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The Myths of “Libertarian” economics

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What determines price within capitalism?

Both “libertarian” and “anarcho” capitalists support the subjectivist theory of value (STV), as explained by the Austrian School of economics. Economists from this school included Ludwig Von Mises, Frederick Hayek and Murray Rothbard.

In a nutshell, the subjective theory of value states that the price of a commodity is determined by its marginal utility to the consumer. This is the point, on an individual’s scale of satisfaction, at which the desire of a good is satisfied. Hence price is the result of individual, subjective evaluations within the market place. For anyone interested in individual freedom, the appeal of this can easily be seen.

However, the subjective theory of value is a myth. Like most myths, it does has an element of truth within it, but as an explanation of the price of a commodity it has serious flaws.

The element of truth which the theory contains is that, indeed, individuals, groups, companies, etc do value goods and consume them. This consumption is based on the use-value of goods to the users (although this is modified by price and income considerations). The use-value of a good is a highly subjective evaluation and so varies from case to case, depending on the individual’s taste and needs. As such it has an *effect* on the price, as we will see. But as the means to *determine* a product’s price it ignores the reality of production under capitalism.

The first problem within marginal utility is that it leads to circular reasoning. Prices are supposed to measure the “marginal utility” of the commodity. However, prices are required by the consumer in order to make the evaluations on how best to maximise their satisfaction. Hence subjective value “obviously rested on circular reasoning. Although it tries to explain prices, prices were necessary to explain marginal utility” [Paul Mattick, Economics, Politics and the Age of Inflation, p.58]

In addition, it ignores the differences in purchasing power between individuals and assumes the legal fiction that corporations are individual persons. If, as many Libertarians say, capitalism is “one dollar, one vote” its obvious whose values are going to be reflected in the market.

So, if the subjectivist theory of value is flawed, what does determine prices? Obviously, in the short term, prices are heavily influenced by supply and demand. If demand exceeds supply, the price rises and vice versa. This truism, however, does not answer the question. The key to understanding prices lies understanding the nature of capitalism, profit production.

Capitalism is based on production of profit. Once this and its implications are understood, the determination of price is simple. The price of a capitalist commodity will tend towards its production price in a free market, production price being cost price plus average profit rates.

Consumers, when shopping, are confronted by given prices and a given supply. The price determines the demand, based on the use-value of the product to the consumer and their money situation. If supply exceeds demand, supply is reduced until average profit rates are generated. If the given price generates above average profits, then capital will move from profit-poor areas into this profit-rich area, increasing supply and competition and so reducing the price until average profits are again produced. If the price results in demand exceeding supply, this causes a short term price increase and these extra profits indicate to other capitalists to move to this market. The supply of the commodity will stabilise at whatever level is demanded at this price which produces average profit rates. Any change from this level in the long term depends on changes on the production price of the good (lower production prices means higher profits and so indicates that the market could be profitable for new investment from other capitalists).

Thus production price determines the price of a commodity, not supply and demand, in the long term. In fact, price determines demand as consumers face prices as (usually) an already given objective value when they shop and make decisions based on these prices. The production price for a commodity is a given and so only profit levels indicate whether a given product is "valued" enough by consumers to warrant increased production. This means that "capital moves from relatively stagnating into rapidly developing industries . . . The extra profit, in excess of the average profit, won at a given price level disappears again, however, with the influx of capital from profit-poor into profit-rich industries" so increasing supply and reducing prices, and so profits. [Paul Mattick, Economic Crisis and Crisis Theory, p.49]

As can be seen, this theory (the labour theory of value) does not deny that consumers subjectivity evaluate goods and that this can have a short term effect on price (which determines supply and demand). However, it explains why a certain commodity sells at a certain price and not another, something which the subjective theory cannot do. It develops its ideas from a consideration of reality (namely prices exist before subjective evaluations can take place and the nature of capitalist production).

In the end, the STV just states that "prices are determined marginal utility; marginal utility is measured by prices. Prices . . . are nothing more or less than prices. Marginalists, having begun their search in the field of subjectivity, proceeded to walk in circle". [Allan Engler, Apostle's of Greed, page 27]

In reality, the price of a capitalist commodity is, in the long term, equal to its production price, which in turn determines supply and demand. If demand changes, which it of course can and does as consumer values change, this will have a short term effect on prices but the average production price is the price around which a capitalist commodity sells for.

Where do profits come from?

As can be seen, profits are the driving force of capitalism. If a profit cannot be made, a good is not produced, regardless of how many people "subjectively value" it. But where do profits come from?

In order to make more money, money must be transformed into capital, ie work places, machinery and other "capital goods". However, by itself, capital (like money) produces nothing. Capital only becomes productive in the labour process, when workers use capital. Under capitalism, labour not only creates sufficient value (ie produced commodities) to maintain existing capital and themselves, it also produces a surplus. The surplus expresses itself as a surplus of goods, ie an excess of commodities. The price of all produced goods is greater than the money value represented by the workers wages when they were produced. The labour contained in these "surplus-products" is the source of profit, which has to be realised on the market (in practice, of course, the value represented by these surplus-products is distributed throughout all the commodities produced in the form of profit — the difference between the cost price and the market price).

This surplus is then used by the owners of capital for (a) investment, (b) to pay themselves dividends on their stock, if any, and (c) to pay their wage-slave drivers (i.e. executives and managers, who are sometimes identical with owners) much higher salaries than workers. The surplus, like the labour used to reproduce existing capital, is embodied in the finished commodity and is realised once it is sold. This means that workers do not receive the full value of their labour, since the surplus appropriated by owners for investment, etc., represents value added by labour; hence capitalism is based on exploitation. It is this appropriation of wealth from the worker by the owner which differentiates capitalism from the simple commodity production of artisan and peasant economies.

It is the nature of capitalism for this monopolisation of the worker's product by others to exist. It is enshrined in "property rights" enforced by either public or private states. A workers wage will always be less than the wealth he or she produces. This unpaid labour is the source of profits, which are used to increase capital, which in turn is used to increase profits.

At any given time, there is a given amount of unpaid labour in circulation (ie available profits). This is either in the form of unpaid goods or services. Each company tries to maximise its share of the available total and if a company does realise an above average share it means that some other companies recieve less than average. The larger the company, the more likely that it will recieve a larger share of the available surplus. The reasons for this will be highlighted later, in the section on why the market becomes dominated by big business. The important

thing to note here is that there is, at any given time, a given surplus of unpaid labour (ie the available pool of profits) and that companies compete to realise their share of it on the market. However, the *source* of these profits do not lie in market, but in production. You cannot buy what does not exist.

As indicated above, production prices determine market prices. In any company, wages determine a large percentage of the costs. Looking at other costs (such as raw materials), again wages play a large role in determining their price. Obviously the division of a commodity's price into costs and profits is not fixed, which mean that prices are the result of a complex interaction of wage levels and productivity. The class struggle determines, within the limits of a given situation, the degree of exploitation within a workplace and industry and so the relative amount of money which goes to labour (ie wages) and the company (profits). Therefore an increase in wages may not drive up prices as it may reduce profits or be tied to productivity, but this will have more widespread effects as capital will move to other industries and countries in order to improve profit rates, if this is required. Usually wage increases lag behind productivity, (for example, during Thatcher's reign of freer markets, productivity rose by 4.2%, 1.4% higher than the increase in real earnings between 1980–88. Under Reagan, productivity increased by 3.3%, accompanied by a fall of 0.8% in real earnings. Remember, though, these are averages and ignore often the massive differences in wages between employees, eg the CEO of McDonalds and one of its cleaners).

The effects of increased capital investment is discussed below.

Why does the market become dominated by big business?

The "free" market becomes dominated by a few firms, which results in oligarchic competition and higher profits for the companies in question. This is due to the ability to enter the market being reduced, as only other established firms can afford the large capital investments needed to compete. For people with little or no capital, entering competition is limited to new markets, with low capital costs. Sadly, however, due to competition, these markets become dominated by a few big firms as some fail and capital costs increase. "Each time capital completes its cycle, the individual grows smaller in proportion to it" [Josephine Guerts, Anarchy 41, page 48]

Therefore, due to the nature of the market, certain firms receive a bigger share of the available surplus value in the economy due to their size. However, "it should not be concluded that oligopolies can set prices as high as they like. If

prices are set too high, dominant firms from other industries would be tempted to move in and gain a share of the exceptional returns. Small producers — using more expensive materials or out-dated technologies — would be able to increase their share of the market and make the competitive rate of profit or better." [Elgar, op. cit., page 53]

This form of competition results in big business having an unfair slice of available profits, leading many small businessmen and member of the middle-class to hate them (while trying to replace them!) and embracing idealogies which promise to wipe them out. Hence we see that both idealogies of the "radical" middle-class, libertarianism and fascism, attack big business (either as "the socialism of big business" of "Libertarianism" or the "International Plutocracy" of fascism).

However, the tendency of markets to become dominated by a few big firms is an obvious side effect of capitalism. In their drive to expand (which they must do in order to survive) capitalists invest in new machinery in order to reduce production costs (and so increase profits). This increases the productivity of labour, so allowing wages to be also increased (but not by the same amount). With the increasing ratio of capital to worker, the costs in starting a rival firm prohibit all but other large firms from so doing.

This would be the case under "anarcho" capitalism, with the other obvious result that the market for private "defense" firms would also soon be run by a few large companies, which however no one would be allowed to call a "state" without being fired even though that's what it would be.

What causes the capitalist business cycle?

Increased capital results in the individual worker being reduced to a small cog in a big wheel. As indicated in section b.3 (Is capitalism based on freedom?) increased capital investment results in increased control of the worker by capital *plus* the transformation of the individual into "the mass worker" who can be fired and replaced with little or no hassle.

But where there is oppression, there is resistance; where there is authority, there is the will to freedom. This means that capitalism is marked by a continuous struggle between worker and boss at the point of production. It is this struggle that determines wages, and so the prices of commodities on the market.

The common "Libertarian" myth which flows from the STV is that free market capitalism will result in continuous boom as it is state control of credit and money which is the problem. Let us assume, for a moment, that this is the case (it is, in fact, not the case as will be highlighted). In the "boom economy" of Libertarian dreams, there will be full employment. But in periods of full employment, workers are in

a very strong position as the "reserve army" of the unemployed is low, thereby protecting wage levels and strengthening labour's bargaining power.

As Errico Malatesta said, if workers "succeed in getting what they demand, they will be better off: they will earn more, work fewer hours and will have more time and energy to reflect on things that matter to them, and will immediately make greater demands and have greater needs . . . there exists no natural law (law of wages) which determines what part of a worker's labour should go to him [or her] . . . Wages, hours and other conditions of employment are the result of the struggle between bosses and workers . . . Through struggle, by resistance against the bosses, therefore, workers can up to a certain point, prevent a worsening of their conditions as well as obtaining real improvement" [Life and Ideas, p. 191–2].

If an industry or country experiences high unemployment workers will put up with longer hours, worse conditions and new technology in order to remain in work. This allows capital to extract a higher level of profit from those workers, which, in turn signals other capitalists to invest in that area. As investment increases, unemployment falls so workers are in a better position and so resist capital's agenda, even going so far as to propose their own. As workers power increases, profit rates decrease and capital moves, seeking more profitable pastures, causing unemployment. And so the cycle continues.

For an example, look at the crisis which ended post-war Keynesianism in the early 1970's and paved the way for the "supply side" revolutions of Thatcher and Reagan. This period was marked by calls for workers control while actual post-tax real wages and productivity in advanced capitalist countries increased at about the same rate from 1960 to 1968 (4%) but between 1968 to 1973, the former increased by an average of 4.5% compared to a productivity rise of 3.4%. As a result, the share of profits in business output fell by about 15% in that period. Every slump within capitalism has occurred when workers have seen their living standards improve, not a coincidence.

The Philips Curve, which indicates that inflation rises as employment falls is also a strong indication of this relationship. Inflation is the result of having more money in circulation than is needed for the sale of the various commodities on the market. The reason *why* there is too much money in circulation is that inflation is "an expression of inadequate profits that must be offset by price and money policies . . . Under any circumstances inflation spells the need for higher profits . . . "[Paul Mattick, Economic Crisis and Crisis Theory, p.19]. It does this by making labour cheaper as it reduces "the real wages of workers . . . [which] directly benefits employers . . . [as] prices rise faster than wages, income that would have gone to workers goes to business instead" [Brecher and Costello, Common Sense for hard times, page 120].

Hence, from a consideration of the authority relations implicit in capitalism and the nature of profit generation, a continual "boom" economy is an impossibility simply because capitalism is driven by profit considerations. With full employment, capital is weak, labour strong and working class people are in a stronger position to fight for economic freedom — self-management in the workplace and the community.

However, even assuming that individuals can be totally happy in a capitalist economy, willing to sell their freedom and creativity for a few extra pounds, capitalism does have objective limits to its development. These limits are discussed now.

Is state control of credit the cause of the business cycle?

The rise of productivity means that profit is spread over an increasing number of commodities, and still needs to be realised on the market. As wages lag behind productivity, the demand for goods cannot meet the supply and so a glut occurs on the market. This is caused by the fact that labour is not productive enough to satisfy the profit needs of capital accumulation (which is the point of production). Because not *enough* has been produced, capital cannot expand at a rate which would allow full realisation of what *has been* produced. As the profit rates fall, this leads to cost cutting in an attempt to realise more profits. Production is cut back and workers laid off, which leads to declining demand which makes it harder to realise profit on the market, leading to more cost cutting until such time as profit levels stablise at an acceptable level. The social costs of such cost cutting is yet another "externality", to be bothered with only if it threatens capitalist power and wealth.

Hence, capitalism will suffer from a boom and bust cycle due to its nature as capitalist profit production, even if we ignore the subjective revolt against authority by workers explained before. It is this two way pressure on profit rates, the subjective and objective, which cause the business cycle and such economic problems as "stagflation". The question of state manipulation of credit is of far lessor effect, being more related to indirect profit generating activity such as ensuring a "natural" level of unemployment to keep profits up, an acceptable level of inflation to ensure increased profits and so forth.

It is a fact, of course, that all crises have been preceded by a speculatively-enhanced expansion of production and credit. This does not mean, however, that overproduction results from speculation and the expansion of credit. The

expansion and contraction of credit is a mere symptom of the periodic changes in the business cycle as the decline of profitability contracts credit just as an increase enlarges it. But Libertarians confuse the symptons for the disease.

Where there is no profit to be had, credit will not be sought. While extension of the credit system "can be a factor deferring crisis, the actual outbreak of crisis makes it into an aggravating factor because of the larger amount of capital that must be devalued" [Mattick, op cit, p.138]. But this is a problem facing private companies, using the gold standard as "the expansion of production or trade unaccompanied by an increase in the amount of money must cause a fall in the price level. . . Token money was developed at an early date to shelter trade from the enforced defaltions that accompanied the use of specie when the volume of business swelled. . . Specie is an inadequate money just because it is a commodity and its amount cannot be increased at will. The amount of gold available. . . [cannot be increased] by as many dozen [per cent] within a few weeks, as might be required to carry out a sudden expansion of transactions" [Polyani, The Great Transformation, p. 193].

Hence token money would increase and decrease in line with capitalist profitablity, as predicted in Libertarian economic theory. But this could not affect the business cycle which has its roots within production for capital and capitalist authority relations and which the credit supply would obviously be tied, and not vice versa.

Would laissez-faire reduce unemployment, as right libertarians claim?

The right libertarian argument is that if workers are allowed to compete 'freely' among themselves for jobs then wages would increase and unemployment would fall. State intervention (eg minimum wage laws, legal rights to organise, etc.) according to this theory is the cause of unemployment, as this forces wages above their market level, thus increasing production costs and 'forcing' employers to "let people go". According to neoliberal economic theory, firms adjust production to bring the marginal cost of their products (the cost of producing one more item) into equality with the product's market-determined price. So a drop in costs theoretically leads to an expansion in production, producing jobs for the "temporarily" unemployed and moving the economy toward full-employment equilibrium.

However, as David Schweickhart points out in *Against Capitalism* (Cambridge Univ. Press, 1993, pp. 106–107), this argument ignores the fact that when wages

decline, so does workers' purchasing power; and if this is not offset by an increase in spending elsewhere, total demand will decline.

The traditional neoliberal reply is that investment spending will increase because lower costs will mean greater profits, leading to greater savings, leading to greater investment.

But lower costs will mean greater profits only if the products are sold, which they might not be if demand is adversely affected. Moreover, as Keynes pointed out long ago, the forces and motivations governing saving are quite distinct from those governing investment. Hence there is no necessity for the two quantities always to coincide. So firms that have reduced wages may not be able to sell as much as before, let alone more. In that case they will cut production, adding to unemployment and further lowering demand. This can set off a vicious downward spiral of falling demand and falling production leading to recession.

As Schweickhart notes, such considerations undercut the neoliberal contention that labor unions and minimum-wage laws are responsible for unemployment. To the contrary, insofar as labor unions, mimimum-wage laws, and various welfare provisions prevent demand from falling as low as it might otherwise go during a slump, they apply a brake to the downward spiral. Far from being responsible for unemployment, they actually mitigate it. This is obvious as wages may be costs for some firms, but they are revenue for even more. Taking the example of the USA, if miminum wages caused unemployment, then why did the South Eastern states (with a *lower* mimimum wage and weaker unions) have a *higher* unemployment rate than North Western states?

Moreover, it should be obvious merely from a glance at the history of capitalism during its laissez-faire heyday in the 19th century that free competition among workers for jobs does not lead to full employment. As indicated above, full employment *cannot* be a fixed feature of capitalism due to its authoritarian nature.

Will "free market" capitalism benefit everyone, *especially* the poor?

Murray Rothbard and a host of other free marketeers make this claim. Again, it does contain an element of truth. As capitalism is a "grow or die" economy, obviously the amount of wealth available to society increases for *all.* So the poor will be better *absolutely* in any growth economy. This was the case under soviet state capitalism as well, the poorest worker in the 1980's was obviously far better off economically than one in the 1920's.

However, what counts is *relative* differences between classes and periods within a growth economy. Given the thesis that free market capitalism will benefit the poor *especially*, we have to ask the question, can all other classes benefit as well?

As noted above, wages are dependent on productivity, with increases in the former lagging behind increases in the latter. If in a free market, the poor "especially" benefit then we would have to see wages increase *faster* than productivity if the worker is to see an increased share in social wealth. However, if this was the case, the amount of profit going to the upper classes would be proportionally smaller. Hence if capitalism especially benefits the poor, it cannot do the same for those who life off the profit generated by the worker.

But, as indicated above, productivity *must* rise faster than wages, so workers produce more profits for the company by producing more goods than they would receive back in wages. Otherwise, profits fall and capital dis-invests. To claim that all would benefit from a free market ignores the fact that capitalism is a profit driven system and that for profits to exist, workers cannot receive the full fruits of their labour. As Spooner noted over 100 years ago, "almost all fortunes are made out of the capital and labour of other men than those who realize them. Indeed, large fortunes could rarely be made at all by one individual, except by his sponging capital and labour from others" [Poverty: Its Illegal Cases and Legal Cure]

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