

# Study Guide to *Human Action* by Robert P. Murphy

## Chapter XXXV. The Welfare Principle Versus the Market Principle

### Chapter Summary

#### 1. The Case Against the Market Economy

Even critics of the market economy must admit that it works satisfactorily day in and day out, and indeed increases standards of living for everyone over time. Now the fashionable critique of the market is that it aims for profit, in contrast to "welfare." Broadly defined, no one objects to the welfare of others, but the term becomes vacuous; both liberals and Nazis can claim their programs aim to achieve as much happiness as possible. In the end, the modern welfare economists' critique of the pure market economy centers on three of its alleged characteristics: poverty, inequality, and insecurity.

#### 2. Poverty

Many utopian writers envision a society where everyone owns a piece of soil large enough to provide for himself. The problem with such an arrangement is that it cannot last; population growth ensures that heirs receive ever smaller portions of land, or that society becomes divided into the landowners and a growing population of disinherited paupers. In the ages before the rise of modern capitalism, it was precisely these "excess" workers whom the statesmen and philosophers meant by "the poor." There was truly no place for these people in the social structure of the day.

This all changed with the rise of laissez-faire capitalism and the industrialization it fostered. Now the destitute beggars could work in factories and support themselves. In modern times, the mass poverty that persists in certain countries is due, first, to their relatively low capital per capita, but ultimately to their failure to embrace capitalism. Even the laborers of the West live as aristocrats compared to the average person elsewhere in the world.

Even under capitalism, there are invalids who cannot sustain themselves. Ironically, the very success of capitalism has allowed people to survive (in need of care from others) who would have perished in earlier ages. The funds to provide for such people have historically come from governments, but also from private charities, often organized through religious organizations.

Charity is criticized for its inadequacy. Yet interventionism itself weakens private charitable efforts, through the creation of mass unemployment, destruction of savings through inflation, etc. Charity is also criticized for its demeaning effects on the recipients. Yet here the interventionist contradicts himself, for it is precisely the "businesslike," contractual dealings in the marketplace—devoid of the personal element—that he also loathes. The substitution of a legal "right" to sustenance removes the incentives for people to support themselves, and it is questionable whether dependence on the whims of bureaucrats is less degrading than dependence on the mercy of philanthropists.

### 3. Inequality

Inequality in incomes and wealth is an inherent feature of the market economy; to insist on equality would destroy the market. In practice, those calling for equality merely want to seize the incomes of those earning more than the reformers; American workers do not intend to share their incomes with the 95 percent of the world who earn less than they do.

Historically, some writers attacked the privileges of the traditional caste system because of a belief in natural rights and the metaphysical equality of all men. The utilitarians and economists also endorsed the equality of men before the law, but this was a pragmatic goal, necessary to allow the most able producers to best satisfy the wants of consumers. The economists understood that some men were far more capable than others, and this was precisely why the meritocracy of capitalism was necessary: to allow them to exercise their superior talents.

The explanation for the stagnation of the oriental and Muslim countries, despite their head start over Western Europe, is that the autocratic rulers of the former regions did not allow their subjects to amass large fortunes. They implemented the ideal of material equality, while the capitalist countries tolerated vast inequality in personal income and wealth.

The only path to rising standards of living is continual increases in the amount of capital per capita. Even though individuals may save only to "selfishly" provide for their future consumption (or for their heirs), even so they provide a service to all by increasing the supply of capital goods and hence raising the productivity of labor. Interventionism erodes or even completely reverses this tendency. Governments tax private wealth and substitute "social-security" provisions instead. Yet these do not consist in genuine savings, but merely in IOUs drawn on future taxpayers. The private citizen's abstinence from consumption does not expand the supply of capital goods, because it is (partially) siphoned away into government expenditures on consumption goods.

The complete absence of considerations of the supply of capital goods in their policy recommendations should disqualify the welfare economists from even being classified as economists at all.

### 4. Insecurity

In one sense, it is true that capitalism gives rise to the "insecurity" of income and wealth that its critics abhor. Yet this insecurity is not the fault of the capitalists, but rather of the consumers. The consumers each day seek those products and services that best satisfy their wants at the lowest prices. This is why successful producers are always at risk of failure: because each day they must outcompete their rivals anew.

The idyllic descriptions of earlier ages were false in this respect; no modern worker would trade places with a medieval farmer. And the insecurity of the Great Depression was caused by interventionism, not laissez-faire.

## 5. Social Justice

In one respect the modern welfare theorists are superior to older schools of reformers. The modern propagandists at least acknowledge that the only metric for a social system is their ability to allow men to achieve their ends.

Even so, once they begin their critique of the market economy, the modern welfare theorists smuggle in their prejudices and ultimately fall back on the vehicle of a superhuman dictator who can always achieve superior outcomes versus the market populated by mere mortals.

The market economy has allowed an unprecedented growth in population, coinciding with an unprecedented growth in living standards. The welfare schools' criticisms of modern society prove only that scarcity exists and that people would benefit from more consumption. These observations do not impugn capitalism, the system that can best conquer these "problems."

### Why It Matters

In this important chapter, Mises relies on the economic theory developed earlier in the book, in order to defend capitalism from the three recurring claims that provide the foundation for virtually all of its critiques: the existence of poverty, inequality, and economic insecurity under capitalism.

### Technical Notes

- (1) Mises writes, "If the Englishmen of the eighteenth century had been preoccupied with the chimera of income equality, laissez-faire philosophy would not have appealed to them, just as it does not appeal today to the Chinese or the Mohammedans. In this sense the historian must acknowledge that the ideological heritage of feudalism and the manorial system contributed to the rise of our modern civilization, however different it is" (p. 838). In the surrounding pages, Mises explains that the Chinese had enshrined the ideal of material equality far more than England. (Despite an autocrat, all of the subjects were equal under him.) Ironically, Mises is arguing that the gross inequality of feudalism allowed the Western peoples to tolerate its existence under modern capitalism, and thus benefit from this new social arrangement.
- (2) In an interesting footnote (fn 5, p. 842) Mises writes, "To establish this fact"—namely, that the maintenance of the capital structure requires abstinence from current consumption—"is, to be sure, not an endorsement of the theories which tried to describe interest as the 'reward' of abstinence. There is in the world of reality no mythical agency that rewards or punishes." Here Mises is criticizing the so-called abstinence theory of interest, which explained the phenomenon of interest as a reward to the painful postponement of consumption on the part of savers. Böhm-Bawerk too gave a lengthy critique of this theory. Of course, both Böhm-Bawerk and Mises thought the true explanation of interest was the higher subjective valuation of present versus future goods.

- (3) Mises cleverly explodes the glib defense of government debt that claims, "We owe it to ourselves." As Mises points out (pp. 843–844), the taxpayers who must fund government obligations are not the same ones who enjoy its spending.

## Study Questions

### 1. The Case Against the Market Economy

Comment: "A principle that is broad enough to cover all doctrines, however conflicting with one another, is of no use at all."

### 2. Poverty

- What system is Mises describing with this quote: "The inherent weakness of such a society is that the increase in population must result in progressive poverty."
- What distinguishes the West from Asia with regard to the capital invested per person? What are the consequences of the lack of capital invested?
- Why is it false to blame the European powers for the poverty of the masses in the colonial countries?

Comment: "Within the frame of capitalism the notion of poverty refers only to those people who are unable to take care of themselves."

- Under capitalism, who cares for those who are handicapped by bodily incapacity?
- What are the two main alleged defects of charity?
- Which incentives are eliminated by the social-security system?

### 3. Inequality

- Why would the elimination of the inequality of incomes and wealth destroy the market economy?

Comment: "The most despotic system of government that history has ever known, Bolshevism, parades as the very incarnation of the principle of equality and liberty of all men."

- Why has the principle of equality under the law been chosen by the liberals?
- What is wrong with the argument that the public debt is no burden because "we owe it ourselves"?

Comment: "Spending and unbalanced budgets are merely synonyms for capital consumption."

#### **4. Insecurity**

Comment: "A characteristic feature of the unhampered market is that it is no respecter of vested interests."

- What is the explanation of the events of 1929, according to Mises? Why is this date important with regard to the question of security?

#### **5. Social Justice**

Comment: "Their last word is always state, government, society, or other cleverly designed synonyms for the superhuman dictator."

- Why doesn't the market economy need apologists and propagandists?