

# THE FREE MARKET

THE MONTHLY PUBLICATION OF THE MISES INSTITUTE

## How Labor Unions Hurt Workers

GEORGE REISMAN

**M**any Americans, perhaps a substantial majority, still believe that, irrespective of any problems they may have caused, labor unions are fundamentally an institution that exists in the vital

self-interest of wage earners. Indeed, many believe that it is labor unions that stand between the average wage earner and a life of subsistence wages, exhausting hours of work, and horrific working conditions.

Labor unions and the general public almost totally ignore the essential role played by falling prices in achieving rising real wages. They see only the rise in money wages as worthy of consideration. Indeed, in our environment of chronic inflation, prices that actually do fall are relatively rare.

Nevertheless, the only thing that can explain a rise in real wages throughout the economic system is a fall in prices relative to wages. And the only thing that achieves this is an increase in production per worker. More production per worker—a higher productivity of labor—serves to increase the supply of goods and services produced relative to the supply of labor that produces them. In this

way, it reduces prices relative to wages and thereby raises real wages and the general standard of living.

What raises money wages throughout the economic system is not what is responsible for the rise in real wages. Increases in money wages are essentially the result just of the increase in the quantity of money and resulting



*This article is adapted and abridged from Capitalism: A Treatise on Economics by George Reisman.*

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increase in the overall volume of spending in the economic system. In the absence of a rising productivity of labor, the increase in money and spending would operate to raise prices by as much or more than it raised wages. This outcome is prevented only by the fact that at the same time that the quantity of money and volume of spending are increasing, the output per worker is also increasing, with the result that prices rise by less than wages. A fall in prices is still present in the form of *prices being lower than they would have been* had only an increase in the quantity of money and volume of spending been operative.

With relatively minor exceptions, real wages throughout the economic system simply do not rise from the side of higher money wages. Essentially, they rise only from the side of a greater supply of goods and services relative to the supply of labor and thus from prices being lower relative to wages. The truth is that the means by which the standard of living of the individual wage earner and the individual businessman and capitalist is increased, and the means by which that of the average wage earner in the economic system is increased, are very different. *For the individual, it is the earning of more money. For the average wage earner in the economic system, it is the payment of lower prices.*

What this discussion shows is that the increase in money wages that labor unions seek is not at all the source of rising real wages and that the source of rising real wages is in fact a rising productivity of labor, which always operates from the side of falling prices, not rising money wages.

Indeed, the efforts of labor unions to raise money wages are profoundly *opposed* to the goal of raising real wages and the standard of living. When the unions seek to raise the standard of living of their members by means of raising their money wages, their policy inevitably comes down to an attempt to make the labor of their members artificially scarce. That is their only means of raising the wages of their members. The unions do not have much actual power over the demand for labor. But they often achieve considerable power over the supply of labor. And their actual technique for raising wages is to make the supply of labor, at least in the particular industry or occupation that a given union is concerned with, as scarce as possible.

Thus, whenever they can, unions attempt to gain control over entry into the labor market. They seek to impose apprenticeship programs, or to have licensing requirements imposed by the government. Such measures are for the purpose of holding down the supply of labor in the field and thereby enabling those fortunate enough to be admitted to it, to earn higher incomes. Even when the unions do not succeed in directly reducing the supply of labor, the imposition of their above-market wage demands still has the effect of reducing the number of jobs offered in the field and thus the supply of labor in the field that is able to find work.

The artificial wage increases imposed by the labor unions result in unemployment when above-market wages are imposed throughout the economic system. This situation exists when it is possible for unions to be formed easily. If, as in the present-day United States, all that is required is for a majority of workers in an establishment to decide that they wish to be represented by a union, then the wages imposed by the unions will be effective even in the nonunion fields.

Employers in the nonunion fields will feel compelled to offer their workers wages comparable to what the union workers are receiving—indeed, possibly even still higher wages—in order to ensure that they do not unionize.

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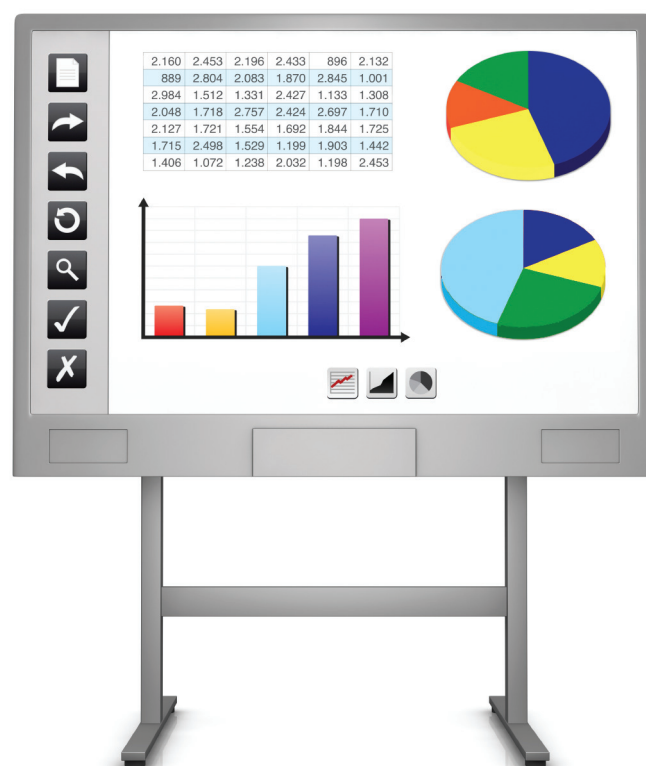
# You Can't Run an Economy With Spreadsheets

Nicolás Cachanosky

Argentina's economic minister, Axel Kicillof, has become famous for his assertion that it is possible to centrally manage the economy now because we have spreadsheets such as Microsoft Excel. This assertion comes from the mistaken view that the cost of production determines final prices, and it reveals a profound misunderstanding of the market process. This issue, however, is not new. The first half of the twentieth century witnessed the debate over economic calculation under socialism. Apparently, Argentine officials have much to learn from this old debate. The problem is not whether or not we have powerful spreadsheets at our disposal; the problem is the impossibility of successfully creating a centrally-planned market.

At the turn of the century Ludwig von Mises, Max Weber, and Boris Brutzkus independently offered critiques on the socialist commonwealth, understood to be a society where there is no privately-held means of production. Mises was simple and direct. Unlike families or small tribes, where there is intimate knowledge among members, a large society requires prices to organize efficiently. The socialists, argues Mises, are quick to point out market failures, but are silent on how to efficiently organize the socialist commonwealth without the existence of prices. Marx, who does not offer an explanation of how socialism would work once capitalism withers away, calls the socialists (i.e., Saint-Simon and Fourier), who do describe the resulting socialist community, "utopians." Without economic calculation to reveal which activities add value to society (profits) and which do not (losses), it is an illusion to assume that efficiency would just happen. Arguments other than economic calculation can be put forward as a principle to organize society, but the question of how economic efficiency is achieved remains unanswered.

As a response to this critique, writers in the socialist literature went from describing imaginary societies and



criticizing capitalism to trying to solve Mises's challenge. Oskar Lange and Wassily Leontief are two of the most famous authors who tried to solve this problem. One of the answers offered is the assumption of perfect information (still present in economics textbooks). The argument goes, if we assume to have all the required information, then the economy can be at equilibrium, and therefore Mises's challenge is interesting, but inadequate. A centrally-managed economy is possible, *if* we have perfect information. At this point in the debate, it is Hayek who responds to the socialists' contention with four important points:

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# Mises Scholar and Alumni Notes



**LEW  
ROCKWELL**

Mises Institute Founder and Chairman **LEW ROCKWELL** spoke at the Committee for Monetary Research & Education's Spring Dinner in New York City in May.



**MARK  
THORNTON**

Senior Fellow **MARK THORNTON** discussed the drug war as part of the Formal Thursday Debates series at Oxford University. Dr. Thornton also authored the chapter "At First I Thought Prohibition Was a Good Thing: The Economics of Alcohol Control" in the new book *Homer Economicus: The Simpsons and Economics*, now available from Stanford University Press.



**ROBERT  
HIGGS**

Also in *Homer Economicus*, Senior Fellow **PETER KLEIN** co-authored with Associated Scholar **PER BYLUND** and Christopher M. Holbrook the chapter "They Have the Internet on Computers Now? Entrepreneurship in *The Simpsons*."

**PER BYLUND**'s op-ed "What Sweden Can Teach Us About ObamaCare" appeared in the *Wall Street Journal* in April.



**PASCAL  
SALIN**

Senior Fellow **ROBERT HIGGS** presented six lectures in June on "Austrian Economics and Economic Liberty" at the University of Akron, hosted by the university's department of economics. Dr. Higgs also presented several lectures on economic history and political economy at the Independent Institute's week-long summer seminar for college students in Denver.

Senior Fellow **PASCAL SALIN** wrote the preface to a new book by Austrian economists Serge Schweitzer and Loïc Floury titled *Théorie de la révolte fiscale, Enjeux et interprétations* (A Theory of Tax Revolt, Issues and Interpretations), now available from Presses Universitaires d'Aix-Marseille.



**PHILIPP  
BAGUS**

Associated Scholar **PHILIPP BAGUS** published a new book in German titled *Warum andere auf Ihre Kosten immer reicher werden* (Why Others Are Getting Richer at Your Expense), co-authored with Andreas Marquart, now available from Finanzbuch Press.

Associated Scholar **DAVID HOWDEN** recently published "Knowledge Flows and Insider Trading" in the *Review of Austrian Economics*, and co-authored "Central Bank Insolvency, Effects and Remedies" in the *Journal of Social, Political, and Economic Studies* with Associated Scholar **PHILIPP BAGUS**.



**DAVID  
HOWDEN**

Associated Scholar **PAUL PRENTICE** gave a lecture in March, titled "Teaching Capitalism as a Moral Philosophy" at the Symposium on Teaching Capitalism at Michigan State University, Ely Broad School of Management; and a lecture in May titled "The U.S. Department of Agriculture: An Economic Perspective" at the Bastiat Society of Colorado Springs.



**PAUL  
PRENTICE**

Associated Scholar **PETER CALCAGNO** was recently promoted to full professor at College of Charleston, and won the distinguished service award for the School of Business for running the college's Initiative for Public Choice & Market Process, a free-market organization.

Associated Scholar **JAMES BENNETT** recently completed *Mandate Madness: How Congress Forces States and Localities to Do Its Bidding and Pay for the Privilege*, now available from Transaction Publishers.



## YOU CAN'T RUN AN ECONOMY WITH SPREADSHEETS CONTINUED FROM PAGE 3

(1) The amount of information needed and the calculation constraints are prohibitive to the socialist project, *even if* we grant the assumption of perfect information. But this is just an illustrative point that Hayek is making. Even though socialists and Marxists usually stop at this point, Hayek's point is much more subtle as the following points show.

(2) The assumption of perfect information is invalid. The challenge is not to *be* in equilibrium, but in the *transition* to equilibrium. Just as it is not possible to open a can of food by assuming a can opener, it is not an acceptable response to assume Mises's challenge away by assuming perfect information. Where does this perfect information come from and to whom is it given? The assumption of perfect information does not simplify the problem to be solved; it alters it and becomes irrelevant to the debate. This is why Austrians have been traditionally more concerned with the market process and less with the equilibrium conditions.

(3) Hayek also distinguishes (admittedly with some confusion) between information and knowledge. Information is a quantitative concept, and as such, can be either complete (perfect) or incomplete (imperfect). This is what socialists refer to as the assumption of perfect information. But knowledge is a qualitative concept, and because of this it can be neither complete nor incomplete. Knowing how to ride a bike or how to successfully run a business is not the type of knowledge that can be input into an Excel spreadsheet. This distinction is important because it is entrepreneurs who are the engine of economic growth and development. In other words, Excel cannot solve the market problem that entrepreneurs have to solve because this requires interpretation and knowledge, not just numerical data. Little is achieved if all information is given to Kicillof's team if they don't know how to interpret it.

(4) Information and knowledge are not independent of the market process. Without private property there are no

prices; without prices there is no information. Hayek is using the other side of Mises's argument to say that by getting rid of private property one is at the same time getting rid of the information that the socialists need to assume as given.

As soon as we recognize all of Hayek's points, we realize that to take the Excel spreadsheet approach is like building a car without an engine (the entrepreneurs) and without road signs (the market) to signal the right way to go. It is no surprise that the Argentine economy malfunctions without a clear route taken by government officials. It is a mistake to confuse market prices with regulated prices, and the prices that provide useful information are the ones that emerge from free exchanges in the market, not government imposed prices originating in an Excel spreadsheet. To use the same word "price" to describe these two different phenomena misleads him who arrogates to himself the right to decide the fate of thousands of people. It is an illusion to believe that the same information that arises from market prices will magically emerge from government-imposed prices. What Kicillof's team inserts into the Excel spreadsheet are not prices, but expressions of desires detached from economic reality.

The success of economic policy and market regulation, however, is not evaluated on desires and intentions, but on results. The problem with the Excel spreadsheet approach is not the intentions of the policymakers, but that such tools cannot possibly replace the market process.

The undeniable economic problems of Argentina run much deeper than what number to input into Kicillof's spreadsheet. The problem is a confused reading of how markets work, and how governments continue with deficit spending in the service of favored interest groups. ■



*Nicolás Cachanosky, a native of Argentina, is assistant professor of economics at Metropolitan State University of Denver.*



**JO ANN  
CAVALLO**

Associated Scholar **JO ANN CAVALLO** was invited to present her latest book *The World beyond Europe in the Romance Epics of Boiardo and Ariosto*, as part of the De Bosis Colloquium in Italian Studies at Harvard University. Dr. Cavallo's essay "On Political Power and Personal Liberty in The Prince and The Discourses" was published in the Spring 2014 issue of *Social Research: An International Quarterly*.

Associated Scholar **RANDALL HOLCOMBE** in May published *Advanced Introduction to The Austrian School of Economics*, now available from Edward Elgar Publishing, an intermediate economics book for students of economics interested in learning more about the Austrian School.

## HOW LABOR UNIONS HURT WORKERS CONTINUED FROM PAGE 2

Widespread wage increases closing large numbers of workers out of numerous occupations put extreme pressure on the wage rates of whatever areas of the economic system may still remain open. These limited areas could absorb the overflow of workers from other lines at low enough wage rates. But minimum-wage laws prevent wage rates in these remaining lines from going low enough to absorb these workers.

From the perspective of most of those lucky enough to keep their jobs, the most serious consequence of the unions is the holding down or outright reduction of the productivity of labor. With few exceptions, the labor unions *openly combat the rise in the productivity of labor*. They do so virtually as a matter of principle. They oppose the introduction of labor-saving machinery on the grounds that it causes unemployment. They oppose competition among workers. As Henry Hazlitt pointed out, they force employers to tolerate featherbedding practices, such as the classic requirement that firemen, whose function was to shovel coal on steam locomotives, be retained on diesel locomotives. They impose makework schemes, such as requiring that pipe delivered to construction sites with screw thread already on it, have its ends cut off and new screw thread cut on the site. They impose narrow work classifications, and require that specialists be employed at a day's pay to perform work that others could easily do—for example, requiring the employment of a plasterer to repair the incidental damage done to a wall by an electrician, which the electrician himself could easily repair.

To anyone who understands the role of the productivity of labor in raising real wages, it should be obvious that the unions' policy of combating the rise in the productivity of labor renders them in fact a leading enemy of the

rise in real wages. However radical this conclusion may seem, however much at odds it is with the prevailing view of the unions as the leading source of the rise in real wages over the last hundred and fifty years or more, the fact is that in combating the rise in the productivity of labor, *the unions actively combat the rise in real wages!*

Far from being responsible for improvements in the standard of living of the average worker, labor unions operate in more or less total ignorance of what actually raises the average worker's standard of living. In consequence of their ignorance, they are responsible for artificial inequalities in wage rates, for unemployment, and for holding down real wages and the average worker's standard of living. All of these destructive, antisocial consequences derive from the fact that while individuals increase the money they earn through increasing production and the overall supply of goods and services, thereby reducing prices and raising real wages throughout the economic system, labor unions increase the money paid to their members by exactly the opposite means. They reduce the supply and productivity of labor and so reduce the supply and raise the prices of the goods and services their members help to produce, thereby reducing real wages throughout the economic system. ■



George Reisman is an Associated Scholar of the Mises Institute, and is professor emeritus of economics at Pepperdine University. He is the author of *The Government Against the Economy* and *Capitalism: A Treatise on Economics*.

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## IN MEMORIAM

Both the Mises Institute and the cause of liberty mourn the passing of two good friends. Their support for our mission and concern for the future of freedom will always inspire us.



**Mr. Yetta G. Samford, Jr.**, a Charter Member of the Mises Institute, passed away in December of last year. Mr. Samford earned an LLB degree from the University of Alabama Law School and was active in promoting higher education as a member of the University of Alabama's Board of Trustees and as one of the founding Trustees of Mobile College.

Mises Institute Member and Supporter **Capt. Frank A. Liberato** passed away in October 2013. Captain Liberato was a Navy fighter pilot and a graduate of the Naval Academy.



## COMING EVENTS

Register online at [mises.org](http://mises.org) or by phone at 800.636.4737.

- July 20–26, 2014 MISES UNIVERSITY • Mises Institute
- November 8, 2014 WEST COAST REGIONAL MISES CIRCLE IN COSTA MESA, CALIFORNIA
- January 24, 2015 SOUTHWEST REGIONAL MISES CIRCLE IN HOUSTON, TEXAS
- March 12–14, 2015 AUSTRIAN ECONOMICS RESEARCH CONFERENCE • Mises Institute



## Thank You!

Thanks to Adam Daniels for donating this portrait of Ludwig von Mises (pictured with Senior Fellow Mark Thornton).

Mr. Daniels operates a portrait business specializing in prints of historical figures, including Ludwig von Mises and Murray Rothbard.

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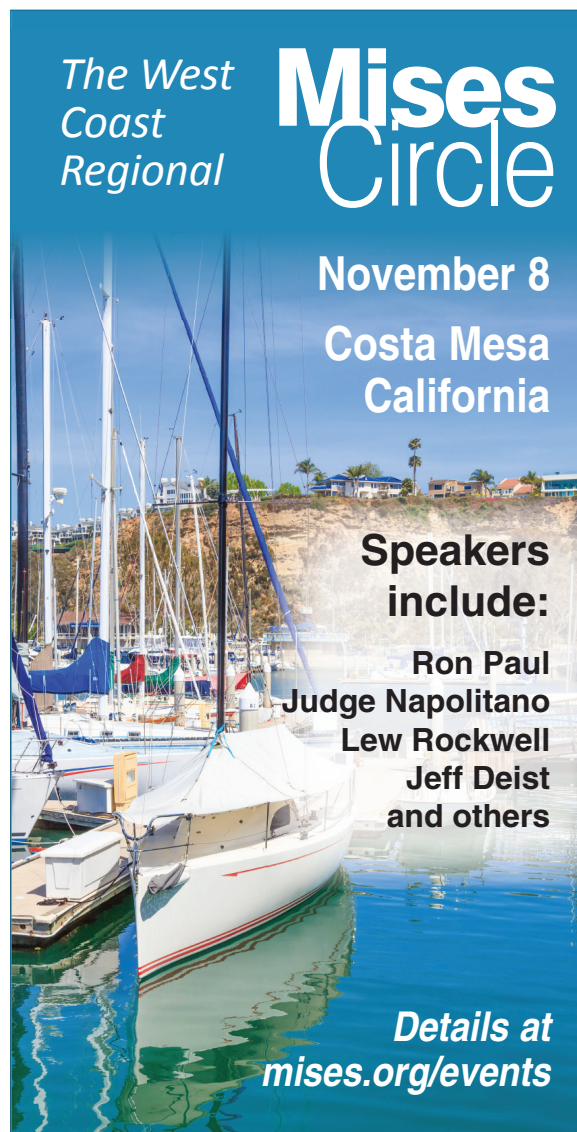
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