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EUROPE'S ECONOMIC STRUCTURE AND THE PROBLEM
OF POST-WAR RECONSTRUCTION

by

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It is customary in this country to call the free enterprise system the American system. This appellation is appropriate insofar as the marvelous achievements of America are an accomplishment of its economic freedom and capitalist individualism. But it would be a serious blunder to interpret this term in such a way as to underrate the feats of European capitalism.

It is quite right to call Europe an old country and America a young or new country. However, Europe's economic system as it existed on the eve of the present war was no less an achievement of 19th century liberalism, individualism, and capitalism than the economy of this country. We must not fall prey to what may be called the sightseer's fallacy. The average tourist admires in Europe the medieval cathedrals and castles and very often neglects to see the modern plants. For instance, in Nurnberg he visits the city of Meistersinger with its old churches and with its famous museum. He mostly does not go beyond the walls that enclose this narrow region and separate it from what is one of the most important centers of German manufacturing.

On the eve of the industrial revolution, Europe was already long since completely colonized. There were no empty spaces of virgin soil left. Every spot was used to the extent possible under the then prevailing methods of exploitation. But there were neither highways nor canals; primitive roads, furrowed by the wheels of carts, were the only facilities of transportation. The dwellings of the burghers and peasants were, from the point of view of our standards, hardly better than slums. The palaces of the aristocracy lacked all that equipment which no American of modest means would like to miss in his home. There were neither factories nor machines. All these things came later only as an achievement of the industrial era.

But European capitalism had not only to provide for the needs of the very dense population which already peopled the countries at the end of the 18th century. It had, moreover, to make provisions for an unprecedented increase in their numbers. In the period from 1800 to 1925 the population of the four main European nations--outside of Russia--that is, Great Britain, France, Germany, and Italy, increased by 107 millions. In the same period the population of this country increased by 109 millions. This means: these four old completely colonized European countries with a total area considerably smaller than that of the five largest states of the Union had to provide the means of subsistence for an additional population of almost the same magnitude as the United States.

While America had millions of square miles of practically empty land at its disposal, these European nations were under the necessity of cramming the increment into the narrow space of already overpopulated areas.

Europe outside of Russia has a population of about 400 millions, that is, three times the population of the continental United States. But Europe's soil is poor in natural resources. It does not produce any cotton, rubber, coffee, tea, copra, or jute. Its capacity to produce wool and many basic metals is insignificant. In 1937 the European production of crude petroleum was 55 million barrels, namely, 52 millions in Rumania and 4 millions in Poland. In the same year the United States produced 1,279 million barrels, 22 times more. Moreover, the outcome of the present war will give these European oil wells to Russia.

The predominantly industrial countries of Europe can neither feed nor clothe their citizens out of domestic resources. In order to acquire the badly needed foodstuffs and raw materials, they must export manufactures, most of which are produced out of imported raw materials. One of the main export industries of Europe, for instance, was the cotton goods industry. The raw material was imported primarily from this country, smaller quantities from Egypt and British India.

The vital strength of Europe was its export trade. The economic background of 19th century European civilization, which begot Pasteur and Darwin, Verdi and Wagner, Ampère and Freud was capitalism. The flowering of the nations was an achievement of free enterprise. It was surely not an outcome of government policies and the activities of politicians.

But capitalism in Western and Central Europe did even more than that. It provided the greater part of the capital needed for the development of the natural resources in the economically backward areas of Russia, Southeastern Europe, Asia, Africa, Australia, and Latin America. Almost all railroads outside of Europe were built by European capital. Even in this country the early history of railroad construction was to some extent a record of European investment.

In dealing with the specific economic problems of Europe, I want to disregard Russia, Sweden, Spain, and Portugal. The Soviet Empire is, properly speaking, not a part of Europe. It is the vastest empire history has ever seen. It covers one-sixth of the earth's surface. Its territory is much better endowed by nature than any other part of the world. It is very thinly populated. It is, in any economic regard, just the opposite of Europe. Sweden, too, is different from the rest of Europe. Its population is small and its natural resources, iron ore and lumber, are immense. Spain and Portugal have economic problems of their own. In a short lecture it would be impossible to deal adequately with these questions.

Now, in Europe proper there are two different zones: the predominantly industrial Western and Central area, and the predominantly agricultural South-East. The predominantly industrial part can live only by exporting manufactures. It must sell these products on the open world market in competition with products of countries in which the natural conditions for manufacturing are much more favorable. It must leap over trade barriers towering to the skies. It has only one means to compensate for the handicaps set by nature and foreign trade barriers: low wages and a low standard of living.

The predominantly agricultural section of the South-East entered the scene of the world market in the second part of the 19th century, when the railroads gave them the opportunity for shipping their excess production to Western and Central Europe. With the intensification of the competition of overseas countries the conditions for Southeastern Europe became worse and worse. Its soil is fertile when measured with West European standards; it is poor when compared with the fields of Canada and other countries. Here, too, the only way out is low wages and a low standard of living.

Foreign observers sometimes make the mistake of blaming European enterprises for an alleged economic backwardness. But what they call backwardness is precisely the adjustment of technical methods to unfavorable conditions beyond the control of business. Natural resources are poorer and capital is more scarce than in this country; on the other hand, there is plenty of labor available. In such a state of affairs, many mechanical devices which can be profitably used in this country would not pay in European manufacturing. European farming does not use some of the machines known in this country, but it employs more fertilizers. Its average yield per acre is, in spite of the comparative poverty of the soil, greater than outside of Europe. The large estates in Germany, Czechoslovakia, and Hungary were certainly not less skilfully operated than any other agricultural outfit on the earth.

The capital consumption caused by the war is enormous. Homesteads and plants have been destroyed. Industrial equipment worn out by the intensified production has not been properly replaced. But even worse is the fact that the spirit of free enterprise has vanished. The governments and political parties are firmly resolved not to go back to the system to which Europe owed its well-being in the past. They are committed to the ideas of totalitarian economic management. They are fascinated by the alleged success of German and Russian planning.

What these planners fail to realize is that Russia can, by and large, live in economic self sufficiency. Those imports which the Russian authorities do not want to miss can be bought by the exportation of gold mined in Russia and of some other raw materials. The Soviets are not faced with the problems of manufacturing for the world market.

But the Germans must face these problems. The German pattern of socialist management was precisely adopted for the purpose of not impairing the vital nerve of Germany's economy, export of manufactures. It failed utterly. In 1932, the deepest point of the depression, German exports were 5,700 million marks; in 1938 they were only 5,300 million marks. Taking the figures of 1930 as 100, the index of foreign trade in 1937 was 72 for Germany, but 97 for this country and 101 for Great Britain. Even these figures understate the decline of Germany's foreign trade, for they are based on the artificial rate of the mark and on the high prices at which Germany traded with the clearing countries. Besides, we must take into account that Germany paid enormous export subsidies, amounting to 1,500 million marks in 1938.

Disregarding both sound theories and experience, Great Britain's rulers believe that the only way to solve the nation's post-war problems is full government control. In the three years preceding the outbreak of the present war, Great Britain paid for only 58% of its imports by exporting merchandise. The rest was mainly paid by the net national income from shipping and from overseas investments. After the war, these two sources will bring much less than they used to bring before the war. If Great Britain is to preserve its prewar standard of imports of food and raw materials it must increase the volume of its exports of merchandise by half or two-thirds.

Deluded by the fallacies of socialist doctrines, British public opinion considers this fact as a sufficient justification for the abandonment of the free enterprise system. No attempt was ever made to prove the thesis that a government-controlled industry would produce more cheaply or better than private entrepreneurs. No unbiased man would dare to assert that government agencies are better fitted than merchants to adjust production to the needs of consumers in various overseas countries, to overcome the handicap of trade barriers and to meet successfully the competition of other exporting nations.

A reconstruction of the United Kingdom's badly battered industrial equipment can hardly be effected without the aid of American credits. It is unlikely that enterprises, subject to government control and at every turn obstructed by bureaucratic regimentation, will inspire more confidence in American investors and bankers than entrepreneurs who are free to go their own way.

The truth is that what the British really have in mind is to balance foreign trade not by an expansion of exports but by a restriction of imports. This would be tantamount to a resumption and intensification of the unfortunate economic warfare that was the characteristic feature of the interwar period and one of the main causes of distress and political conflict. It would not only lower the standard of living of the British masses. It would also bring disaster to all other nations, and frustrate all endeavors to safeguard durable peace.

The plans of the French government are no less contrary to purpose than those of the British. The French want to divide their industries into three groups. Each group will be subject to a different treatment. The first section, comprising mining, public utilities, and some essential processing industries, is to be expropriated and directly operated by bureaucrats. The second section will seemingly remain in the hands of business, but will be completely controlled by the government, according to the Nazi methods. Only the third section, consisting of the enterprises manufacturing consumers' goods for export, is to be left free. Of course, the French realize very well that it would be simply idiotic to deliver the Paris haute couture, the parfumerie, and the production of champagne and brandy to bureaucratic management. However, they are mistaken in the expectation that these and other famous French export industries could thrive within an environment of government controlled business. The inefficiency of the controlled sections will impose a heavy burden upon the free section. The whole incidence of taxation will fall upon the export industries and suffocate them.

All the smaller nations of Europe want in some way or other to copy the British and French plans. They all aim at foreign exchange control. One must not forget the fact that the smaller a country the greater comparatively is its foreign trade. If a New York businessman sells something to a place 3,000 miles away, or buys something from such a place, it can still be domestic trade. But if a man in Zürich or Copenhagen buys or sells something over a distance of 200 miles it always means foreign trade. In a small country foreign exchange control practically subjects all enterprises to government control. And all these nations are firmly resolved to utilize foreign exchange control for the most rigid restriction of imports.

While Europe can flourish only under a system of international division of labor, the Europeans have espoused a hyper-perfectionist policy hostile to any kind of imports. While exporting manufactures is only possible under a free enterprise system, Europe is opposed to any kind of profit-seeking business. They abhor as orthodox and reactionary that system which in the past made Europe prosperous, and advocate enthusiastically the methods which failed everywhere they have been tried.

A few remarks more are needed in order to discuss some special plans regarding those countries whose leaders expect to enter into a close economic and political cooperation with Russia. Left-wing politicians of Poland, Czechoslovakia, and Austria hope that such a cooperation can open for their industries the Russian market. They would provide Russia with manufactures, and Russia would provide them with food and raw materials. Let us, for the sake of argument, assume that such plans could be realized. But at any rate it would be unrealistic to expect that the Soviets would be prepared to pay for the manufactures of their vassals prices which would secure for the wage-earners of these nations a standard of living higher than that of the Russian masses. If the Russians were in a

position to pay world market prices for imported manufactures, they could as well increase their buying in America or anywhere else. The only advantage which the Soviets could find in such a kind of bilateral exchange would consist in the cheapness of the products. The standard of living was very low indeed in the three above mentioned countries when compared with West European standards, to say nothing of American standards. But even in the years of the great depression it was much higher than that of the Russian peasants and workers.

American common sense is quite correct in blaming European disunity. It is simply craziness that the various European nations, many of them inferior in size, population figures and economic power to the greater part of the American states, are anxious to fight one another by all devices of economic nationalism. But a European customs union would not solve Europe's economic problem if not supplemented by economic freedom. The economies of the various European countries do not complement each other. Europe as a whole depends upon the importation of food and raw materials from other parts of the world, and must consequently export manufactures.

It is a sad fact that Europe has lost the advantages which a hundred and fifty years of economic freedom have secured for it. A great part of the capital accumulated in previous years has been squandered. Saving and capital accumulation must start anew. The scarcity of capital has necessarily lowered the marginal productivity of labor. For a period of transition, wage rates and standards of living must necessarily be lower than they were in the years preceding the wars. No government tampering with industrial relations and no labor union pressure and compulsion can alter this fact. On the contrary. The more government or union interference delays the accumulation of new capital, the more it protracts the period of transition and the return to prosperity. There is no other recipe than this: produce more and better and save more and more. Privations cannot be spared. The nations must suffer for the deficiencies of their policies. It would be wrong to blame the economists who establish this truth with seeming callousness. The economists have done all they could do when for more than eighty years they warned the nations.

There is but one way toward a steady rise in the general standard of living: the progressive accumulation of capital and the improvement of methods of production which this additional capital renders feasible. However, the countries of continental Europe were committed to policies which not only checked the further accumulation of capital, but even resulted in the consumption and erosion of capital accumulated in earlier times. The main vehicle of these policies was credit expansion. It is true that credit expansion creates a boom at first. But the artificial prosperity of the easy money orgy of a few years must needs lead to slump and depression. Credit expansion is very popular with politicians who do not worry about tomorrow. But conscientious statesmen must not espouse short-run policies. Only a long-run policy is sound.

Of course, there are pseudo-economists preaching the gospel of short-run policies. "In the long run we are all dead," says Lord Keynes. But it all depends upon how long the short run will last. The classical formulation of the short-run principle was provided by the Marquise de Pompadour: "Après nous le déluge." The lady was fortunate enough to die in the short run. But her successor, Madame Du Barry, outlived the short run and was beheaded in the long run. Europe has now entered the stage in which it experiences the long-run consequences of its short-run policies. The short-sighted politicians bump their heads against the walls, the reality of which they stubbornly try to deny.

Europe's distress is also a calamity for all other parts of the world. It makes illusory the plans for America's post-war recovery to the extent that they are based on the expectation of a full revival of international trade. If Europe does not recover soon, it will not be able to buy sufficient quantities of American products. Even complete free trade in this country will not revive international trade if the European nations do not abandon their anti-import policies.

There is much talk about American credits for the reconstruction of Europe. But credits are sound only if the debtor makes the proper use of the money borrowed. Credits are neither charity nor lend-lease; they mean business. There must be a reasonable chance that the debtor will employ the amount credited for an improvement of his conditions, and accordingly will be able to pay interest and principal. Credits granted to foreign governments for the continuation of inappropriate economic policies harm both the creditor and the debtor. It would be very unfortunate indeed if American credits were accorded to governments which will waste them in the pursuit of illusory policies.

It is not true that a country needs foreign credits for the stabilization of its foreign exchange rate. If there is neither inflation nor credit expansion, such credits are superfluous. But if a country takes recourse to what is called today euphemistically an expansionist policy, no credit can prevent a devaluation of its currency. Credits are needed for the acquisition of industrial and agricultural equipment which can raise the productivity of labor. But they are useless if employed for the continuation of deficit spending.

Yet, people are right in saying that post-war reconstruction in all parts of the world depends entirely upon America. But America must give something much more essential than credit; it must provide an ideology. It must revive the idea of economic freedom, private initiative, and individual enterprise. After the war this nation will enjoy all over the world an unprecedented moral prestige. If America stands for economic freedom, no country will be in a position to withdraw from this influence. The great ideological conflict between totalitarianism and individualism will be decided in this country, and all other peoples will follow the example set by America.

America is indebted to Europe for many things. From Europe came its citizens, its civilization, and its religious and moral principles. But it will discharge this debt with compound interest if it gives Europe anew the political and economic ideas which in the past have produced in Europe and America the highest human civilization hitherto known. The freedom mankind needs most in our day is freedom from utopian superstitions. What is ranked above all for economic and political reconstruction is a radical change of ideologies. Economic prosperity is not so much a material problem; it is first of all an intellectual, spiritual, and moral problem.