the "Third Way." It is a difficult task which summons all the intelligence, human understanding, goodwill and energy which is available in the present world. If we fail in this, I see no escape from collectivism and tyranny. For this is the real alternative to serfdom. How crushing the weight of responsibility, how momentous this hour in the world's history, but also how inspiring the very difficulty and importance of the task and how indispensable it is to view it from far beyond the level of party strife and group interest and under a wider angle than that of narrow ideologies--all that I have never felt more intensely than at this place and hour when I had the unforgettable privilege to speak of one of the most crucial issues of our civilization on the very spot where it began six thousand years ago.



Welfare, Freedom and Inflation



## I

## FACING THE FUTURE

Let the reader throw his mind back to his childhood, and recall one of those mythical heroes who has set his mind on carrying out, against death and the devil, the most difficult and seemingly impossible of tasks. I do not think that any such protagonist could have been faced with a more appropriate task than that which I have voluntarily assumed in agreeing to write this essay. I have only done so after deep and soul-searching thought. Far from giving way to what some will doubtless think a frivolity ill-suited to my age, I have, rather, yielded to an overpowering feeling that it is something that must be done, however unrewarding it may be. My purpose is to present an opinion, carefully substantiated and, I hope, unequivocal, on a matter which uniquely affects the interests, and arouses the passions, of everyone living in the free world and which has, at the same time, become so much the preserve of specialists that it very nearly eludes all attempts of those who do not enjoy specialist knowledge to grasp it. There can be few, if any, amongst my readers whose interests, passions and, in some cases, specialist knowledge are not engaged in this problem--which may best be described as how to make provision against the vicissitudes of life in a society like ours which we still call--or still like to call--free. I fear I am involving myself in a situation very much like that of a Daniel in a lion's den of the committed, and I have enough experience to know what the devoted are capable of when they come face-to-face with a firm opinion solidly opposed to their own--one which they find both unanswerable and irremovable.

Be that as it may, I am quite certain that the analysis on which I am embarking will be of real use, not only to myself, but to my readers as well. My purpose is to help, with the impartiality of a noncommitted person to direct attention to the matters of principle involved, to bring down, as I sincerely

hope, the temperature of the discussion to a reasonable level and to impart at least some clarity and precision to arguments, which, whatever else one may say about them, are not likely to be settled in the immediate future.

To forearm ourselves in advance against the chances and changes of life--both those which are calculable, and therefore insurable, and those which are likely to come without warning out of the blue--to provide ourselves with a cushion against adversity, in short, to make provision for our future, is a challenge to which every one of us has to respond. The impulse to meet this challenge is deeply rooted in every human being who has reached the stage of moral maturity, and all efforts to eradicate it will destroy something which is an integral part of the human character. It is, in any case, a reassuring fact that such eradication requires considerable effort, and that, however successful it may appear to have been, it always leaves odd ends of roots around which are sure to sprout again before very long.

Nowadays, all provision against the risks inherent in living operates within a closely knit society which is characterised by a highly developed division of labour and, therefore, by a degree of interdependence and general entanglement of interests such as no other period in history has known. The result is, as in all other fields of social development, an institutionalization and collective organization through which provision against possible misfortune in the future is shifted further and further away from the individual and closer and closer to the public sphere of action. The ripe--some would say overripe, if not already rotten--fruit of this process is what is known as the Welfare State.

#### AN IMMEDIATE DANGER

I do not think it would be wrong to say that this term, the Welfare State, arouses rather mixed feelings in most of those who hear it. To put it as mildly as possible, people have been getting more and more worried over the problem for the last ten years or so. It is a highly involved problem which concerns every one of us, and a fair and informed judgment can be neither enthusiastically approving nor sourly

disapproving. Everybody knows that there are large sections of the population which cannot be left helplessly exposed to events that may plunge them into wholly undeserved distress, and that this is not simply a matter of political calculation, but a human reality with a moral justification. Where individuals or groups are unable to shoulder the burden of providing for themselves, society must provide for them. Nevertheless, accepting that as true, the experience gathered in a number of countries since the war has made it clear that the modern conception of what is called the Welfare State carries with it a not altogether unwarranted suggestion of possible misuse and dangerous excess. The more scientific enquirer quickly senses the serious threat to the stability of the economy, the state and society as a whole, and also to the freedom, responsibility and spontaneity of human relations. The desire for security, which is perfectly natural and legitimate in itself, can easily become an obsession. Those who give in to it, consciously or unconsciously, will find that, in the long run, it means giving up freedom and human dignity, and they will have lost their security as well, for its inevitable result is a constant erosion of the value of money. Security is one of those things which recede farther and farther into the distance the more desperately and passionately they are pursued.

This is no mere fantasy born of an ingrained pessimism; it is a real and immediate danger. We cannot hope to counter it unless we put a stop to our present drift and turn to face it, armed with a clear and discerning judgment.

What then is involved?

#### A PIED PIPER SLOGAN

Let us begin with the seductive slogan which has caused considerable harm all over the world by the confusion of mind it has brought about. I mean the slogan of "freedom from want," coined by an unparalleled master of attractive formulae, the late President of the United States, Franklin D. Roosevelt, and launched as part of a request list of freedoms with which everybody is now familiar.

A little thought will show very clearly that this

is primarily a demagogic misuse of the word "freedom"; for "freedom from want" means nothing more than the absence of something which is undesirable, not unlike "freedom from pain" or any other unpleasantness we may conjure up. This purely negative concept cannot be accepted on an equal footing with positive freedom, which is one of our highest moral concepts without which genuinely moral conduct, guided by the sense of duty, would be impossible. An inmate of a prison enjoys "freedom from want" in its purest form, but he would feel mocked if we were to praise this as a real freedom and tell him that others should envy him. Should we not, then, be wary of following the Pied Piper tune of "freedom from want" to the point where we find ourselves deprived of all genuine freedom and placed in a situation all too little distinguishable from that of real prisoners?

If we look at this slogan more closely, we discover something strange: what is, in point of fact, meant by "freedom from want" is actually indissolubly bound up with compulsion. We are brought to this conclusion through the following line of thought.

To be in a state of want means to be, for one reason or another, in a situation in which we lack the necessary means of subsistence and are unable to provide them by our own efforts, either because we are ill, or unemployed, or bankrupt, or temporarily unable to work, or too young, or too old. We can be freed from this want only if means are put at our disposal which come from somebody else's contribution to the existing volume of production. In other words, in order to remedy our distress we have to consume goods at a time when we are not in a position to contribute to their production.

The most simple and least problematic example of such provision for subsistence in bad times is when we are able, though not at the moment in a position to produce anything, to consume goods which we have ourselves accumulated during an earlier phase of productive effort. But, apart from the obviously very important case of house ownership, which ensures us a roof over our heads in times of distress, the accumulation of goods against possible want at a later date is, neither for the individual nor the national economy, the normal thing to do. That is not a

practical way of taking precautions in a highly complicated society like ours. Saving money against a rainy day and then using it up when the rainy day arrives, does not mean that we are actually consuming butter and bacon which were produced at an earlier date, and stored up somewhere so that they could be drawn upon in the case of need. On the contrary, if such stores did exist they would be a symptom of a serious disturbance in the routine of economic circulation. Using up our savings means, normally, that we get our supplies from current production on the strength of a title which we have acquired by an earlier productive effort, in witness whereof society has equipped us with money. In other words, and in a nutshell: in times of distress we live by consuming what somebody else is producing for us, while restricting his own consumption. This is--subject to certain qualifications and refinements to be discussed later on--how real provision is made for the nation as a whole. In the aggregate, it is the contemporaries who produce both for themselves and for those who are in distress, i.e., those who are for the moment consumers only, and are not contributing to the process of production.

That, then, in rough outline, is the pattern by which, in modern society, future risks are anticipated and provided against.

The title on the strength of which those in distress are permitted to draw goods from the current flow of production introduces another question. Provision against future risks can be made in two completely different ways, and it is here that we find ourselves at the road junction where one of the two arms of the signpost points in the direction of the Welfare State.

#### THE ALTERNATIVE TO COMPULSION

Provision against the changes and chances of life may be provided either by one's own resources or come from outside; that is to say, I can either take my own precautions against a rainy day by using my own money on my own responsibility, or I can shift this burden on to the shoulders of others. Provision from outside can be voluntary, if, for instance, I borrow money or appeal to the charity or the clan spirit of my kinsmen

or of some other group which will, in turn, count on me when another of its members finds himself in need of help. Everything else is compulsion, and since compulsion is simply the last resort in the absence of a voluntary response, the conclusion is that compulsory provision for others is felt as a burden imposed by the power of the State, and it is, therefore, very proper to speak about "social burdens," as the phrase runs, in this connection.

Now it is obvious that the slogan which was launched by President Roosevelt, and which found a ready echo all over the world, the slogan of "freedom from want", was not meant to be an appeal to us to show more foresight in providing for our own life. What it demands is rather a maximum of provision from outside, based on the coercive powers of the State. If this is so, then "freedom from want" obviously means that certain individuals are permitted to consume without producing, while others produce, but are compelled by the State to refrain from consuming part of what they have produced. This is the sober, basic fact which must be put into the foreground of our considerations. Three corollaries follow from it.

#### ROBBING PETER TO PAY PETER

First, it becomes obvious that the very widespread idea that there is something like a monetary fourth dimension from which the claims for support at times of genuine or imagined distress can be satisfied is highly illusory. Peter can only be given what is taken from Paul, and if we demand that "the State" should help us, we are asking it to supply us with somebody else's money, the fruit of his own efforts or his savings. Looking at it in this way, it becomes quite obvious that such help cannot really be taken for granted, as the generosity of the State usually is, for the State is actually nothing more than an intermediary link between those who are to give and those who take. The State cannot hand out more than what it has taken from others, be it by taxation or by the imposition of other duties or by the insidious and appallingly unfair method of inflation, which is simply a camouflaged

taxation of those who have to restrict their spending because their incomes do not rise as fast as the value of money falls.

It is, thus, only fair that any demand for help, from whatever side it may come--and there are hardly any groups now which would be ashamed to clamour for it--should be regarded as a strict exception and subjected to a careful test and a close scrutiny. One cannot constantly increase the number of those who are to be supported, and thus the total of funds required for that purpose, without reaching, sooner or later, a point where the resources of those who have to foot the bill without getting any return will become too slim to pay for all of it. Thereafter, the whole system gradually comes to be run in such a way that the masses who take from the State in one form or another are at the same time requested to give to the State in one form or another. A policy of robbing Peter to pay Paul is in itself far from commendable, but when it degenerates to the point where it involves taking from almost everybody so as to give to almost everybody, and when as a result, it becomes increasingly difficult for the individual to find out whether this strange game of give and take leaves him with a net surplus or a net deficit, it amounts merely to a senseless pumping of money backwards and forwards within society.

Now this point has, in fact, been reached some considerable time ago in those countries, like Britain and the Scandinavian States, which may be referred to as the models of the modern Welfare State. Well-informed economists, of whom I will only mention Mr. Colin Clark (Welfare and Taxation, 1954), have become more and more outspoken about the Welfare State illusion which is thus revealed. To those observers, it has become increasingly obvious that provision for the masses, enforced by the coercive powers of the State, has long ceased to be paid out of the ruthlessly squeezed higher incomes of the wealthy but has to be paid, in the main, by the masses themselves. This again means simply that their money is juggled from their right-hand into their left-hand pockets. Apart from becoming increasingly nonsensical, this practice is also becoming increasingly dangerous, because, quite apart from its dampening effect on individual effort and responsibility, it involves the expenditure of large sums by a vast public machine constantly growing

in size and power; its price is a dull, grey society, in which public spirit, voluntary service to the community, creative leisure, brotherliness, generosity and the true sense of belonging to a human family are all smothered by resentment in the higher and envy in the lower income groups. What is left is the pumping system of Leviathan, the modern, insatiable State. The Welfare State can thus advance to the point--and has done so in more than one country--where its pumping system is an illusion for all, a purpose in itself, which suggests the heretical question whether everybody would not be rather better off if the Welfare State were to be reduced to its indispensable minimum of outside provision, and where the money which could be saved in this way were to be left to the individuals to make provision for themselves in their own way, or to join voluntary arrangements by groups.

#### PROGRESS UP OR PROGRESS DOWN?

This leads us to the second point in our examination into possible forms of provision against future misfortune. If it is accepted that the modern Welfare State is nothing but an ever-expanding system of publicly organised compulsory provision, then it follows that it enters into competition with other forms of provision available in a free society: personal provision, by saving and insurance, or voluntary collective provision by families and groups. The more compulsory provision encroaches upon the other forms, the less room will be left for individual and family provision, as it absorbs resources which might be devoted to this purpose and at the same time threatens to paralyse the will towards individual provision and for voluntary mutual assistance. Worse still, it is impossible to stop or turn back on this road once one has advanced beyond a certain point, because the weakening of self-reliance and mutual assistance automatically gives rise to increasing pressure for further public provision for the masses, which, in its turn, still further paralyses individual provision and voluntary mutual assistance.

This should be a sobering thought; no effort should be spared to avoid reaching this point of no return. Where it has already been reached, no expedient should be left untried to reduce the inflated Welfare State to manageable proportions and to widen

the field for individual provision and voluntary mutual assistance. No further argument is needed to explain why this must be one of the first and foremost tasks of our time, if we are to enjoy the benefits of a sound and well-balanced society, for here we stand at a crossroads where one way leads to a free and the other to a pre-collectivist way of life. The increase in the prosperity of the masses and in the incomes of wage and salary earners is a highly welcome helping hand in such a transition, in contrast to the early phases of industrialization when large sectors of the population were suddenly reduced to the status of proletarians through the decay of the old paternalistic system of society and when there was, therefore, a tremendous need for assistance and welfare relief too vast to be dealt with adequately except through the State.

If we look at what has happened from this point of view, we find that it is quite wrong to regard the modern Welfare State with its mechanical and compulsory mass relief as a sign of progress, or as a response to a genuine need of our time. The precise opposite turns out to be true, if we cast our minds back over a sufficiently long period and avoid the mistake of concentrating on the distress wrought by the war and its consequences. What is today hailed as progress can really only be justified by the special conditions of a phase of economic and social transition which existed for a short time but which we are about to leave behind us. It is all too often forgotten that anyone who is serious about human dignity should measure progress less by what the State does for the masses than by the degree to which the masses can themselves solve the problem of their rainy days out of their own resources and on their own responsibility. This, and only this, is worthy of free and grown-up persons, certainly not constant reliance on the State for an assistance which, as we have seen, can, in the last analysis, come only out of the pockets of the taxpayers themselves or from an enforced reduction of the standard of living of those whom inflation really hits. Alternatively, is it really progress if we classify more and more people as economic wards to be looked after by that colossal guardian, "The State"? Would it not be much more progressive if more and more members of the broad masses were permitted to reach the status of economic "grown-ups", thanks to rising incomes resulting from their own labour?

It is a separate question as to how far compulsory Welfare State provision should actually go. But it would be a considerable progress in the right direction if we were all to decide that the Welfare State should no longer be glorified as an ideal but regarded, at best, as a necessary evil, an emergency arrangement which was indispensable as long as the great masses were too poor, and too depressed by their proletarian status, to help themselves, and too sharply cut off from the old social organism to rely on the solidarity of real small communities. This emergency arrangement can be dispensed with to the degree to which we are able to overcome the infamous results of the proleterianisation and uprooting of the masses, which stemmed from the industrial revolution. Mass relief organised by the State is the crutch of a society which is crippled by the proletarian status of many of its members and our prime purpose should be to help the patient to get well enough to discard his crutches. This would be real progress, and the yardstick of our accomplishment will be how far we succeed in widening the field of individual provision and mutual assistance while narrowing down the field of compulsory public relief. To that same degree we will overcome the proletarian form of existence and the mass character of society, and not the least of our achievements will be our triumph over the very real danger that man may be reduced to the status of an obedient domesticated animal in the State's big stables, crammed together with other similar animals, all of them more or less well-fed by the patron.

#### CERTAIN STATE MEASURES ESSENTIAL WITHIN LIMITS

This, then, will give us a clear indication which way to go, and the way is clearly towards less, not more, Welfare State, and more, not less, individual self-reliance and voluntary mutual assistance. But, and this leads me to the last of my three points: it is, of course, perfectly clear that the problem of provision against the vicissitudes of life cannot be solved in our time without a minimum of compulsory provision by the State. Old-age pensions, sickness insurance, unemployment relief, all those institutions which are as familiar to us as railway stations and post offices must of course keep their place in a sound system of provision in a free society, although one

cannot say they are exactly heartwarming. It is not their necessity which seems doubtful, only their degree, their organization and the spirit in which they are run.

The degree, the organisation and the spirit of this minimum of compulsory public provision will in the first instance have to be determined by reference to their purpose. This is the point where the philosophers disagree: personalism(1) versus collectivism, freedom versus concentration of power, spontaneity versus super-organization, humanism versus welfare technique, the desire of modern "mass-produced" men to shirk their own responsibility, to evade decisions, and to find escape in State-guaranteed security versus the ideal of an individual life and an individual responsibility. But all those who have clearly recognized the dangers of the modern Welfare State, which can be no more than hinted at here, and about which more will be said in the next essay, will agree with me if I say that the purpose of social institutions cannot reasonably be to misuse the fiscal power of the State in order to build up a system of general provision for all State's subjects or for an all-encompassing organisation of social security. Still less should the problem of providing for the weak and helpless be used as an excuse for levelling down all incomes and all property ownership. That would be a real revolution and it would be hard to exaggerate the dark side of its inevitable consequences, which have already become clear enough and in an appalling manner, in those countries which have ventured out too far in this direction.

If we want to avoid all this, we must limit our purpose to giving the weak and helpless something to hold on to, to putting a floor under their feet which will prevent their falling into bitter distress and poverty; no less, no more. The help extended in this way should be simply a supplement made available when individual and group provision are inadequate; it should not be looked on as the normal method of facing

---

(1) "Individualism" is probably a more appropriate term in this context (ed.).

misfortunes. This applies in particular to the wholly legitimate demand for old age support and for relief for those who become prematurely unable to work owing to physical disability, and the only dignified form such provision can take is a genuine social insurance, which does not depend exclusively on State subsidies and which sweetens compulsion by the knowledge of the individual concerned that he has earned his pension by his own contributions and in his own right.

One of the tests by which the rightness of the measure can be judged is whether such a satisfaction of minimum security requirements does or does not weaken the spirit of voluntary self-help and mutual group assistance, by which the bare minimum is supplemented. It has been learned from experience gathered in Switzerland and in the United States, where despite, or perhaps because of, a comprehensive old-age insurance system, the total of savings and of life insurance has appreciably increased, that such a gratifying and encouraging development is indeed possible, whereas the model countries of the extreme Welfare States--Britain and the Scandinavian countries--provide discouraging counter-examples--not without serious consequences for the soundness and balance of their national economies. A good survey of the respective contributions of private insurance and social insurance in the United States is provided by Chester C. Nash: *The Contribution of Life Insurance to Social Security in the United States* (International Labour Review, July 1955). The corresponding figures for Switzerland are given by Emile Marchand: *The Evolution of Insurance in Switzerland* (Journal des Associations Patronales, 1956).

#### SOME ILLUSTRATIONS

An illuminating illustration is provided by the fact that in Switzerland the total of insurance companies' capital and savings rose from 11.5 billion s.frs. in 1946 (when the federal system of old-age pensions was introduced) to 16.3 billion s.frs. in 1954. Thus, individual protection through saving increased even more than through state insurance (according to the Statistical Yearbook of Switzerland). The statistics are rather incomplete and do not, therefore, provide the full picture, as neither saving for the acquisition of securities nor assistance by

private enterprises are included: they are, unfortunately, unascertainable. A further illustration which de-serves to be mentioned is that in 1953, the last year for which these figures have been published, payments by insurance companies exceeded those by the federal system of old-age pensions by 100 million s.frs. An authoritative American comment says: "The governmental old-age pension organisation has created a security floor below which no worker is permitted to drop. Additional provision for old age has been made on a considerable scale by the existing facilities of private insurance. The introduction of public provision has not completely turned the masses away from private insurance; on the contrary, it has helped to increase the number of those who turn to private insurance in order to broaden the basis of existence which has been created by such public arrangements."(2)

It is only if we are mindful that there are natural limits to the Welfare State which cannot be exceeded without a corresponding penalty, and it is only if we reduce its scope, where it is excessive, to the proportions which correspond to its reasonable purposes, that we shall be able to steer clear of the ultimate extreme danger which threatens to kill everything, including our efforts to expand the sphere of individual provision by saving and insurance. We all know what this danger is. The whole world is already in its grip; it is the progressive erosion of the value of money by creeping inflation.

It is because we have allowed the Welfare State to exceed its proper bounds that we now find ourselves subjected at an increasingly alarming rate to the chronic disease of our currencies. This has come about in several ways, by inflationary expansion of government spending as well as by the paralysis of saving. But in having this effect, the Welfare State becomes self-defeating, and what has been hailed as a great social measure of progress will in the end prove the most damaging social experiment one can imagine.

---

(2) Nash, The Contribution of... p. 4 et seq.

## A QUESTION OF SOCIAL PHILOSOPHY

The obvious conclusion of all these considerations is that the problem of provision against the vicissitudes of life in a free society is not in the first instance a technical question of social administration or mass relief, let alone a question of political opportunism; it is rather a problem of social philosophy. In order that we may think constructively about it, we must begin with a clear idea of what we believe to be a sound society; only then will we know how to distribute the weight on the scales, how far to encourage the strength, responsibility and saving spirit of the individual and the natural solidarity of small communities, with the family first and foremost, or alternatively how far to encourage the already almost irresistible drift towards collectivism, state omnipotence, machine-like organisation and the reduction of human beings to the status of minors. All this is being brought about with the best intentions, sometimes under the flag of "solidarity of the generations", or even "solidarity of the living", and it sounds all very attractive; all the same it has never been sufficiently thought out in the light of social philosophy. We must also realise that we have to choose, in the end, between the individual and the family on the one hand and collectivism on the other or, to put it quite bluntly, between the social climate of freedom and its exact opposite. Whoever thinks this is a mere twisting of words has not understood what is at stake today.

There are two points we should not overlook. One is the fact that the Welfare State contains nothing in itself which would set a limit to its own activities. It has on the contrary the opposite and very strong tendency towards further and further expansion. Thus it is urgently necessary that the appropriate limits be set from outside. This continuing expansion of the Welfare State, the tendency to cover more and more potential insecurity, to increase its benefits, and with them also the burdens it imposes, is highly dangerous, because expansion is easy and tempting, while any going back on a measure which is later revealed as ill-advised is difficult and may well prove politically impossible. One would scarcely imagine that Britain would have instituted her National Health Service in its present form had it been known

beforehand what would happen to it, or even if certain important aspects of it had been gone into thoroughly beforehand, questions which today appear elementary. A leading British economist says this of the National Health Service: "The important economic question about that scheme was this: if there is a service the demand for which at zero price is almost infinitely great, if no steps are taken to increase the supply, if the cost curve is rising rapidly, if every citizen is guaranteed by law the best possible medical service and if there is no obvious method of rationing, what will happen? I do not recall any British economist, before the event, asking these simple questions."(3) It is hardly less difficult to say how this risky step could today be reversed, and it seems that all one can do is to put up with things as they are with as much good grace as possible. Any further step on the road towards the support state should, therefore, be taken with the utmost circumspection, with the ideal pattern of society in mind and in the certain knowledge that it cannot be undone any more than the voting age can be raised once it has been reduced.

#### A SOURCE OF NATIONALISM

The other point which should be given most earnest consideration is a fact which is too easily blurred by the social phraseology of our time namely, that outside provision by direct or even indirect governmental compulsion means that social safeguards are dragged into the sphere of politics with all the obvious consequences involved; provision against the vicissitudes of life is placed at the mercy of domestic politics and state bureaucracy, with the result that the tendency of politics to encroach ever more widely on the field of social life is steadily encouraged. The result of this is just another paradox to be placed alongside all the others, namely that lip-service to internationalism is accompanied, in reality, by an increasing nationalism. Since the national government is both the organiser of welfare and the compulsive agent, the fact that economic and social life become objects of political action means that they become

---

(3) J. Jewkes, in "Economics and Public Policy", Washington: 1955, p. 96.

nationalized themselves, which, in its turn, means that an excessive social integration grows up within the framework of the national state, making all the more difficult the process of international integration. The more frequently appeals are made to the "solidarity" of people who share the same passport or the same national residence, the more they are forced into a self-supporting, economically isolationist "national community", the more complete is the "nationalization" of human beings at the expense both of the free international community of nations and of international solidarity. In the nineteenth century, Renan coined the famous definition of a nation as a "perpetual plebiscite", but we are now approaching the day when we can define it as a pension fund, a compulsory insurance organisation with the passport or certificate of residence acting as a free insurance policy, as a perpetual income pumping-system.(4) While saving and private insurance are forms of provision which belong to the sphere of economics, the market, private law and freedom, and are not, therefore, confined by national boundaries, public provision belongs to the realm of politics, collectivist organisation, public law and compulsion and, therefore, tends to lock up people within their national boundaries. Social services, whose backbone is governmental coercion, are by their nature nationalized services, and social insurance is simply nationalized insurance, barring, of course, the remote possibility of a world state in which Germans, Italians, Ethiopians and people from Argentina are all integrated into a single world pension fund.

It would be frivolous to disregard all those considerations, unfamiliar though they may be to some. Understanding of them is necessary if we want to know precisely where we are going when we decide upon details of the technical organisation of social policy.

---

(4) Ernest Renan (1823-'92) French historian and philosopher. He wrote several influential works such as "The Life of Jesus" (1863), "The Intellectual and Moral Reform of France (1872) and "The Future of Science" (1891). The second book cited above contains his political views (ed.).

While some steps in a rather questionable direction are unavoidable, we should at least take them reluctantly when we must and realise that we are putting up with a necessary evil and that the dangers of this road grow more serious with every step we take on it. We should be very clear in our minds about which is the rule and which is the exception, which is the sound, normal thing to do and which an unavoidable deviation from it. The rule, the norm, the gladly accepted ideal, if we are serious about the basis of our culture, should be self-reliance and the various forms of voluntary mutual assistance within existing communities; the ideal should be that of a well-run household, an ideal which we cannot sacrifice without endangering the very basis of free society and without reducing the difference between a Communist society and ours to a mere difference in degree.

#### IS INDIVIDUAL PROVISION IMPRACTICABLE?

Those who feel unable to advance any argument of merit to disprove this decisive conclusion but have little inclination to agree with it may now assume the air of superiority which the realist enjoys in dealing with a fantastic idealist, and claim that self-reliance and spontaneous voluntary mutual assistance just do not work these days, at least not to the extent which would permit us to reduce compulsory provision to the point where it would be but a supplement to self-help. Here we meet with a defeatist attitude which masks a certain measure of satisfaction. It is, in fact, the kind of resignation which, while pretending to submit to inescapable facts, contributes itself to the creation of the conditions which are used to justify state intervention. If it is assumed that, in our time, the problem of the welfare of the masses cannot be solved except by collective and compulsory arrangements, and that an expansion of individual provision lies outside the bounds of possibility, then the obvious conclusion is that compulsory provision will have to take care of so much that the masses, burdened by correspondingly high contributions and taxes and unworried about their future, will finally have neither the economic ability nor the moral readiness to look after themselves. Thus all that need be done is to organize a sufficiently radical and broad compulsory welfare system to be able to declare triumphantly that individual provision is at best a pipe dream. But all this goes to prove merely

what we know already, namely, that the Welfare State is always in danger of running into a vicious circle, and of this we should beware.

Some people even go so far as to represent far-reaching individual provision not only as hopeless but even as undesirable from the point of view of the national economy. They say that so much saving would be more than our modern monetary system could bear. We must avoid a spate of "over-saving," which might plunge the economy into deflation, depression and unemployment. The capital accumulated must be absorbed by investments. And where should these come from? The answer is that this argument is an exaggeration of popular Keynesianism, and it is only to be regretted that we can no longer ask the Insurance Director Keynes himself what he thinks of this attempt to advance his ideas as an argument against the human effort to secure a personal foothold by saving and insurance.

The first point that is overlooked is that a general expansion of individual provision presupposes high average incomes and that these must come from a high level of economic productivity. This again is dependent on a genuine--not an artificial or inflationary--economic growth which in its turn relies on high investment balanced by genuine saving, if it is to be noninflationary. A rising rate of saving in the process of increasing individual provision is, indeed, urgently necessary in order that the high mass income, which alone renders rising savings possible, may be maintained without resort to an inflationary financing of investment. It is a matter of course that these additional investments, which not only balance, but rely on additional savings, would also include investments abroad. Moreover, as I indicated earlier, there is still a wide field in which the question of the balance of saving and investment is no problem at all; this is where house ownership is acquired, with or without a garden, which represents one of the most desirable forms of individual provision. It really would not make sense to suggest that this would render the equilibrium between saving and investment problematic.

To speak in quiet concrete terms, it would be highly desirable if individual provision everywhere could reach the same degree it has attained in

Switzerland or the United States. But it is clear that here as well as there, the head-ache to watch out for is inflation, not deflation. Switzerland in particular provides good evidence against the theory of "oversaving." Certainly she ought to have run into all the difficulties predicted by the post-Keynesians, as her old age insurance is run according to the principle of previous capital accumulation, and her rate of individual provision is high. In fact, however, if the record saving in Switzerland has led to any problem at all, it is to the fall in interest as a source of income, not investment lagging behind saving. As saving rises with economic growth, it provides, at the same time, the basis of further non-inflationary growth.

Non-inflationary, to be sure. This is always the decisive point. The one thing on which individual provision by saving and insurance must rely is confidence that the value of money will remain constant; where such confidence is weakened, self-reliance will likewise peter out. Where radical projects of collective security give further vigorous impulses to active inflationary tendencies--as is happening in France today and may happen in Germany tomorrow--they will secure the triumph of compulsory over individual provision--and at the same time the triumph of inflation, and through that the disruption of the free economy and the free society.

I have come to the end of my brief survey, although the subject is far from being exhausted. But perhaps I may be permitted to say more by referring to a personal experience of my own. Not so long ago, I stood, deeply moved, before one of the most overpowering of all works of occidental art, the paintings by Tintoretto on the walls and ceilings of the halls in the Scuola di San Rocco at Venice. This Scuola di San Rocco was one of those ecclesiastical welfare societies which in that Adriatic Republic of merchants solved the problem of provision for the weak in their own way: without its work Venice could never have existed for over a thousand years without a revolution. The unselfishness of that brotherhood was matched by that of the artist of whom it is reported that he did not ask for any fee for his tremendous work.

Let us make the bold assumption that there is, today, an artist of the rank of Tintoretto. Could we imagine a Welfare State office which would have him decorate its rooms, and could we imagine a Tintoretto who, carried away by his task, would sacrifice himself to this work, for the greater glory of God, and for the sake of beauty and charity?

Cruel questions. But then, we have the modern Welfare State.

## II

## REFLECTIONS ON THE WELFARE STATE

More than decade ago, a large section of society turned enthusiastically to the concept of a comprehensive State Welfare Scheme. It was thought at that time, both by laymen and experts, that after the war the future would belong to this Welfare State. In fact, people everywhere (particularly in those countries which were entirely or preponderantly under Socialist influence) eagerly set to work to create a State which would guarantee security and adjust incomes. Fear of a great wave of post-war unemployment--a fear nourished by false economic predictions --proved to be a strong driving force. No country was able to escape altogether from the universal trend towards the Welfare State. The voices of the few who criticised and gave warning faded away without echo.

Today, the time should be ripe for drawing up a balance sheet of experiences and opinions, and for posing the question: how has the ideal of the Welfare State vindicated itself? It cannot be doubted that the working of the modern Welfare State has had, on the average, an effect ranging from disillusion and disappointment to anxiety and bitterness. So it is not to be wondered at that what was an inspiring ideal a few short years ago is now a drab, everyday activity, coming increasingly under the cross-fire of criticism.

## CHANGES OF VIEW

Even Lord Beveridge, the originator of the famous "Beveridge Plan", seems to have crossed over into the camp of the disillusioned sceptics; and Professor Pigou, who contributed more than any one else to the theoretical foundations of the Welfare State, today points out that the Welfare State can become a

cumulative danger to the productivity of a country.(5) In an article entitled "Welfare and Taxation", which appeared in 1954, Colin Clark (another noted theoretician) directs at the general concept of the Welfare State a criticism whose sharpness and radicalism could hardly be exceeded. He demonstrates that in Great Britain, generally speaking, it would now be more profitable for the broad masses to renounce the state system of social services and to use the contributions paid for these services in the form of taxation, to make provision for their own future. In the "Revue de Paris" some years ago, the eminent French historian Pierre Gaxotte applied the same heretical idea to French conditions. He asked whether anything would really be different (except that freedom would be substituted for compulsion), if the whole social insurance system were to be abolished tomorrow and wages increased by the amount of the contributions previously paid by employers and employees, with an invitation to those previously covered by social insurance to make their own arrangements thenceforth.

Bertrand de Jouvenel advanced some very sharp criticisms along the same lines in his essay, "The Ethics of Redistribution" (1951) criticisms which, a mere decade ago, would certainly have fallen on deaf ears. Even a German Socialist (not one of the staunchest) recently ventured to remark in the "German Inquiry" that precisely owing to the development of the Welfare State, the humanization of the State which was the noble goal of Pestalozzi is giving way more and more--even on this side of the Iron Curtain--to a disastrous state-regimentation of humanity.

These are just a few lines of the picture which emerges today when we attempt to find out how the reality of the modern Welfare State is reflected in the minds of thinking people. If we try to interpret the actual situation, and, in so doing, select from the above-mentioned criticisms those which appear to be of use, a striking contradiction at once becomes apparent.

---

(5) Diogenes, July 1954.

On the one hand, it is incontestable that organized State aid has its historical origin and purpose in that period between the old pre-industrial society and the highly-developed industrial society of today when the outworn social fabric was disintegrating and the individual, released from its bonds, found himself a virtually helpless proletarian. An unforeseen vacuum arose, and with it a need for assistance; only with the greatest difficulty could this need have been satisfied without State aid. On the other hand, the system of State-organised public assistance in the modern Welfare, State, with its restraints and controls, rapidly becomes redundant; paradoxically at the very time when in the economically advanced countries that interim period has been largely superseded, so that the opportunities for voluntary self-help and group-help have become incomparably better.

#### THE WOODEN LEG

State-organized mass welfare is the "wooden leg" (crutch?, ed.) of a society crippled by its proletariat. It was an unavoidable expedient, based on the presumed economic and moral infancy of the classes that rose out of the disintegration of the old society. To the extent that this phase has been superseded in the countries that consider themselves advanced--at least so far as concerns the material position of the wage-earner, who is now able (though not necessarily willing) to insure himself--the principle of the Welfare State has lost its urgency. Yet it is hard to understand why, now that its machinery is less urgently required, the Welfare State is spreading even further afield. An institution which derived its original purpose from a purely temporary critical phase in economic-social development is now called "progress"; it is apparently forgotten that the sensible way to measure progress is by the extent to which we can manage today without that "wooden leg"--without it, and without the restraints and controls which are inseparable from it. Is it really progress continually to enlarge the circle of those who are to be treated, economically speaking, as infants to be dragooned by the State for their own good? Or should we not rather seek to raise up the mass of the people into economic maturity--to this extent diminishing the scope of the Welfare State instead of increasing it?

It is only when we realize that the aim of the modern Welfare State diverges widely from the purpose of its precursors that what seemed so hard to understand acquires a meaning. There is absolutely no doubt about it; the Welfare State of our time has developed, in the majority of countries, not only in its scope and technique, but also in principle --in such a manner, that something fundamentally new has arisen. Nothing less than a revolution has taken place; and more and more people are, it seems, beginning to realise that is a revolution that gnaws at the very roots of our society.

#### A REVOLUTIONARY DEVELOPMENT

Many efforts have recently been made to reduce to a short formula this transformation, as fundamental as it is critical, which the Welfare State has undergone. Thus, it has been said that the development of social policy during the last 100 years has passed through three major phases. The first was the phase of individual assistance, graduated according to actual individual need; this developed into the phase of compulsory national social insurance; and this culminated finally in the present phase--a general provision, aimed at an all-embracing insurance. According to another interpretation, not very different from the first, the original intention was that the welfare scheme should make itself superfluous and disappear as quickly as possible, i.e., as soon as it had performed its function. But (according to this interpretation) that original intention is being replaced by the idea that State aid should become a permanent institution, even though it might operate only in certain well-defined cases, until finally the new revolutionary principle should prevail--a principle which turns the State into a revenue-pumping station, working day and night, with its tubes, valves, suction and pressure streams, exactly as it was described by its inventor, Lord Beveridge, more than a decade ago.

Whichever way we look at it, the revolutionary character of this latest phase of development is evident. There is a world of difference between a State which protects unfortunates, as the need arises, from falling below subsistence-level, and a State where (in the name of economic equality, but at the expense of an increased blunting of individual responsibility)

a large part of private income is continually being fed into the pumping station of the Welfare State and redistributed by the State, with considerable wastage in the process. Everything into one pot, everything out of one pot--this is quite seriously becoming the ideal. Out of the old, soundly conservative, philanthropic principle that even the poorest should have as roof over his head, has arisen something completely different: the all-embracing socialization of income-expenditure, born of the egalitarian and State-deifying theory that every extension of State provision for the masses is a milestone of progress. But as soon as genuine, individual need, assessed in each particular case, ceases to be the yardstick of assistance, the poorest and weakest very often come off worst.

This revolutionary character of the modern Welfare State can be detected in every little detail. It gives rise to the unceasing expansion of mass insurance to more and more classes who would, if left alone, make provision for themselves, but who are now placed under State tutelage instead. Equally striking is another peculiarity of the Welfare State, inherent in its nature. Whereas, as has been said, State aid was formerly intended to be a subsidiary measure and to guarantee no more than a minimum (being a mere substitute for self-insurance), State provision is now becoming more and more the normal way of satisfying needs--very often scarcely concealing its claim to provide a maximum, even a luxuriant standard of living.

#### SPECIFIC INSTANCES

Perhaps all this becomes clearer, when we study specific instances of the transformation. If we begin with the field of education, we see that, in the place of the approved principle of helping gifted students by means of scholarships but demanding that other students pay at least part of the cost of higher education, Great Britain and other countries are increasingly accepting the idea of a unified system of State education, open to everyone free of charge in all its stages, that is to say, a completely socialized system. The idea that people should normally be expected to make sacrifices for the education of their children hardly dares to raise its head today; though it is possible that the results of this cultural Jacobinism,

which are becoming increasingly apparent, are responsible for the fact that even in this field a swing of opinion seems to be taking place.

The field of housing is possibly an even more apt source of illustration, since all countries are concerned with the way in which the principle of the Welfare State has justified itself in this connection. Out of the time-honoured principle that on the fringe of the housing market there do exist problems where it is only proper that a helping hand (to whoever it may belong) should be extended, something completely different has developed. (The situation is blamed on the immediate consequences of the war--but this excuse cannot be used indefinitely.) I refer to the development of a permanent policy of progressive subsidization of rents, partly at the expense of a politically weak minority, i.e., the house owners, and partly at the expense of the tax-payer (who is, of course, largely identical with the subsidized tenant). We have reached a stage when, to many people, it sounds strange when we ask the question why the earlier rule no longer holds good; that anyone who can afford to buy his suit out of his own pocket at the market price should also pay an economic price for his lodging. How does it come about that an otherwise perfectly reasonable citizen, who would be ashamed to let anybody else pay for his refrigerator, his motorcycle or his lunch, has come to look on it as his unassailable right to shift part of the burden of the economic cost of his lodging onto someone else's shoulders? The probable answer is that he has failed to realise that that is what rent-control amounts to.

Let us take, as a further example, the difficult question of health insurance. Here, too, it is possible to trace clearly the passage from the old social policy to the Welfare State conditions of today. The original principle was that the frequently intolerable risk of a costly operation and long illness should be removed from particularly weak shoulders. But out of this has emerged the socialization of the health service (reaching its peak in the British National Health Service), i.e., the exception has been turned into the rule for almost everybody, and occasional assistance has been put on a permanent basis. This means that we are getting further and further away from the norm, which was that people who

are in position to look after themselves in every other respect ought also, in principle, to include incidence of sickness in their private budget, possibly by availing themselves of existing private insurance arrangements. The condition into which compulsory health-insurance has fallen in the majority of Western industrial countries certainly makes it relevant to remember that norm, and to seek a remedy for it. There are three main lines along which such a remedy could be found. First, by limiting compulsory health insurance to those classes for whom the risk means a serious burden, and whom it would be difficult to persuade to insure themselves voluntarily; second, by making concessions to varied, decentralised forms of assistance such as to be found in Switzerland; and, third, by introducing a system of individual fee payment which would really be felt by the participant, but which would not involve any real hardship.

#### AUTOMATIC AND IRREVERSIBLE EXPANSION

In trying to grasp the significance of the Welfare State, as briefly outlined in the above examples, to the culture, the society, the economy, and the general conditions of our time, it is not possible to do more here than to bring up some of the most important points.

We begin with a circumstance that gives special weight to all the difficult considerations we shall discuss; this is the fact that the dangers of the Welfare State are to be taken all the more seriously because there exists in its nature nothing that would of itself set bounds to it. It has no built-in checking mechanism. It rather tends, on the contrary, to spread itself over ever-widening areas; and this makes it all the more necessary that limits be set to it from outside--unless we wish to get tangled in a vicious circle. This continuous expansion of the Welfare State, is inclined to embrace more and more of the uncertainties of life and of a steadily increasing portion of the population. It also tends to set its benefits and taxes at an increasingly high level, which is quite disastrous; for every step forward is easy and tempting, but every retraction of a step recognised after the event as having been ill-considered, is difficult, and eventually becomes a political

impossibility.

#### LOSS OF INDIVIDUAL RESPONSIBILITY

Now, this path along which we must take each step so carefully, indeed reluctantly, leads to the centre of gravity of society being pushed further and further upwards, away from the true, parochial community with its human warmth, towards the impersonality of State administration and its attendant vast and impersonal organisations. This, in its turn, involves an increasing centralization of decision and responsibility, and a growing collectivization of the conditions of the individual's welfare and, therefore, of his way of life. The inevitable effect of this process should be examined carefully in all its aspects. Hitherto, we have relied on certain reactions of the individual to considerations of risk and individual responsibility. Now, however, it appears that, on account of the upward movement of the social centre of gravity in the Welfare State, these reactions are becoming increasingly weakened and distorted. The secret mainspring of society, inherent in the individual and his will for self-assertion, threatens to grow slack if the levelling machine of the Welfare State blurs the positive results of greater personal efforts as well as the negative results of lack of personal effort.

It is the extreme individualism of the past which is largely to blame for the present development towards the opposite extreme of the modern Welfare State with its mechanized mass welfare. Surely the mark of a healthy society is that the centre of gravity of personal planning and responsibility should lie, as far as possible, between the two extremes of the individual and the State; that is to say, in the small, genuine community, most of all in the primary, indispensable and most natural of all communities--the family unit. Thus it should be our task to promote the development of all those small and intermediate communities, of so many varied types, as far as we can; and to promote at the same time "group-help" within whatever circles still accept free will, a sense of responsibility and human warmth which avoid the cold impersonality of the modern mass-welfare machine.

It is undeniable that the Welfare State is certainly an answer to the decomposition of the genuine

community which has taken place in the last 100 years and which burdens our time with one of its most grievous defects--call it, as we will, centralization, proletarianization or anything else. But it is a false answer; and it is this that formed the core of our criticism of the Beveridge Plan more than a decade ago. Far from providing an effective cure for the sickness of our culture, the Welfare State merely soothes a few of the symptoms; and the price we pay is that of allowing the sickness itself to grow steadily worse until it becomes incurable. Can it be insight on the part of the initiator of the Beveridge Plan, that he has, in the meantime, become the author of a book on "Voluntary Action"?

#### MORALLY ROTTEN

Even worse than this, however, is the fact that if the modern Welfare State makes it more and more its business to distribute welfare and security in all directions--now in favour of this group, now in favour of that group--it must degenerate into an institution which is morally rotten and which must, therefore, finally destroy itself. It will come to correspond more and more to the malicious definition of the State given by Frederic Bastiat 100 years ago: "The great illusion through which everybody endeavours to live at the expense of everybody else." It will also justify Dean Inge, who defined politics as the art of taking money out of the pockets of the opposite side's supporters, putting it into the pockets of one's own supporters and living by this art.(6)

The morality of the policy of robbing Peter to pay Paul is very far from obvious, especially when almost everybody is giving and taking at the same time, so that it becomes harder and harder to know, on balance, whether one is giving or receiving. In the same way, it might be advisable to avoid the question of morals,

---

(6) William Ralph Inge (1860-1954) English clergyman and scholar combined in his writings classical scholarship, philosophy and contributed for many years to the "Evening Standard". His distinctive pessimism earned him the title "the gloomy dean" (ed.).

when social resentment or thoughtless fighting for one's own interest leads to claims on the hard-earned income of others, and so to confiscatory taxation. The continual staking of claims for assistance and insurance which can only be satisfied at the expense of somebody else is made easier for both individuals and groups by a kind of mental short-circuit, namely, the habit of seeing the State as an economic fourth dimension and forgetting that in the long run--or, indeed, the short run--it is the taxpayers who must fill its coffers. The modern Welfare State, however, is well adapted to concealing the fact that demanding money from the State always means demanding it indirectly from somebody else, who has to pay for it by way of taxation. It amounts to a transfer of purchasing power effected by the State.

#### A FALSE BELIEF

The more this principle of the Welfare State is extended, the nearer the time comes when the gigantic pumping station will turn into a universal deception, an end in itself, really helping nobody at all other than the operatives who live by it and who, quite naturally, have every interest in not letting the deception be discovered. In order to understand this better, we must realise that few beliefs have contributed more to the latest development of the Welfare State than has the conception, which arose in the nineteen-thirties, of an immense social wealth (resources) to some degree paralyzed by insufficient final demand. Permanent full employment brought about by deficit spending would make this wealth real, tangible and enjoyable. Redistributive policies would make its fruits available to all classes. At the same time (this was an especially popular inference which it was then believed could be drawn from the Keynesian theory), such redistribution of income--with the resulting increase in mass consumption--seemed the best means of securing full employment and keeping the source-reservoir of the Welfare State replenished. Only this faith (kindled through the Great Depression and its effects) in a kind of automatic self-financing of the radical Welfare State can explain the lack of concern which peopled have for so long shown over the problem of how to finance such a policy.

The time of illusion is now past. It has become

clear that any serious attempt to run a Welfare State necessitates stirring up the distribution of income to its very depths with the tax-collector's whisk and assigning to the lower income-groups a share in the financing of the Welfare State. But this amounts merely to a transfer of purchasing-power from the left-hand into the right-hand pocket, by diverting it, with tremendous wastage, through State channels. It is not just that, bewitched by the myth of "poverty amidst plenty," society has overestimated the potential wealth of the Welfare State even in the most favourable circumstances, and underestimated its cost and waste; the essential point is that the Welfare State, in its extreme form, has shown itself to be a primary cause of the restriction of total productivity.

#### A BRAKE ON PRODUCTION

It is impossible to argue today that the financing of the Welfare State can be confined to the tapping of "unearned" and "functionless" income. It is obvious that it is becoming necessary to extend income-levelling taxation to incomes of quite another kind, i.e., to incomes which have their origin in genuine productivity. Such productivity not only earns its own reward, but also presupposes it as a spur. The productive classes cannot be bled white without their productivity being crippled; and, anyhow, their tax-paying capacity is utterly insufficient to satisfy the claims of the Welfare State. This makes oppressive taxation of the masses inevitable. Furthermore, the question is already being asked--especially by Colin Clark--whether the total burden of taxation brought about largely by the claims of the Welfare State is permanently compatible with a free economy, or even possible without constant inflationary pressure.

#### USES OF SURPLUS INCOME

There is another circumstance that explains the largely illusory character of the modern Welfare State. Very many people believe that taxation of the higher income groups simply means a limitation of expenditure on the part of those groups and that what is siphoned off from their purchasing power can thus be directed to social benefits for the lower income groups. This is an obvious elementary error; for it should be obvious that higher incomes provide the foundations

which are essential to certain functions of society. Capital formation, investment, cultural expenditure, patronage of the arts and many other things could be listed under that head. Now, the more the higher income groups are eradicated by progressive taxation, the less likely it is that functions of this kind will be carried out--and, since they are vital to any healthy society, there is no alternative but for them to be taken over by the State.

This means, however, that to the extent that the purchasing power which has been tapped at the higher income levels is not available for such purposes as private investment and the sponsoring of the arts. Therefore, tax receipts must be used by the State to replace the private contributions to investment, culture, the arts, etc., which have been frustrated by taxation. Thus, to the extent that the State has to assume these functions, its primary aim as a welfare mechanism must be abandoned, however meritorious or essential such a welfare mechanism may be. Even if we think well of the Welfare State because it might today educate a genius, such as Gauss, at its own expense, we ought to remember that, in the actual case of Gauss himself, this was, in effect, done by the Duke of Brunswick and others in an admirable and wholly unbureaucratic manner. In short, it is not the masses who gain through confiscatory taxation of higher incomes, but the State, which thus acquires extra power and influence, and, of course, the Civil Service too, with all its inexhaustible demands. The consequence is an extraordinary promotion of modern absolutism, with its centralisation of decision in all the most important fields--in capital formation and capital expenditure, in education, research, art and politics.

#### BOREDOM AND CLASS RIGIDITY

Thus we are getting an increasing socialisation of revenue expenditure, especially in fields of the highest importance for society as a whole. At the same time, the general atmosphere becomes oppressive. Charity, honorary functions, liberality, conversation, leisure, everything that Burke included in the expression, "unbought graces of life", all these are strangled by the choking grip of the State. It is a paradoxical consequence of the Welfare State, that everything is becoming commercialized, that everything is becoming an object of calculation, that everything

is being gathered up into the orbit of the national revenue-pumping station. If honorary functions are rarely performed any longer, either because there are not enough wealthy people or because the spirit of citizenship is becoming dulled and is turning into vexation in the upper classes and into envy in the lower classes, all we can expect is a universal professionalization and commercialization. Narrower and narrower grows the scope for such income as is available for charity, a cultivated way of life, and a certain liberality of expenditure; rarer and rarer becomes the climate in which liberalism, variety, true community, and nobleness can thrive.

Therein lies one of the causes of the deadly boredom which seems to be a distinguishing feature of the radical Welfare State; and this result of the Welfare State cannot be taken too seriously. There is another cause, related to the first. It is to be found in the fact that the Welfare State, contrary to its proclaimed goal, is inclined to petrify the class structure of society and to make it more difficult rather than easier to move from one class into another. Rigorous taxation, above all the steeply progressive income tax, which is an inherent feature of the Welfare State, necessarily strikes exactly those incomes which are high enough for capital formation and the assumption of business risks. It is surely obvious that, just because of this (and because of other reasons which cannot be discussed here) the promotion of new undertakings and the formation of property is becoming more and more difficult. Surely this means that it is far harder than it used to be for anyone to work his way up out of the vast mass of propertyless wage-earners, and correspondingly less attractive even to make the attempt--especially since the Welfare State provides comfortable spoon-feeding for the domesticated masses. Surely only those large enterprises which already exist are favoured.(7) At the same time, life in such a State is about as inspiring and amusing as a

---

(7) See also: L. von Mises, Human Action, Chicago: Contemporary Books, pp. 808-809 and F.A. Hayek, The Constitution of Liberty, Chicago: The Univ. of Chicago Press, 1960, pp. 320-321 (ed.).

game of cards in which the winnings are predestined to be divided equally among all the players. In fact, the task of climbing the social ladder from class to class must, in circumstances such as these, become less and less exciting. All that remains is to pick on the career of State- or union-official, for the members of these new classes are steadily becoming the real supporters and the real beneficiaries of the system.

#### A SOURCE OF INEQUALITY

These are not the only considerations which provoke the question: does not the Welfare State, in point of fact, succeed in defeating its own proposed ends? The same question may be asked in another sense. Is not the Welfare State's claim that it implements equality as questionable as its claim that it resolves class distinctions? It does implement equality in one sense (although a doubtful one); but in another, decisive and relevant sense it does not. By means of the continual diversion of income effected by the State, greater material equality is created. But at what price? Since this policy inevitably brings about a greater and greater concentration of power in the hands of the administration which directs the flow of income, the distribution of power must become correspondingly less equal and who would deny that the distribution of power, imponderable though it may be, is incomparably more important than the distribution of material wealth? For it is the distribution of power that decides the freedom or bondage of man.

In effect, the modern Welfare State, in the dimensions to which it has already grown and threatens to grow in the future, seems to be the primary mechanism through which the subjection of the individual to the State is being achieved throughout the non-Communist world. The problems it is designed to solve, it does not solve--or only apparently solves; on the contrary, it makes them even more serious, and even less susceptible of an effective solution. What it does do, however, is to enhance the power of the State to gigantic dimensions, and finally "it presses every nation to the point where it becomes nothing more than a herd of frightened beasts of burden whose shepherd is the Government." It forces us to reflect that this vision of de Tocqueville's has, a hundred years after he wrote these words, every prospect of becoming the reality of our own day.

## III

## KEEPING MONEY HONEST

It is generally admitted today that, since the war, the economy of almost every country is, to a greater or less degree, under the influence of inflationary pressure; this is in marked contrast to what everyone had expected. Basically wrong economic policy was based on these expectations. It has been widely recognized that the great, and possibly vital, problem affecting our future is not, as was generally believed immediately after the war, deflation. In retrospect we can now see that another long period of inflation began with the outbreak of the Second World War; it still persists and there is no visible end to it. Although, in most cases, it is not a dramatically obvious "hot inflation", it is none the less stubborn and insidious, a creeping, chronic condition of continually declining money values which becomes steadily more apparent; a "cold inflation" which, without rising to fever pitch or showing other alarming symptoms, is for that very reason all the more dangerous. This problem is quite rightly beginning to overshadow all others; it is to be hoped that it will become the focal point on which economic, social and financial policy is concentrated and that these policies, thus re--orientated, will finally put an end to its evil influence.

This process seems all the more evil since its actual nature is obscure. It fits into no known pattern of experience but appears to be something quite new in economic history, the cause of which is so far unknown. It is scarcely surprising that there is great confusion on all sides, and that new attempts to find a solution are continually being made. There is no obvious, increasing flood of money, no printing-press working overtime, no easily detected source of inflationary pressure which can be blamed. Only one thing is certain: goods continue to grow slowly but obviously dearer and there is little prospect of a reversal of that trend. In most countries it is not a question of a deficit in State finances, the usual source of "hot inflation", and, in countries like Germany or Switzerland, the familiar symptom of

inflation; nor is it a question of a deficit in the balance of payments with consequent pressure on exchange rates. On the contrary, we are increasingly mystified by being told that it is actually a surplus in the balance of payments that is one of the main sources of inflationary pressure. This presents us with an extraordinary new conception best described as a "dilemma of imported inflation".

#### NEED FOR NEW PATTERNS OF THOUGHT

What are we to make of it? Some take the easy way out and simply deny that the process even exists; they say there is no inflation today and what we take to be inflation is only an optical illusion; it is quite normal for prices to rise slowly, they say; they always have. Others merely give up looking for a reason and blame an alleged historical factor (the, "Inflation Age"), or more vaguely, institutions or conditions (institutional inflation). Or else charges and countercharges are levelled; labour blames the employers, the employers blame labour or both blame the Government.

It is certainly a difficult problem and it will obviously be hard to solve. One fact, however, stands out clearly and should therefore rank high in our search for a solution. Whatever may be the nature of "cold inflation", it must in any case be an excess demand developing from a surplus of money and this surplus must originate where money is produced, i.e., in the Central Bank, which not only produces spot cash but in most countries, has means at its disposal which enable it to control the production of spot cash by manipulating the liquidity of the banks. This is clearly the tap which would only have to be turned off sufficiently firmly to stop any leakage. This is an unassailable fact and the responsibility of the Central Bank is therefore undisputed. This is the point at which all the threads meet.

#### SOFTENING UP THE WILL TO RESIST

These threads have, however, become extremely tangled and here we find the main difficulty. In theory it is indisputable that the Central Bank could, by restricting credits, cause a shortage of money to

such an extent that every inflationary tendency whatever its origin, whether due to an export trade surplus, or to a rise in investments or in wages, could be suppressed. Alternatively, the Government could produce the same result by immobilising a large budget surplus--though this would be less commendable since experience has shown the dangers of such an action. In practice, however, it is doubtful whether the Central Bank (or the Government) could do either of these things under existing social and political conditions, since such restrictions would produce harmful results, primarily unemployment. It is, therefore, extremely important not to allow inflationary tendencies arising from economic and social causes to develop, thus sparing the Central Bank the necessity of imposing too severe restrictions. It is also equally important that the desire for the stabilization of the value of money should be so unassailable and overwhelming, that all other aims will be subordinated thereto and that any restriction which the Central Bank finds it necessary to impose will be backed by the unqualified approval of the public.

Seen from this viewpoint, the creeping "cold inflation" of our times appears as the result of two components, i.e., the inflationary tendency of the economy and the softening of the will to resist.

#### A NEW LIGHT ON SAVINGS

If we ask what are the inflationary tendencies arising from the economy, we find that they are primarily resulting from a tension between, and from an overloading of, the economic forces such as in the past have frequently been encountered in the movement of the market we call a "boom," with its symptoms of a rise in prices and costs, delivery difficulties, optimistic forecasts and a general tendency to change from money to goods (or investments). The origin of the excess demand which exerts pressure on the market and forces prices up is, as any market expert will know, a rise in investments always provided that they do not pass a critical point either in pace or extent. This critical point is most likely to be passed when the employment of productive forces by investment and the immediate employment of income represented by the building of factories and the manufacture of machinery is not balanced by a corresponding accumulation of consumptive

purchasing power by way of savings. An overheating of the economy by increased investment will thus occur when current savings, which are produced by individuals cutting down their personal consumption, are no longer able to balance increased demand through investment, with the result that investments are correspondingly financed by what are called "alternative" savings, that is to say, by the expansion of credit.(8)

All this is familiar ground on which we need waste no more time. The theory that an increase in savings is of the greatest importance to the economy should receive serious attention, for this would have a damping, relaxing, and cooling effect on a boom. The more investments are financed out of savings, i.e., by reduced consumption, self-imposed by the consumer restricting his own purchasing power, the higher the critical point in the rise in investment and the longer the boom can continue before reaching the danger point. A similar result would be achieved by importing money capital and consumer goods.(9)

---

(8) Here Roepke basically endorses the theory of investment inflation of the Austrian School of Economics, derived from its theory of the business cycle. If, through expansionary monetary policy and/or voluntary credit creation by commercial banks, loans are made available at artificially low interest rates, entrepreneurs will start to invest and resources will be reallocated in order to be put to work in the capital goods industries. An inflationary situation is created because the total amount of resources has not increased. Had the extra loanable funds come out of increased savings, households would by definition have consumed less thus releasing resources producing consumer goods. With consumer demand unchanged and investment demand on the rise, resource prices such as wages go up with higher product prices as a result (ed.).

(9) Imported money capital may validate more investment while increased foreign supplies of consumer goods tend to reduce the rate of increase of their prices. (ed.)

Thus savings, which were once regarded with disfavour in theories applicable only to depression periods, now return to the place of honour which sound common sense has always reserved for them. Whether they will rise or fall in esteem, as a result of any change of circumstances or through the operation of legislation, is something which will have a profound effect on all economic, financial and social politics. It is now equally clear that "negative savings" a good example of which is credit purchasing, will seriously prejudice the situation.

In the above-mentioned symptoms of an overheated boom we have a situation in which the increase in investments are no longer covered by savings and must, therefore, be financed by new credits. They not only press on unused production factors, but, at the same time, they give rise to an inflationary pressure on final demand, even though there is no reason to assume that all these inflationary investments are "economically desirable", or "useful", or to label any curtailment of them as prejudicial to progress and modernisation. We can hardly expect the employers themselves to force such curtailment of investment; it is rather the task of the Government, or, failing the Government, of the Central Bank. The point is that curtailment is essential if we are to ward off the dangerous inflationary tendencies of a boom, and thus avoid painful repercussions which could only be postponed at the price of further credit inflation.

So much for the source of inflation attributable to the over-investment of a boom. It is no more a sensational novelty than the problem with which the Central Bank is faced. This is not the actual danger today, which is to be found rather in a new and unusual (at any rate in extent) set of circumstances which has set in motion an inflationary mechanism of a particularly malicious and intractable nature. It is here that we find the decisive factor in the present situation; one might almost call it the seat of an acute neuralgia in the politico-social system. What we mean is that doses of inflation are continuously being injected by the labour market once the boom, glutted with over-investment, has created the necessary conditions. This should be freely discussed today, particularly in the interests of the salary-and wage-earners themselves, for the danger is so great that

well-mentioned reluctance to discuss it would virtually amount to complicity. Further, what is happening is so obvious and so irrefutable that those who accept it could no longer be accused of bias; all the more so since the problem has now been carried far outside the bounds of party politics.

#### OVER-EMPLOYMENT

To help us see more clearly, we can draw on past experiences. From what we already know, we can assume that the exhaustion of all reserves of production factors, which occurs in boom periods, results in a rise in wages together with a corresponding rise in prices which becomes increasingly difficult to absorb through increased production. In an increasing number of branches of industry full employment develops into the familiar condition of "over-employment," in which the number of vacancies exceeds that of suitable applicants. Not so many years ago a leading economist, Lord Beveridge, considered this an ideal condition, but only some eighteen months ago even he was obliged to acknowledge his error in a striking letter to The Times (20th February, 1956). In actual fact, over-employment is so far from the ideal as to be at the reverse end of the spectrum; it is something to be dreaded since it cannot be maintained without continuous inflationary pressure. It might even be regarded as a definition of inflation in itself for, even without trade unions, wages will, wherever too many employers are chasing too few workers show a tendency to rise beyond the point at which they can be brought into accord with monetary equilibrium; higher wages automatically increase final demand without providing any corresponding increase in production. Any attempt to counter over-employment, with its inherent danger of cost-inflation, by means of labour-saving and production-increasing investments will only serve to create an even more serious inflationary situation than before, since, in an overheated boom, investments have already passed beyond the safety point.

All this would still be no more than the fruit of past experience were it not for the fact that two new factors have now appeared which make today's "creeping inflation" an entirely new and unparalleled phenomenon. The first is that the natural tendency towards inflation, a familiar feature of all booms in the

leading countries, is aggravated by the trade unions whose power (and I write very circumspectly) frequently appears to be controlled only by their own insight and sense of responsibility. But less and less reliance can, from day to day, be placed on these limiting factors, for the growing power of the trade unions makes it increasingly difficult, whatever the circumstances, for any correction of inflationary wage increases to be effected by decreasing wages: the political and social difficulties are virtually insurmountable. Thus, rises both in wages and in prices and costs become a one-way spiral reaching steadily upwards.

The second entirely new factor is that it has become more difficult, one might even say impossible, for the Government and the Central Bank to counteract cost inflation, caused by over-employment and encouraged by trade union monopoly, by restricting money and credit. This is particularly true when it creates a threat to "full employment" and might be expected, if only temporarily, to make some degree of unemployment inevitable. To the economic novelty of trade union monopolistic power we must add the equally important factor of the popular demand for "full employment" as an all embracing, unassailable dogma to which the Government and the Central Bank are committed by democratic necessity if not by actual legislation. That these new factors are closely allied is abundantly clear. Taken together they provide the explanation of the "creeping inflation" of our day.

#### AUTOMATICS OF WAGES

The familiar and dreaded wage-price spiral must be regarded in this light. We are not dealing with a purely mechanical process in which wages and prices drive each other upward. This is not so even where--as in Denmark and certain other countries--we encounter the evil system of wage automatics, where wages are adjusted by means of a sliding scale index. The wage-price spiral needs something even in addition to that to give it continuous movement, i.e., repeated injections of further money. If this were not so, employers would not be able to pay higher wages without reducing their labour force. Nor would consumers possess the necessary purchasing power to enable them to take up the existing quantity of goods at the higher

prices by which employers pass on the wage increase. (This is really only a somewhat uncomplimentary way of saying that employers use this method to reconcile wage rises which they are unable to absorb by increased production with the continued employment of dearer labour). The wage-price spiral, therefore, needs continuous boosting from those responsible for the amount of money in circulation, since if they did not boost it in this way, the rise in wages due to over-employment and the power of the trade unions would result in the unemployment of part of the labour force.

#### TRADE UNIONS CURRENCY

This brings us to the salient point. For where an economy slips into the state of over-employment characteristic of an over-heated boom, it will, with a further rise in wages--and this is normally hardly avoidable, and is fostered and made practically inevitable by trade union policy--find itself faced with the fatal dilemma of having to choose between inflation and unemployment, depending on whether or not wage increases receive monetary accommodation. To put it in another way, a country will then have reached the point at which the stability of money values, "full employment" and further wage increases can no longer be reconciled with each other. One of the three will have to be sacrificed leaving a combination of the other two (money value stability and full employment, money value stability and wage increases or full employment and wage increases). Those who insist on an "expansive" or "dynamic" or any other attractively labelled wage policy, but at the same time abjure even a negligible and temporary impairment of 100 per cent "full employment", will not only have to make the best of a further crumbling of money values but will also have to assume the actual responsibility for that happening. They are, in effect, prime examples of a vast mass of people who, while complaining about inflation simultaneously support other demands which, if accepted, would make inflation inevitable.

#### THE ISSUING BANKS ARE NOT SOLELY RESPONSIBLE

It is clear, therefore, that it would be unfair to saddle the Central Bank with the whole responsibility.

The Bank is in the highly uncomfortable position of an automobile driver who knows that he only needs to brake sharply to avoid an accident, but is faced with irresponsible pedestrians all over the place as well as with a greasy road surface on which he might skid if he applied brakes too sharply. We naturally expect him to brake but the irresponsible behaviour of the pedestrians and the greasy road must also be considered.

This picture approximately fits the real situation: naturally, the final decisions rest with the Central Bank, but an undisciplined wage policy, supported by a boom and over-investment and fed by over-employment, threatens to force onto it more responsibility than public opinion, the Government and the dogmatic insistence on "full employment" will allow. At this point the Central Bank may feel itself under the necessity to adopt a continued expansive or insufficiently restrictive monetary policy in order to keep the wage-price spiral in motion. It is, thus, true to say that the trade union leaders--and the expansion-conscious employers--today share the responsibility for the currency, as the Swedish trade unions recently recognised with their welcome resolve to prevent further wage increases in the interest of the fight against inflation. The same view was recently expressed by a leading British economist, J. Hicks, when he spoke of trade union currency as the currency of today.

#### CREDIT RESTRICTION INADEQUATE

The more disciplined the wage policy the easier it is for the Central Bank to fulfil its responsibilities. Thus, the sooner the trade unions apply the brake the better the chance of saving the economy from the whirlpool of over-employment, since without self-restraint it becomes increasingly difficult to control inflationary forces without causing a considerable degree of unemployment. The creeping inflation of our times can be halted only when the discipline of various economic groups coincides with an early and courageous credit restriction by the Central Bank enjoying the full support of both the public and the Government. Discipline alone without simultaneous credit restriction will remain mere rhetoric and would, at the best, be inadequate. Credit restriction alone without self-control on the part of economic groups could, in

theory, suffice, but would, in practice, be extremely difficult and, to the extent required, would, under certain circumstances, be impossible. The one requires the other. Both must, however, be supported by the general conviction that the unassailability of money values must be the highest aim of economic and social policy, and that a further crumbling of money values would be not only an event which would contribute to the utter discredit of all those responsible, but would also be an unforgivable error, since to accept the development of inflation as a permanent process is itself an admission of defeat. Nor should we ever forget the very real danger that a slow, steady increase in prices might finally develop into the flame of hot inflation.

## IV

## CREEPING INFLATION

THE MANAGERIAL DISEASE OF THE  
PUBLIC ECONOMY

A larger and what is most certainly a steadily increasing proportion of the population is realizing that creeping inflation (which I referred to in the previous essay), is one of the most serious problems of our day, and that it is of the greatest practical significance for every one of us. It is, therefore, scarcely surprising that the discussion of inflationary tendencies is growing like a swelling flood. In parenthesis, let me say at once for the benefit of German readers who are, with justification, specially nervous about inflation that the tendencies in that direction are more strictly checked in Germany than in most other countries and that I do not overlook the fact that Germany is showing a healthy reaction to the threat which entitles us to hope for an eventual and successful mobilisation of all her strategies of defence.

For the present, however, we are a very long way off any effective mastery of the problem; indeed, we must ask ourselves whether the real, underlying causes of the constant pressure of inflation under which we are suffering do not lie very much deeper than most people think. Surely it is time to enlarge the area of discussion, and to carry it into a field where the illness of money appears as a moral and a social disease.

In the previous essay I have anticipated this disturbing interpretation of what is going on by pointing out that today's universal inflationary process clearly has no historical parallel. Even the long-term periods of prosperity and depression stretching over some twenty-five years, which can be traced in the economic history of the nineteenth and

early twentieth centuries, and which were usually connected with long-term movements in gold production, provide, for a variety of reasons, very little of an analogy. For example, it has, as everybody knows, become improbable that we shall in the future have a period of deflation to correct a rise in prices, though it is possible, and indeed probable, that we shall have setbacks in economic activity of shorter duration and lesser intensity.

If then the phenomenon as such is new, there must be new causes which bring it about. If we disregard "imported inflation", it appears that there are essentially two chains of cause and effect which work together to produce the inflation we are experiencing. One can be classified as investment inflation, that is to say a demand which cannot be satisfied out of current production, and which is itself the result of an excess of investment over current savings. The other causal chain begins with increases in wages which are not matched by equivalent increases in productivity and which in their turn result in an increased demand not covered by current production. This increase in demand similarly ends in inflation (wage inflation) if, out of fear of a drop in business activity, currency and credit policies do nothing to check it.

#### INVESTMENT AND WAGE INFLATION

Earlier booms have made us familiar with the phenomenon of investment inflation, not necessarily on today's scale but similar in character. Yet in the case of wage inflation we cannot find any parallel in earlier events. Now the forces which generate this novelty operate in such a way that they are able to put up an extraordinary resistance to any attempt to control them through currency and credit policy. The strength of the trade unions in our generation, owing to which a series of wage increases unmatched by greater production has become almost normal procedure, is nearly as great a stumbling block as the sacred and untouchable dogma of full employment, an economic state of affairs which strengthens the trade unions but which is in fact inseparable from further increases in wages and consequent further inflation. The longer those who direct currency and credit policy shrink from bringing this wage inflation to an end by restrictive monetary policies, even at the risk of a certain amount of

temporary and sporadic unemployment, the more difficult will it be for them to overcome this resistance to which I have drawn attention.

That is, to put it as concisely as possible, the framework within which, as I see it, we must view the process of inflation if we are to understand how it operates and how to isolate not only its causes but also the relevant curative measures. Wage inflation quite clearly emerges as the critical problem on which attempts to combat inflation in most countries break down. If we had to deal only with an investment inflation, we should find ourselves tackling a task which has always presented itself in the course of a boom; that is a very different thing from having to fight against wage inflation, which involves us immediately and intimately in some of the most profound problems of the modern mass societies of industrial states.

That does not mean that investment inflation and wage inflation are not very closely connected with each other; indeed they are so closely related that one feels inclined to lift an eyebrow at those labour leaders who try to divert attention away from wage inflation towards investment inflation in an effort to shift responsibility onto the entrepreneur and his desire for investment. They seem to overlook the fact that it is precisely the fact of investment inflation that ensures continued full employment and thus creates the conditions under which unrestrained wage claims and consequent wage inflation are possible. Conversely, wage inflation reacts upon investment inflation because it is an incentive to capital investments which come from saving out of wages; furthermore, both types of inflation stem from the same source, that is, an expansionist, or insufficiently restrictive, currency and credit policy. It follows that we do not find the one without the other; and that is of the greatest practical significance, for the extraordinarily strong resistance set up against any attempt to control wage inflation necessarily makes the struggle against investment inflation, which in itself ought to be easier even in today's politico-social environment, infinitely more difficult. Anyone who believes that his interest lies in investment inflation must put up with wage inflation, and vice versa. There is very little sense in trying to toss the ball of responsibility from one side to the other. Between

those interested in investment inflation and those interested in wage inflation there is, in fact, an almost absolute solidarity, invisible because it lies behind the open disputes on the labour market. But the real seat of resistance, the hard core which is as frightening as it is new, remains wage inflation with the repercussions which I have described. If this were not the case, the smouldering inflation of today would not really be a problem of the first importance, and we would have ceased to trouble ourselves over it long since.

#### INVESTMENT IN EXCESS OF SAVING

However, since the two principal components of today's mechanism of inflation, excessive investment and excessive wages, are inseparable, we cannot concentrate solely on the latter, but must examine the former a little more closely as well. I do not think that nowadays one need to emphasize the fact that excessive investment does not refer to an excess in relation to what can be justified on technical grounds and as economically profitable, but an excess in relation to current savings: that is to say, in relation to the general readiness to reduce consumption so as to provide the capital to build factories or equipment. On top of this excess of investment over savings, we are faced with an increase in aggregate demand which exceeds aggregate supply, and a consequent over-loading of the economy which as always and quite naturally, responds with inflationary pressure. You can hardly reproach the individual entrepreneur if, subject as he is to the competition of the open market, he takes advantage of such opportunities as come his way to finance his investment programme even at the risk of contributing to such an excess demand upon the economy. The avoidance of such a result is not, indeed, his business; it is for those responsible for currency and credit policy to take the necessary precautions by putting credit facilities a little more out of the reach of those who are anxious to make new investments. It is commonly supposed to be a virtue of the State that it stands outside the market and can freely do what the economy demands; it goes without saying, therefore, that we can ask the State, in accordance with the theory that public finance is an economic tool, to back up the restrictions of the Central Bank by prudent limitation of its own spending. That the State fails in this duty, as so much

experience shows today, increases our respect neither for the State nor for Parliament nor for the theories in question.

If a disequilibrium between savings and investments is partly responsible for today's inflationary pressure, it follows that we must look into the causes which have driven investment so steeply upwards. If, in answer, we are referred to the furious pace of technical progress, to the growth of population which has visited us like an unforeseen flood, to the hunger for capital of the under-developed countries, to the international armament race, to the capital requirements of hire purchase, house building and many other similar demands, then we are brought to a conclusion which makes nonsense of the anxiety over the adequacy of economic growth expressed in the theories which owe their inspiration to Keynes. Our anxiety is precisely the reverse; how can we acquire partial control over the forces of economic growth? And how we can ensure that the present abnormally high demand for capital can be met out of genuine savings instead of from the poisonous sources of inflation and taxation. In the interests of a healthy economic and social structure it is to be hoped that even corporate savings which, within limits, are essential and unobjectionable, should again become merely a subsidiary source, since, if they are too freely tapped, they are apt to turn foul! But that is a question which does not really belong to this section on inflation worries.

#### TOO LITTLE SAVED

A further matter is whether forces which determine the accumulation of savings are not equally responsible for the investment inflation of our day. This question must be answered emphatically in the affirmative. Indeed, I believe it furnishes us with one of the principal clues to an understanding of present inflationary tendencies. Fundamentally, insufficiency of savings and wage inflation are closely related in origin. The pressure of inflation would be much slighter if more were saved; and more would be saved if there were not particular factors keeping the formation of savings under continual downward pressure. If we name these factors, we are at the same time laying bare an essential cause of smouldering inflation. If you could remove them, the pressure of inflation would

diminish to a corresponding degree, or, to look at it from a different angle, the Central Bank would need to turn the credit screw less tightly to combat over-investment. Thus a discussion of the inflationary tendencies at work leads us to an examination of the restrictions on savings now operative. That is without doubt a cardinal point. The total weight of taxation, progressive personal taxes hostile to the accumulation of wealth, the "negative saving" of hire purchase, and, above all, the constant expansion of the Welfare State, which undermines both the will and the power of the individual to practise thrift, are the principal forces militating against savings, and accordingly the immediate causes of constant inflationary pressure. In addition, and as a direct consequence, confidence in the stability of money, in the absence of which there cannot be any substantial saving, is shaken; sooner or later that becomes inevitable, and thus the vicious circle is closed--just as vicious a circle as that into which wage inflation leads us. And so, in both cases, we are concerned with something new, something which has never been seen before, something "modern", as is proudly emphasized by the accredited agents of the super-State, of super-taxation, of the super-Welfare State and of all the institutions which turn the act of saving sour.

But what is new in this situation, what therefore shows up in the constant inflationary pressure of our age as a historical novelty, is the product of profound moral and social changes which ought really to be characterised as pathological, if only because their final result is a disease of money, "the democratic-social" inflation of the present day.

#### INDIVIDUAL SAVING UNDERMINED

Almost every day the careful observer of modern political life can see for himself what forces are operating in this field. The most recent example, is provided by the German Rentenreform.(10) The reform itself and the way in which it was driven through the Bundestag are depressingly disproportionate to the

---

(10) The law linking old age pensions with prices, wage levels and productivity.

almost immeasurable responsibility which the Government and the peoples' representatives have taken upon themselves. The mildest verdict on what has happened can be borrowed from the words of the London Citizen in Richard III:

"All may be well; but, if God sort it so,  
'Tis more than we deserve, or I expect.'

Unfortunately, there can be no doubt that in one respect it goes anything but well; the Law ignores everything which urgently recommends a complete reversal of policy and the encouragement of individual thrift and individual responsibility. On the contrary, it gives most powerful support to further attacks on the accumulation of savings, not only because it is an expansion of compulsory State welfare services, but above all because it is based on a system which completely lacks any actuarial basis. Those who are responsible for this bludgeoning of the will to save cannot be excused either on the ground that they were ignorant of the arguments against their point of view, or on the ground that they had marshalled any satisfactory arguments in their own defence.

#### THE STATE ENCOURAGES INFLATION

When we turn our attention to the vast expansion of national budgets, and to the consequent increase in taxation which forces savings below the level necessary to finance the investment essential to any economic growth free from an inflationary expansion of credit we find ourselves face-to-face with what might be called the sixty-four dollar question: what share does this fiscal elephantiasis have in chronic inflation? It has, of course, a direct share in so far as an additional demand is created by the budget itself, whether it is in deficit, as in France, or whether, as in Germany, there is a sterilized budget surplus, which must inevitably be liquidated in due course, thus causing a disbursement indistinguishable from that occasioned by a budget deficit. The higher the proportion of the national income confiscated by the State through taxation, the more depressed the level of savings becomes; the lovely conception of taxation as a balancing mechanism has long since been shattered by the facts of politico-social life.

But even if we turn our backs on this particular effect of the gigantic size of the modern budget, there are several other reasons why it tends to encourage inflationary movements. Quite apart from an excessive budget's unfavourable influence on savings, there is the fact that if government spending as a percentage of the national income--and here the theory put forward by the English economist, Colin Clark, is certainly correct--exceeds a certain figure, the critical proportion being about 25 per cent, the pressure on the national economy cannot be borne without an eventual fall in the value of the money. The point is--and it must be emphasised again and again--that, in the long run, this gigantic tumour of exaggerated taxation destroys the efficiency of the interest rate as an essential weapon in the battle to secure equilibrium between the money supply and production; what it means is that the interest rate, as a factor in production costs, becomes steadily less important than the taxation burden. The consequence is a progressive enfeeblement of the discount policy of the Central Bank as a brake on inflation.

#### A HALT TO STATE EXPENDITURE

All thinking people have realised for a long time that the share the State allocates to itself out of the economy in these days is in the long run incompatible not only with a free but even with a remotely healthy state of society. It is a problem which heads the list of the great problems of our time; it is one which, given the evident danger of a chronic inflation, is crying out for a solution. On the other hand, the extraordinary difficulties in the way of any satisfactory solution are there for all to see. Since very little can be expected from savings in mere administration costs, everything depends on the ability at least to prevent any further increase in State activities, for they are the determining factor in the amount of State expenditures. This is a most favourable time to prevent such an increase for no time could be more favourable than a period of general economic growth such as we are now enjoying; it makes it possible for us to reduce the State's share of the total, not through a once and for all cut in State expenditures, which would be extremely difficult but by a gentle diminution of its proportionate share, a method which would not involve any extraordinary

sacrifices on the part of the general public. When can the problem ever be resolved if not now, when a general economic expansion can be used to reduce the tumour simply be means of moderation and wise caution?

#### THE CENTRAL BANK UNDER STRAIN

Perhaps all these points we have considered make clearer what is meant by saying that the inflationary process of today is so complicated, and evolves in such special circumstances, that the Central Bank simply does not have the means to control it effectively. We now see that this must be properly understood. It does not mean that if the Central Bank is properly armed with all the modern instruments of monetary policy--which is not always the case (take, for example, a country like Switzerland)--and does not have to rely solely on the weapon of discount policy, which is nowadays less effective than it was, it cannot deal with the pressure of demand, in whatever way it arises, through a correspondingly severe policy of restrictions. Quite on the contrary, the Central Bank can act today as it used to in the past. Nevertheless, we have to face the question, which is becoming increasingly grave, whether the Central Bank, labouring under an inflationary pressure which springs from so many sources, does not have to deal with phenomena which are essentially political and social in their nature, and which it is totally unequipped to handle. Are we not asking a little too much from it? Wage inflation, investment inflation, the impulses towards inflation created by the budget, and now as in Germany, "imported inflation"--all this the Central Bank would have to correct by a still greater tightening of the credit screw. That is what the theory demands, and we also must ask the Central Bank to do whatever it can; but who can say whether what is possible is the same thing as what is necessary?

#### WEAKENED FIGHTING SPIRIT

It is obvious that the approach in the struggle against inflation must be just as broad-based as its causes; the heavy artillery of the Central Bank must retain its position in the centre and use its heaviest firing power. This necessary broadening of the front means, that the struggle will be not only a long drawn out one and subject to endless ups and downs, but

that it will have to be fought in depth as well. Any hope of some kind of "co-existence" based on index calculations is just as much an illusion as similar hopes in the field of world politics. Fundamentally, what is important is the morale of the troops which have to fight inflation; and the fact that this morale is none too good today gives all the more weight to the argument that modern inflation is essentially an ethical and social problem. That is precisely why no easy, quick and simple solution can be found, least of all a solution based simply on the techniques of money and credit policy.

#### WANT OF MODERATION AND PATIENCE

We can see the problem in its true perspective when we come to realize that inflation is the way in which a national economy reacts to a continuous overstraining of its capacity, to demands which are extravagant and insistent, to a tendency towards excess in every sphere and all circles, to presumptuous overconfidence in oneself, to a frivolous attempt always to draw bigger cheques on the national economy than it can honour and to a perverse desire to combine what is incompatible. People want to invest more than savings permit; they demand wages higher than the growth of productivity justifies; they want more imports than exports can earn; and above all, the government, which should know better, raises its claims on this overstretched economy higher and higher. Thus, there is a riot of claims and an insufficiency of goods produced to meet them. Just as there are organs in the human body, in which, if consistently abused, ailments slowly but surely accumulate, eventually taking their revenge, so the national economy has its own equally sensitive organ. That organ is money. It becomes feeble and ceases to resist, and it is this enfeeblement which we call inflation, a dilation of money so to speak, a managerial disease of the national economy.

#### DECAY OF LEGALITY

We may thank heaven that there are brakes and counterforces. One of the most efficacious is that a country which is too frivolous in its lack of discipline in the monetary field is soon brought face-to-face with the immediate consequences in the form of a balance of payments deficit and a lack of foreign

exchange reserves. The smaller a country is, the greater its dependence on external trade, and the more care is taken not to absolve it from its responsibility for monetary discipline, the more effective the brake will be. After the credit mechanism of the European Payments Union had already done much to impair the efficacy of that brake, the Common Market Agreement, as it is at present formulated, threatens still further to weaken its functioning in Europe.

But even all these considerations do not serve to carry us to the ultimate roots of the inflationary process. We do not discover them until we recognize that inflation, and the spirit which nourishes it and accepts it, is merely the monetary aspect of the general decay of law and a decline of respect for law. It requires no special astuteness to realise that the vanishing respect for private property is very intimately related to the numbing of respect for the integrity of money and its value. In fact, laxity about private property and laxity about money are very closely bound up together; in both cases what is firm, durable, earned, secured and designed for continuity gives place to what is fragile, fugitive, fleeting, unsure and ephemeral. And that is not the kind of foundation on which free society can long remain standing.