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Historical Capitalism vs. the Free Market

by Richard Ebeling

During the dark days of Nazi collectivism in Europe, the German economist Wilhelm Röpke used the haven of neutral Switzerland for continuing to write and lecture on the moral and economic principles of the free society. “Collectivism,” he warned, was “the fundamental and moral danger of the West.” The triumph of collectivism meant “nothing less than political and economic tyranny, regimentation, centralization of every department of life, the destruction of personality, totalitarianism and the rigid mechanization of human society.”

If the Western world was to be saved, Röpke said, it would require a “renaissance of [classical] Liberalism” springing “from an elementary longing for freedom and for the resuscitation of human individuality.” At the same time, such a renaissance was inseparable from the establishing of a capitalist economy. But what is capitalism? “Now here at once we are faced with a difficulty,” Röpke lamented, because “capitalism contains so many ambiguities that it is becoming ever less adapted for an honest spiritual currency.”

As a solution, Röpke suggested that we “make a sharp distinction between the principle of a market economy as such... and the actual development which during the nineteenth and twentieth centuries has led to the historical foundation of market economy... If the word ‘Capitalism’ is to be used at all this should be with due reserve and then at most only to designate this historical form of market economy... Only in this way we are safe from the danger... of making the principle of the market economy responsible for things which are to be attributed to the whole historical combination... of economic, social, legal, moral and cultural elements... in which it (capitalism) appeared in the nineteenth century.”

Röpke’s distinction between the principle of a capitalist or market economy and the historical forms in which capitalism has manifested itself in various times is as important now in the post-Soviet socialist era of the 1990s as when he presented his argument during the zenith of Nazi socialism in the 1940s.

In the face of the collapse of communism as an ideology and as a practical economic system, the market economy is being hailed by some and reluctantly conceded by others to be the only decent and viable economic order. The Eastern European countries declare

their desire to construct capitalist economics on the ruins of their socialist past. In increasing parts of Asia and South America, liberalized markets and privatization of state enterprises are said to be among the goals of governmental policy. And in both Western Europe and the United States, all the major political parties insist that they are “pro-market” for purposes of generating economic growth, increased employment and technological innovations.

Capitalism stands triumphant. But what is “capitalism”? The fact is that the market economy has evolved both in Europe and the United States during the last two hundred years in the historical context of the following: conflicting cultures and world views, contradictory political philosophies, special-interest intrigues in the face of economic and institutional changes, and ideological wars both on and off the battlefields of the world.

As a consequence, even before all of the implications and requirements for a free-market economy could be fully appreciated and implemented in the 19th century, it was being opposed and subverted by the residues of feudal privilege and mercantilist ideology. And even as the proponents of the market economy were proclaiming their victory over oppressive and intrusive government in the middle of the 19th century, new forces of collectivist reaction were arising in the form of socialism and communism. Three ideas in particular undermined the principle of the market economy, and, as a result, historical capitalism has contained within it the seeds of its own destruction.

1. The Idea of the National Interest and the Rationale for “Public Policy.” In the 17th and 18th centuries, the emergence of the nation-state in Western Europe produced the idea of a “national interest” superior to the interests of the individual subject and to which he was subservient. The purpose of public policy was to define what served the interests of the state and to confine and direct the actions of individuals into those channels and forms that served this national interest.

In spite of the demise of the divine right of kings and the rise of rights of man, and in spite of the refutation of mercantilism by the free-trade economists of the late 18th and 19th centuries, democratic governments continued to retain the notion of a national interest. But instead of being defined as serving the interests of the king, it was now postulated as serving “the people” of the nation as a whole. In the 20th century, public policy came to be assigned the tasks of guaranteeing full employment, generating economic growth, and directing investment and resources into those activities considered to foster the economic development considered most advantageous to “the nation.”

Capitalism, therefore, has come to be viewed as compatible with and indeed even requiring activist government: a government that manipulates investment patterns through fiscal policy, regulates production, supervises competition through licensing and antitrust laws, stimulates exports by use of subsidies, and controls the purchase of imports with tariffs

and quotas. The interventionist state, in the evolution of historical capitalism, has come to be considered the prerequisite for the maintenance of the market economy.

2. *Monetary Central Planning and the Rationale of Central Banking.* Whether in Europe or the United States, the application and practice of the principles of the market economy were subverted from the start with the existence of monetary central planning in the form of central banking. First seen as a device for assuring a steady flow of cheap money to finance the operations of government in excess of what those governments could extract from their subjects directly through taxation, monopolistic central banks were soon rationalized as the essential monetary institutions for economic stability. But as the German economist Gustav Stolper clearly explained in 1942 in his book, *This Age of Fable*,

“Hardly ever do the advocates of free capitalism realize how utterly their ideal was frustrated at the moment the state assumed control of the monetary system... A ‘fire’ capitalism with governmental responsibility for money and credit has lost its innocence. From that point on it is no longer a matter of principle but one of expediency how far one wishes or permits government interference to go. Money control is the supreme and most comprehensive of all governmental controls short of expropriation.”

Once government controls the supply of money, it has the capacity to redistribute wealth; create inflations and cause industrial depressions; distort the structure of relative prices; generate misallocations of labor and capital throughout the economy; rationalize new governmental interventions in the face of the market “instability” that has actually been caused by the state’s mismanagement of the money supply; manipulate the patterns of and the profits from international trade; and confiscate the income and wealth of millions through the hidden tax of rising prices arising from inflation.

3. *The “Cruelty” of Capitalism and the Rationale for the Welfare State.* The privileged classes of pre-capitalist society hated the market. The individual was freed from subservience and obedience to the nobility, the aristocracy, and the landed interests. And for these privileged groups, the market meant loss of cheap labor, the disappearance of “proper respect” from their inferiors, and the economic uncertainty of changing market-generated circumstances. And for the socialists of the 19th century, capitalism was seen as the source of exploitation and economic insecurity for “the working class,” who were dependent for their livelihood upon the apparent whims of the “capitalist class.”

The welfare state became the solution to capitalism’s supposed cruelty, a solution that

created a vast and bloated welfare bureaucracy, made millions perpetual wards of a paternalistic state and drained society of the idea that freedom meant self-responsibility and mutual help through voluntary association.

The ideal and the principle of the market economy was never fulfilled. What is called capitalism today is a distorted, twisted and deformed system of increasingly limited market relationships as well as market processes hampered and repressed by state controls and regulations. And overlaying this entire system are the ideologies of 18th-century mercantilism, 19th-century socialism, and 20th-century welfare statism.

In this perverse development and evolution of “historical capitalism,” the institutions necessary for a truly free-market economy have been either undermined or prevented from emerging. And the principles and actual meaning of a free-market economy have become increasingly misunderstood and lost. But it is the principles and the meaning of a free-market economy that must be rediscovered if liberty is to be saved and the burden of historical capitalism is to be overcome.

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