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THE ECONOMIC SYSTEMS OF THE DEMOCRACIES AND TOTALITARIAN STATES

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BY a totalitarian economic system or policy I mean an economic system or policy that largely eliminates or makes necessary for its success the elimination of basic economic freedoms—the freedom of consumers' choice, the freedom of choosing one's occupation, the freedom to start a business and invest one's money, the freedom to work or not to work, the freedom to move and change the place of work. These economic freedoms are not only valuable in themselves but there can be no doubt that a certain measure—although it is not easy to say how large a measure—of economic freedom is essential for the preservation of the more fundamental human and political freedoms as laid down in the bill of rights.

Unfortunately, the boundary which separates the sphere of totalitarian economic policy from that economic policy which is compatible with freedom and the democratic way of life is not clearly marked. It is clearly not true that only a strictly laissez-faire, do-nothing policy is compatible with democracy and freedom. No simple formula such as those proposed by my friend Professor Hayek in his *Road to Serfdom*—"planning for competition" or "policies compatible with the rule of law"—is satisfactory. The question is too complicated for a short formula and needs elaborate, casuistic treatment. This I cannot attempt here, but I should like to point out that, although there exists in any given historical situation such a boundary line which it would be dangerous to overstep, this line shifts in time and it is not the same for different countries. It is not today where it was fifty years ago, and it is safe to predict that in another twenty years it will not be where it is today. A country like Great Britain with a strong tradition of democracy and freedom, an efficient and honest civil service, evidently can

venture farther afield than, say, Italy or France or any Latin American country or even the United States, without running the risk of being forced to give up essential freedoms and turning the country into a totalitarian police state. Whether at the present time Great Britain is not going too far, I would not be sure. It seems to me that she is on the border line; but I personally am convinced that if it should become clear, as may very well be the case, that the economic policy of the Labor Government is not only economically unsound but also incompatible with democracy, democracy and freedom will prevail and the socialist economic policy will be modified.¹

My contention then is that economic regimentation, from a certain point on becomes incompatible with political democracy. (With Mr. Molotov absent, and with only twenty minutes at my disposal, I take the chance of not defining formally what I mean by democracy.) We may now ask the opposite question: Is the absence of political democracy, that is, is an oppressive political dictatorship incompatible with a large measure of *laissez-faire* in economic matters, that is, with liberal economic policies? My answer is no, at least not under all circumstances. There have been cases of very oppressive police states which pursued nevertheless a very liberal economic policy.² A good example is the Second French Empire of Napoleon III. It was a police state of the most rigid and oppressive kind, but it pursued an economic policy which today we would call ultra-liberal (liberal in the old-fashioned *laissez-faire* sense). It was Louis Napoleon who signed the famous Cobden Treaty with England, which marked the climax of the short-lived free-trade period in Europe. Or, to cite a more recent example, even Mussolini, during the first years of his régime, pursued fairly liberal economic policies. In the Russian and German brand of totalitarianism, on the other hand, politi-

¹ What is disquieting is not so much the nationalization program, to the extent that it has been carried out or mapped out for the next three years, but the maintenance—and evidently maintenance with gusto—of wartime controls (price fixing, rationing, allocation, etc., in one word, of controlled inflation).

² Some people will say that a totalitarian régime by definition must embrace the totality of social spheres including the economic system. This is, of course, true if totalitarianism is so defined, but it would not be a very useful statement to make.

cal dictatorship and suppression of elementary human rights and freedoms were inextricably linked with economic regimentation from the beginning. Their example, especially the German and its apparent economic successes, made a deep impression, not only on other dictators—Mussolini, Franco, Perron, and others—but also on democracies. Therefore, it is safe to say that they have set the pattern for a long time to come. It is hard to think that future dictators anywhere will pursue liberal economic policies, like Napoleon III or Mussolini in the early years of his régime.

I do not think that it can be said that any of the modern totalitarian régimes—the Russian, Italian, German, Spanish, Argentinian or Japanese or wherever we draw the line—has been created from the economic side, in the sense that the pre-totalitarian régime pursued interventionistic economic policies which became incompatible with a non-authoritarian political and social framework. I think the development was in every single case the other way round: political dictatorship sprang up which quickly transformed the economic system of the country according to the totalitarian pattern.

It can, however, not be denied, it seems to me, first, that the rapid perfection of an efficient totalitarian pattern was aided or even made possible by the development of interventionistic policies on the part of previous governments and by the existence, necessitated by those policies, of an efficient administrative apparatus; and, secondly, that the popular demand for a strong régime and its initial popularity were greatly enhanced by adverse economic conditions which were often the consequence of badly conceived or mismanaged economic policies. Without disastrous inflation, deflation and depression Hitler would hardly have come to power, in spite of the lost war and in spite of a certain ideological and historical predisposition of the German people. A most unfortunate configuration of political, psychological, social and economic factors was required to bring Hitler to the top and to make his régime economically possible and successful. To mention just one economic element in the situation: If there had not been a deep depression and an unemployed reserve army of five to six million men at the time when Hitler came to power—in other words, if he had not inherited a situation which was ideal for a successful expansionary policy—

he could not have provided the German people with guns *and* butter at the same time for several years, there would not have been spectacular economic successes, and he would have found the going much harder.

Let me devote the rest of my time to a discussion of the rôle of inflation and deflation in the rise of totalitarian régimes and their maintenance in power. There is no doubt that, apart from war itself, inflation and deflation are the most powerful economic factors upsetting economic equilibrium.

Let us look, first, at the case of inflation. Here we have to distinguish two kinds, "open" and "repressed" inflation. (This distinction has been rightly stressed in recent writings of some continental economists, Jacques Rueff and Wilhelm Roepke.) After the First World War, inflation was of the open type, it was inflation in a comparatively unfettered economy. In the twenties, attempts at price fixing, rationing, allocation of labor and material, exchange control were very weak, inefficient and unsuccessful compared with what happened in the late thirties and after the Second World War. Prices were allowed to rise freely and there was a continuous and rapid mutual adjustment of price level and exchange rates, between the internal and external purchasing power of money. These open, laissez-faire inflations wrought havoc with the German, Italian, French and other economies while they were going on and left some dangerous legacies behind. But looking back it is remarkable how quickly and completely the various economies recovered from the ordeal.

I think the deflation of the early thirties was a greater calamity than the open inflation of the early twenties. Some people will argue that the deflation was nothing more than the necessary consequence of the hyperinflation of the early twenties or of what has sometimes been called "latent" or "concealed" inflation of the late twenties. Both these views seem to me untenable and based on a much too simplistic view of economic depressions. Deflations and depressions have deeper roots and cannot simply be prevented by avoiding inflation.

The type of inflation which was developed and perfected in Nazi Germany in the later thirties and was then during the war copied by many other countries and is now in many countries continued into the post-war period is an entirely different mat-

ter. I call it "repressed" inflation. It is the direct and more dangerous offspring of the open inflation of the twenties. Because the open inflation has been carefully studied and is well understood by many people, it no longer works. It is a workable method of confiscating a large part of the national income for government purposes only, if it is not well understood by the majority of the people. But you cannot fool the majority of the people all the time at least not by the same device. This is especially true in countries which had much experience with inflation such as Germany. This is the reason that the symptoms of inflation had to be repressed, and prices and wages have to be fixed. The inescapable consequence is rationing of consumers' goods and allocation of means of production, of labor, materials and equipment, etc. If the inflationary pressure is strong, a repression of its symptoms must lead very quickly to a completely controlled economy. The stronger the pressure of inflation, the heavier the repressive measures that are necessary. Europe today offers many examples of countries in different stages of this process: Italy, on the one hand, where all controls have broken down and where an old-fashioned open inflation is in full swing; England, on the other hand, with a controlled, repressed inflation; France and Holland in between; and so on. Of course, surrounding conditions, social milieu, war damage, and dislocations are not the same in different countries so that it would require an elaborate study to disentangle the consequences attributable to inflation and the measures and policies used to repress its symptoms. Such a comparative study would be extremely important and instructive.

I agree on the whole with Rueff, Roepke and others that under present conditions inflation is likely to lead to repression of symptoms and to a degree of regimentation and central control which is in the long run incompatible with political democracy and freedom. In Rueff's words, inflation today leads directly to slavery.

However, this statement needs qualification. Let us remember the words of the great Victorian economist, Alfred Marshall. "Every statement in regard to economic affairs which is short is a misleading fragment, a fallacy or a truism."

Rueff's statement is evidently not true of any kind of inflation, only for strong inflations and a lot depends on the sur-

rounding social-political milieu. The era of open inflation is not yet quite over, as the Italian and some Latin American examples show.

But let me now, in conclusion, say a few words on another facet of the problem which is more important from the American point of view. There is a tendency to extend the concept of inflation beyond all reasonable bounds. Concretely, inflation is interpreted to include any expansionary policy, even if it is undertaken in times of depression to counteract deflation, to check a fall in prices rather than to bring about a rise. In other words, the fear of inflation is used to discredit any kind of anti-depression, full-employment policy. This position is often supported by the entirely unwarranted optimistic assumption that there never could and would be a depression, if there were no deliberate policy of expansion.

I think this is an entirely untenable and in its consequences extremely dangerous theory. It is, of course, true that a full-employment policy can be overdone. There is such a thing as "over-full" employment. The words "full employment" should not be taken too literally. Full employment in the technical sense is compatible with several million unemployed—how many depending upon concrete circumstances. I think it is true that Lord Beveridge's proposals are incompatible with a free-enterprise economy. You could not, as he suggests, reduce unemployment to a maximum of 3 per cent by expansionary policies without maintaining a tremendous inflationary pressure, which would necessitate extensive regimentation. But we should not pour out the child with the bath water. We have to guard against inflation and an extreme full-employment policy. "Over-full" employment gradually merges with genuine inflation. But the preoccupation with inflation must not make us blind to the dangers of deflation. And it is simply not true that deflation can occur only in reaction to inflation.

The capitalistic, free-enterprise system in the United States has again performed miracles during the war and during the transition from war to peace. It is nevertheless regarded with hostile feelings ranging from suspicion to violent hatred almost everywhere in the world outside North America. Under these circumstances, even a partial and temporary failure of this system to function smoothly could easily have serious, perhaps

disastrous, consequences. The capitalistic system is subject to such recurrent disturbances; the business cycle is still with us and we can be sure that there will be a cyclical depression sooner or later.

To be sure, a depression, if left alone, will lift sooner or later. But the point is that in the present social and political milieu which is so hostile to the free-enterprise system we cannot wait for the natural recuperative forces. If we do not adopt a monetary and fiscal policy of expansion—monetary policy alone would not be enough—to cut short the depression, if we do not apply these policies which can be conducted in a way that makes them perfectly compatible with the free-enterprise system and avoid any undue regimentation of industry, we can be sure that the pressure for the adoption of much more drastic policies of regimentation will become irresistible.

REMARKS

CHAIRMAN LEFFINGWELL: I thought that was an acute analysis. I was particularly interested in what was said by Mr. Haberler about repressed inflation. It is a sort of "Typhoid Mary" going around the community, communicating a disease which is not apparent on the surface.

We invented methods of preserving money from deterioration in some countries by making money entirely useless or almost entirely useless and substituting a coupon and the privilege of standing in a queue to get what was wanted. That is a kind of inflation that may last longer and debilitate the patient more than even the exposed inflation which so many nations suffered after the First World War.

One thing about our speakers today is heartening. They are learned economists; but they have stepped out of the academic halls, and every one of them is helping to guide the government of this country and has at one time or another been an adviser in world policies. That contact between the world of practical affairs and the world of academic thought and learning must be, in view of changed world conditions, one of the reasons for our hope of finding solutions, now that governments, more and more, whether we like it or not, take control of our affairs.

The third speaker this afternoon, who will speak on "International Agreements and International Trade", must be speaking in terms of prophecy, because there has not been much agreement yet. He is a professor of economics and Assistant Secretary of State of the United States for Economic Affairs. I have great pleasure in introducing to you Mr. Willard Thorp!

MR. WILLARD THORP: Mr. Chairman, before I start speaking, I think perhaps I should warn you that I am going to shift the level of this discussion somewhat.

When I saw the announcement of the program and realized that the wisdom of Harvard and Columbia was going to be brought to bear on international economic problems, I saw an opportunity for me to escape from that particular responsibility. I felt even more keenly the results of the fact that I had already made six speeches this week, analyzing international economic affairs of the world. I thought, therefore, that it was time, in spite of the fact that that speech has gotten mighty good, to venture into some other type of discussion. So my speech this afternoon is directed to the problem of how countries go about getting into agreement with each other. I then propose to discuss some of the problems that we are facing, as a result of the new way of trying to reach international agreement that has appeared in so many different forms in the last few years, primarily since the war.