in ONE LESSON

Henry Hazlitt

INTRODUCTION BY WALTER BLOCK

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Economics in One Lesson

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Economics in One Lesson

Henry Hazlitt

Introduction by Walter Block

Ludwig von Mises Institute
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Contents

Introduction by Walter Block vii

Preface to the First Edition by Henry Hazlitt xi

Part One: The Lesson 1

1 The Lesson 3

Part Two: The Lesson Applied 9

2 The Broken Window 11
3 The Blessings of Destruction 13
4 Public Works Mean Taxes 17
5 Taxes Discourage Production 23
6 Credit Diverts Production 25
7 The Curse of Machinery 33
8 Spread-the-Work Schemes 45
9 Disbanding Troops and Bureaucrats 51
10 The Fetish of Full Employment 55
11 Who's "Protected" by Tariffs? 59
12 The Drive for Exports 69
13 "Parity" Prices 75
14 Saving the X Industry 83

15 How the Price System Works 89
16 "Stabilizing" Commodities 97
17 Government Price-Fixing 105
18 Minimum Wage Laws 115
19 Do Unions Really Raise Wages? 121
20 "Enough to Buy Back the Product" 133
21 The Function of Profits 141
22 The Mirage of Inflation 145
23 The Assault on Saving 159

Part Three: The Lesson Restated 173

24 The Lesson Restated 175

Part One: The Lesson

CHAPTER 1

The Lesson

1

Economics is haunted by more fallacies than any other study known to man. This is no accident. The inherent difficulties of the subject would be great enough in any case, but they are multiplied a thousandfold by a factor that is insignificant in, say, physics, mathematics, or medicine—the special pleading of selfish interests. While every group has certain economic interests identical with those of all groups, every group has also, as we shall see, interests antagonistic to those of all other groups. While certain public policies would in the long run benefit everybody, other policies would benefit one group only at the expense of all other groups. The group that would benefit by such policies, having such a direct interest in them, will argue for them plausibly and persistently. It will hire the best buyable minds to devote their whole time to presenting its case. And it will finally either convince the general public that its case is sound, or so befuddle it that clear thinking on the subject becomes next to impossible.

In addition to these endless pleadings of self-interest, there is a second main factor that spawns new economic fallacies every day. This is the persistent tendency of men to see only the immediate effects of a given policy, or its effects only on a special group, and to neglect to inquire what the long-run effects of that policy will be not only on that

special group but on all groups. It is the fallacy of overlooking secondary consequences.

In this lies almost the whole difference between good economics and bad. The bad economist sees only what immediately strikes the eye; the good economist also looks beyond. The bad economist sees only the direct consequences of a proposed course; the good economist looks also at the longer and indirect consequences. The bad economist sees only what the effect of a given policy has been or will be on one particular group; the good economist inquires also what the effect of the policy will be on all groups.

The distinction may seem obvious. The precaution of looking for all the consequences of a given policy to everyone may seem elementary. Doesn't everybody know, in his personal life, that there are all sorts of indulgences delightful at the moment but disastrous in the end? Doesn't every little boy know that if he eats enough candy he will get sick? Doesn't the fellow who gets drunk know that he will wake up next morning with a ghastly stomach and a horrible head? Doesn't the dipsomaniac know that he is ruining his liver and shortening his life? Doesn't the Don Juan know that he is letting himself in for every sort of risk, from blackmail to disease? Finally, to bring it to the economic though still personal realm, do not the idler and the spendthrift know, even in the midst of their glorious fling, that they are heading for a future of debt and poverty?

Yet when we enter the field of public economics, these elementary truths are ignored. There are men regarded today as brilliant economists, who deprecate saving and recommend squandering on a national scale as the way of economic salvation; and when anyone points to what the consequences of these policies will be in the long run, they reply flippantly, as might the prodigal son of a warning father: "In the long run we are all dead." And such shallow wisecracks pass as devastating epigrams and the ripest wisdom.

But the tragedy is that, on the contrary, we are already suffering the long-run consequences of the policies of the remote or recent past. Today is already the tomorrow which the bad economist yesterday urged us to ignore. The long-run consequences of some economic

policies may become evident in a few months. Others may not become evident for several years. Still others may not become evident for decades. But in every case those long-run consequences are contained in the policy as surely as the hen was in the egg, the flower in the seed.

From this aspect, therefore, the whole of economics can be reduced to a single lesson, and that lesson can be reduced to a single sentence. *The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups.*

2

Nine-tenths of the economic fallacies that are working such dreadful harm in the world today are the result of ignoring this lesson. Those fallacies all stem from one of two central fallacies, or both: that of looking only at the immediate consequences of an act or proposal, and that of looking at the consequences only for a particular group to the neglect of other groups.

It is true, of course, that the opposite error is possible. In considering a policy we ought not to concentrate *only* on its long-run results to the community as a whole. This is the error often made by the classical economists. It resulted in a certain callousness toward the fate of groups that were immediately hurt by policies or developments which proved to be beneficial on net balance and in the long run.

But comparatively few people today make this error; and those few consist mainly of professional economists. The most frequent fallacy by far today, the fallacy that emerges again and again in nearly every conversation that touches on economic affairs, the error of a thousand political speeches, the central sophism of the "new" economics, is to concentrate on the short-run effects of policies on special groups and to ignore or belittle the long-run effects on the community as a whole. The "new" economists flatter themselves that this is a great, almost a revolutionary advance over the methods of the "classical" or "orthodox" economists, because the former take into consideration short-run effects which the latter often ignored. But in themselves

ignoring or slighting the long-run effects, they are making the far more serious error. They overlook the woods in their precise and minute examination of particular trees. Their methods and conclusions are often profoundly reactionary. They are sometimes surprised to find themselves in accord with seventeenth-century mercantilism. They fall, in fact, into all the ancient errors (or would, if they were not so inconsistent) that the classical economists, we had hoped, had once for all got rid of.

3

It is often sadly remarked that the bad economists present their errors to the public better than the good economists present their truths. It is often complained that demagogues can be more plausible in putting forward economic nonsense from the platform than the honest men who try to show what is wrong with it. But the basic reason for this ought not to be mysterious. The reason is that the demagogues and bad economists are presenting half-truths. They are speaking only of the immediate effect of a proposed policy or its effect upon a single group. As far as they go they may often be right. In these cases the answer consists in showing that the proposed policy would also have longer and less desirable effects, or that it could benefit one group only at the expense of all other groups. The answer consists in supplementing and correcting the half-truth with the other half. But to consider all the chief effects of a proposed course on everybody often requires a long, complicated, and dull chain of reasoning. Most of the audience finds this chain of reasoning difficult to follow and soon becomes bored and inattentive. The bad economists rationalize this intellectual debility and laziness by assuring the audience that it need not even attempt to follow the reasoning or judge it on its merits because it is only "classicism" or "laissez-faire," or "capitalist apologetics" or whatever other term of abuse may happen to strike them as effective.

We have stated the nature of the lesson, and of the fallacies that stand in its way, in abstract terms. But the lesson will not be driven home, and the fallacies will continue to go unrecognized, unless both

are illustrated by examples. Through these examples we can move from the most elementary problems in economics to the most complex and difficult. Through them we can learn to detect and avoid first the crudest and most palpable fallacies and finally some of the most sophisticated and elusive. To that task we shall now proceed.

Part Two: The Lesson Applied

Chapter 2

The Broken Window

Let us begin with the simplest illustration possible: let us, emulating Bastiat, choose a broken pane of glass.

A young hoodlum, say, heaves a brick through the window of a baker's shop. The shopkeeper runs out furious, but the boy is gone. A crowd gathers, and begins to stare with quiet satisfaction at the gaping hole in the window and the shattered glass over the bread and pies. After a while the crowd feels the need for philosophic reflection. And several of its members are almost certain to remind each other or the baker that, after all, the misfortune has its bright side. It will make business for some glazier. As they begin to think of this they elaborate upon it. How much does a new plate glass window cost? Fifty dollars? That will be quite a sum. After all, if windows were never broken, what would happen to the glass business? Then, of course, the thing is endless. The glazier will have $50 more to spend with other merchants, and these in turn will have $50 more to spend with still other merchants, and so *ad infinitum*. The smashed window will go on providing money and employment in ever-widening circles. The logical conclusion from all this would be, if the crowd drew it, that the little hoodlum who threw the brick, far from being a public menace, was a public benefactor.

Now let us take another look. The crowd is at least right in its first conclusion. This little act of vandalism will in the first instance mean more business for some glazier. The glazier will be no more unhappy to learn of the incident than an undertaker to learn of a death. But the shopkeeper will be out $50 that he was planning to spend for a new suit. Because he has had to replace a window, he will have to go without the suit (or some equivalent need or luxury). Instead of having a window and $50 he now has merely a window. Or, as he was planning to buy the suit that very afternoon, instead of having both a window and a suit he must be content with the window and no suit. If we think of him as a part of the community, the community has lost a new suit that might otherwise have come into being, and is just that much poorer.

The glazier's gain of business, in short, is merely the tailor's loss of business. No new "employment" has been added. The people in the crowd were thinking only of two parties to the transaction, the baker and the glazier. They had forgotten the potential third party involved, the tailor. They forgot him precisely because he will not now enter the scene. They will see the new window in the next day or two. They will never see the extra suit, precisely because it will never be made. They see only what is immediately visible to the eye.

CHAPTER 3

The Blessings of Destruction

So we have finished with the broken window. An elementary fallacy. Anybody, one would think, would be able to avoid it after a few moments' thought. Yet the broken-window fallacy, under a hundred disguises, is the most persistent in the history of economics. It is more rampant now than at any time in the past. It is solemnly reaffirmed every day by great captains of industry, by chambers of commerce, by labor union leaders, by editorial writers and newspaper columnists and radio commentators, by learned statisticians using the most refined techniques, by professors of economics in our best universities. In their various ways they all dilate upon the advantages of destruction.

Though some of them would disdain to say that there are net benefits in small acts of destruction, they see almost endless benefits in enormous acts of destruction. They tell us how much better off economically we all are in war than in peace. They see "miracles of production" which it requires a war to achieve. And they see a postwar world made certainly prosperous by an enormous "accumulated" or "backed-up" demand. In Europe they joyously count the houses, the whole cities that have been leveled to the ground and that "will have to be replaced." In America they count the houses that could not be built during the war, the nylon stockings that could not be supplied, the worn-out automobiles and tires, the obsolescent radios and refrigerators. They bring together formidable totals.

It is merely our old friend, the broken-window fallacy, in new clothing, and grown fat beyond recognition. This time it is supported by a whole bundle of related fallacies. It confuses *need* with *demand*. The more war destroys, the more it impoverishes, the greater is the postwar need. Indubitably. But need is not demand. Effective economic demand requires not merely need but corresponding purchasing power. The needs of China today are incomparably greater than the needs of America. But its purchasing power, and therefore the "new business" that it can stimulate, are incomparably smaller.

But if we get past this point, there is a chance for another fallacy, and the broken-windowites usually grab it. They think of "purchasing power" merely in terms of money. Now money can be run off by the printing press. As this is being written, in fact, printing money is the world's biggest industry—if the product is measured in monetary terms. But the more money is turned out in this way, the more the value of any given unit of money falls. This falling value can be measured in rising prices of commodities. But as most people are so firmly in the habit of thinking of their wealth and income in terms of money, they consider themselves better off as these monetary totals rise, in spite of the fact that in terms of things they may have less and buy less. Most of the "good" economic results which people attribute to war are really owing to wartime inflation. They could be produced just as well by an equivalent peacetime inflation. We shall come back to this money illusion later.

Now there is a half-truth in the "backed-up" demand fallacy, just as there was in the broken-window fallacy. The broken window did make more business for the glazier. The destruction of war will make more business for the producers of certain things. The destruction of houses and cities will make more business for the building and construction industries. The inability to produce automobiles, radios, and refrigerators during the war will bring about a cumulative postwar demand *for those particular products*.

To most people this will seem like an increase in total demand, as it may well be *in terms of dollars of lower purchasing power*. But what really takes place is a *diversion* of demand to these particular products from others. The people of Europe will build more new houses than otherwise

because they must. But when they build more houses they will have just that much less manpower and productive capacity left over for everything else. When they buy houses they will have just that much less purchasing power for everything else. Wherever business is increased in one direction, it must (except insofar as productive energies may be generally stimulated by a sense of want and urgency) be correspondingly reduced in another.

The war, in short, will change the postwar *direction* of effort; it will change the balance of industries; it will change the structure of industry. And this in time will also have its consequences. There will be another distribution of demand when accumulated needs for houses and other durable goods have been made up. Then these temporarily favored industries will, relatively, have to shrink again, to allow other industries filling other needs to grow.

It is important to keep in mind, finally, that there will not merely be a difference in the pattern of postwar as compared with pre-war demand. Demand will not merely be diverted from one commodity to another. In most countries it will shrink in total amount.

This is inevitable when we consider that demand and supply are merely two sides of the same coin. They are the same thing looked at from different directions. Supply creates demand because at bottom it is demand. The supply of the thing they make is all that people have, in fact, to offer in exchange for the things they want. In this sense the farmers' supply of wheat constitutes their demand for automobiles and other goods. The supply of motor cars constitutes the demand of the people in the automobile industry for wheat and other goods. All this is inherent in the modern division of labor and in an exchange economy.

This fundamental fact, it is true, is obscured for most people (including some reputedly brilliant economists) through such complications as wage payments and the indirect form in which virtually all modern exchanges are made through the medium of money. John Stuart Mill and other classical writers, though they sometimes failed to take sufficient account of the complex consequences resulting from the use of money, at least saw through the monetary veil to the underlying realities. To that extent they were in advance of many of their

present-day critics, who are befuddled by money rather than instructed by it. Mere inflation—that is, the mere issuance of more money, with the consequence of higher wages and prices—may *look* like the creation of more demand. But in terms of the actual production and exchange of real things it is not. Yet a fall in postwar demand may be concealed from many people by the illusions caused by higher money wages that are more than offset by higher prices.

Postwar demand in most countries, to repeat, will shrink in absolute amount as compared with pre-war demand because postwar supply will have shrunk. This should be obvious enough in Germany and Japan, where scores of great cities were leveled to the ground. The point, in short, is plain enough when we make the case extreme enough. If England, instead of being hurt only to the extent she was by her participation in the war, had had all her great cities destroyed, all her factories destroyed and almost all her accumulated capital and consumer goods destroyed, so that her people had been reduced to the economic level of the Chinese, few people would be talking about the great accumulated and backed-up demand caused by the war. It would be obvious that buying power had been wiped out to the same extent that productive power had been wiped out. A runaway monetary inflation, lifting prices a thousandfold, might nonetheless make the "national income" figures in monetary terms higher than before the war. But those who would be deceived by that into imagining themselves richer than before the war would be beyond the reach of rational argument. Yet the same principles apply to a small war destruction as to an overwhelming one.

There may be, it is true, offsetting factors. Technological discoveries and advances during the war, for example, may increase individual or national productivity at this point or that. The destruction of war will, it is true, divert postwar demand from some channels into others. And a certain number of people may continue to be deceived indefinitely regarding their real economic welfare by rising wages and prices caused by an excess of printed money. But the belief that a genuine prosperity can be brought about by a "replacement demand" for things destroyed or not made during the war is nonetheless a palpable fallacy.