CLASSICAL ECONOMICS VERSUS THE EXPLOITATION THEORY

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For over a century, one of the most popular economic doctrines in the world has been the exploitation theory. According to this theory, capitalism is a system of virtual slavery, serving the narrow interests of a comparative handful of businessmen and rentiers, who, driven by insatiable greed and power lust, exist as parasites upon the labor of the masses.

This view of capitalism has not been the least bit shaken by the steady rise in the average standard of living that has taken place in the capitalist countries since the beginning of the Industrial Revolution. The rise in the standard of living is not attributed to capitalism, but precisely to the *infringements* which have been made upon capitalism. People attribute economic progress to labor unions and social legislation, and to what they consider to be improved personal ethics on the part of employers. By the same token, they tremble at the thought of unions not existing, of a society without minimum wage laws, maximum hours legislation, and child labor laws—at the thought of a society in which no legal obstacles stood in the way of employers pursuing their self-interest. In the absence of such legislation, people believe, wage rates would return to the minimum subsistence level; women and children would labor once more in the mines; and the hours of work would be as long and as hard as it is possible for human beings to bear—all for the benefit of the capitalists, precisely as Marx maintained.

The Exploitation Theory and the Overthrow of Classical Economics

It is obvious that the exploitation theory is one of the most powerful factors that have been operating to lead the world down *The Road to Serfdom*—as the title of Prof. Hayek's book so aptly describes the trend toward socialism.[1] Indeed, the pernicious influence of the exploitation theory goes far beyond the direct and obvious support it gives to socialism. It has contributed to the triumph of socialism in more subtle ways, as well. It played a major, perhaps the decisive, role in the overthrow of British classical economics. The system of Smith and Ricardo was perceived as inescapably implying the essential tenets of the exploitation theory. The opponents of the exploitation theory, therefore, quite understandably felt obliged to discard such a perverse system. And discard it they did. Along with "the labor theory of

1. F. A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944).

value" and the "iron law of wages," they discarded such further features of classical political economy as the wages fund doctrine and its corollary that savings and capital are the source of almost all spending in the economic system. Two generations later, the abandonment of the classical doctrines on saving made possible the acceptance of Keynesianism and the policy of inflation, deficits, and ever expanding government spending. In similarly paradoxical fashion, the abandonment of the classical doctrine that cost of production, rather than supply and demand, is the direct (if not the ultimate) determinant of the prices of most manufactured or processed goods led, with just about the same time lag, to the promulgation of the doctrines of "pure and perfect competition," "oligopoly," "monopolistic competition," and "administered prices," with their implicit call for a policy of radical antitrust or outright nationalizations to "curb the abuses of big business." Thus, along these two further paths, the influence of the exploitation theory has served to advance the cause of socialism.

Indeed, so successful has the exploitation theory been in the discrediting of classical economics, that even to suggest that cost of production can be a direct determinant of price is to invite the censure both of being ignorant of all that economics has taught since 1870 and of being sympathetic to Marxism. Thus, it is important to point out in this connection that Böhm-Bawerk and Wieser were well aware of the fact that cost of production is often the direct determinant of price. They held merely that the determination of the prices that constitute the costs is based on supply and demand (a position very close to that of John Stuart Mill, incidentally) and thus on the operation of the principle of diminishing marginal utility.[2] Most of the followers of Böhm-Bawerk and Wieser seem, unfortunately, to be more influenced by Jevons on this subject than by Böhm-Bawerk and Wieser.[3]

My purpose here is to show how classical economics can easily cast off those aspects of it which in the past did contribute to the exploitation theory.

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2. Cf. Eugen von Böhm-Bawerk, *Capital and Interest,* Huncke and Sennholz translation, 3 volumes (South Holland Illinois: Libertarian Press, 1959), Vol. II, pp. 168-76, pp. 248-56; Vol. III, pp. 97-115; idem, "Wert, Kosten und Grenznutzen," *Jahrbuch für Nationalökonomie und Statistik,* Dritte Folge, Vol. III, 1892, p. 328; Friedrich von Wieser. *Ursprung und Hauptgesetze des Wirtschaftlichen Werthes,* Vienna, 1884, pp. 146-160; idem, *Natural Value,* London and New York, 1893, p. 78, p. 181n, p.183; John Stuart Mill, *Principles of Political Economy,* Ashley Edition (reprint, Fairfield, New Jersey: Augustus M. Kelley, 1976), Bk. III, Chaps. III - VI. See also, George Reisman, *The Government Against the Economy* (Ottawa, Illinois: Caroline House Publishers, 1979), pp. 36-38, pp. 50-53.

3. Jevons held that the only possible connection between cost of production and price was through the intermediary of variations in supply. Cf. W. S. Jevons, *The Theory of Political Economy,* Fourth Edition, (London: Macmillan and Co., 1924), p.165.

And, more, to show how it can actually supply the basis for a fundamental and radical *critique* of the exploitation theory. If my effort is judged successful, then perhaps some interest can be reawakened in classical economics as an important source of knowledge, in particular in regard to the critique of Keynesianism and the currently dominant views on monopoly and competition. (The precise nature of these applications is a subject far too vast to be dealt with on this occasion. I have, however, attempted to explain it elsewhere.[4])

The Conceptual Framework of the Exploitation Theory

There are three aspects of classical economics which contribute to the exploitation theory. The two best known are, of course, the labor theory of value and the iron law of wages. Somewhat less prominent, but no less important, is the conceptual framework within which the exploitation theory is advanced. This framework is *the belief that wages are the original and primary form of income, from which profits and all other non-wage incomes emerge as a deduction with the coming of capitalism and businessmen and capitalists.* The framework easily leads to the assertion of the wage earner's right to the whole produce or to its full value. It itself is based on the further belief that all income which is due to the performance of labor is wages and that all who work are wage earners. It is on the basis of these beliefs that Adam Smith opens his chapter on wages in *The Wealth of Nations* with the words:

> The produce of labour constitutes the natural recompense or wages of labour. In that original state of things, which precedes both the appropriation of land and the accumulation of stock, the whole produce of labour belongs to the labourer. He has neither landlord nor master to share with him.

And Smith continues, a little further on:

> But this original state of things, in which the labourer enjoyed the whole produce of his own labour, could not last beyond the first introduction of the appropriation of land and the accumulation of stock. It was at an end, therefore, long before the most considerable improvements were made in the productive powers of labour, and it would be to no purpose to trace further what might have been its effects upon the recompense or wages of labour.
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> As soon as land becomes private property, the landlord demands a share of almost all the produce which the labourer can either raise or collect from

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4. George Reisman, "Aggregate Economic Accounting on a Classical Base," a paper delivered at the meetings of the Western Economic Association, San Francisco, July 2-4, 1981; revised version, with M. Northrup Buechner, presented at the meetings of the History of Economics Society, Charlottesville, Virginia, May 26, 1983; George Reisman, "Platonic Competition," *The Objectivist,* August and September, 1968.