Chapter 7

Interventionism

> Coercive intervention, on the other hand, signifies *per se* that the individual or individuals coerced would not have done what they are now doing were it not for the intervention. The individual who is coerced into saying or not saying something or into making or not making an exchange with the intervener or with someone else is having his actions changed by a threat of violence. The coerced individual loses in utility as a result of the intervention, for his action has been changed by its impact."
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> —Murray Rothbard (1970), *Power and Market*: 13.

Well-intentioned government policymakers seek to help low-income families purchase milk. In order to make cow's milk more affordable, the policymakers impose a price ceiling. A price ceiling is a government mandate on the maximum monetary price that can be legally charged for a product.

Milk producers, however, are not passive in the wake of the government's price decree. They adjust their behaviour to the price ceiling by holding some milk off the market until the price is allowed to again rise above the price established by the ceiling. This reduces the supply of milk available to consumers, including those less well off who were the intended beneficiaries of the initial government price control. That's not all. In the face of the reduced supply of milk, consumers shift to milk substitutes—like soy milk and almond milk—and this leads to an increase in the price of these goods, making them less affordable to the least well-off in society.

At this point, government policymakers face a decision. They can remove the initial price control on cow's milk, which will lead to an increase in the quantity supplied, as the higher price induces producers to bring more milk to market. Alternatively, policymakers can impose additional regulations on producers. For example, they could place price controls on milk substitutes as well in an attempt to make these goods more affordable. Alternatively, they can maintain the initial price control on cow's milk but attempt to induce producers to increase supply through subsidies or through the forceful seizure of milk production, which transfers private property to government control.

This thought experiment was presented by Ludwig von Mises to illustrate the problems with interventionism, which refers to efforts by government policymakers to manipulate economic activity to align with their goals. This requires employing the discretionary power of the administrative state to replace the preferences of private economic actors with those of policymakers. As illustrated by the example of the price control on milk, government interference in a market generates a range of interrelated effects on economic activity. In addition, subsequent attempts by policymakers to counteract the emergence of unintended consequences and to make the initial intervention yield the desired results leads to increasingly extensive controls over economic activity, which threatens the dynamism of the market process. Let's explore why.

Interventionism is a form of non-comprehensive planning. It does not abolish ownership over the means of production or attempt to plan all economic activity, as under socialism. But it does involve piecemeal economic planning. Under piecemeal planning, policymakers replace what emerged through the market process with their own judgments of what they believe should exist. The underlying implicit assumption of interventionism, therefore, is that policymakers have access to the economic knowledge necessary to engage in piecemeal planning to achieve their ends. More specifically, there are three types of economic knowledge that policymakers are assumed to possess.

First, since government interventions into the market are justified as a means of improving social welfare, the policymakers are assumed to possess knowledge of ways of allocating scarce resources that are superior to the market alternative. Second, intervenors are assumed to possess knowledge of how to adjust interventions in the face of constant change. As broader economic conditions change, so too will the efficacy of even well-intentioned interventions. Given the goal of improving social welfare, past intervention will need to be continually revised, and perhaps removed or replaced, in the face of changing circumstances. This requires that policymakers possess knowledge of the new conditions as well as the knowledge of how best to revise existing regulations or introduce new regulations that improve social welfare in the face of circumstances different from those in the past. Third, the policymakers are assumed to possess knowledge of what would have emerged absent the intervention. Claiming an intervention is necessary to achieve an outcome implies that the same outcome, or an even better outcome, would not have emerged in future periods absent the intervention.

The main constraint on policymakers in obtaining each of these categories of economic knowledge is the knowledge problem that Mises and Hayek highlighted during the socialist calculation debate. Absent the ability to rely on market-determined prices and profit and loss, there is no way for policymakers to know the highest-valued uses of scarce resources. This ignorance poses issues for the initial design of interventions because there is no way for policymakers to acquire the tacit and context-specific knowledge of dispersed actors throughout society. As a result, they cannot have superior knowledge, relative to market participants, about the allocation of resources. This same issue also plagues attempts by policymakers to revise interventions as conditions change. Since they are unable to acquire the economic knowledge of time and place necessary to determine the best allocation of scarce resources, there is no way to ensure that interventions will be revised and adjusted to improve social welfare.

Finally, since the market is an open-ended process of competition, discovery, and change, there is no way for policymakers to know what would have emerged through voluntary interaction and exchange absent the intervention. This makes it impossible for policymakers to determine if an intervention has produced an outcome that is superior to the counterfactual—namely, the spontaneous order that would have emerged if economic actors were left to engage without intervention in discovery and exchange. Recall that markets are desirable because they create an environment that allows people to experiment and learn the best use of resources. This process is curtailed when government policymakers replace the market process with their own plans and judgments of what resource allocations should exist.

Because policymakers rely on their limited reason and knowledge to intervene in the market process, which is a complex system beyond the full grasp of the human mind, unintended consequences emerge. These unintended consequences can be broken into three general categories. The first is the obfuscation of current and future profit opportunities that would exist absent the intervention. Absent a government-granted license that restricts entry, for instance, there might be profit opportunities pursued by entrepreneurs. However, because these entrepreneurs lack a state-issued license, they are not able to pursue those opportunities. This reduces the welfare of both the entrepreneurs and the customers who would have been made better off by their products. Second, interventions often create new opportunities for entrepreneurial activity that do not enhance wealth. For example, entrepreneurs may seek to avoid regulations by paying bribes or investing resources in influencing regulators. These behaviours benefit the individual entrepreneurs, but they are harmful to society because they represent resources and entrepreneurial talent that are diverted from satisfying consumers to instead avoiding the consequences of government interventions. Third, interventionism can lead to "regime uncertainty," which refers to the inability of economic actors to accurately gauge the future actions of the government as it pertains to interventions. A well-functioning market economy requires stable and predictable rules. The resulting relative certainty allows people to make better plans for the future. The future is always characterized by some uncertainty, but that uncertainty can be reduced if rules are expected to remain constant over time.

To understand why this matters, consider the thought process of an entrepreneur who is deciding whether or not to pursue a venture that might only yield profits in a decade. If the entrepreneur believes that there is a good chance that the government will change the rules and confiscate her wealth over the next decade, she will have a weaker incentive to invest. If, in contrast, the entrepreneur has confidence that the existing rules, which allow entrepreneurs to keep the profits from their investments, will remain constant over the next decade, she will be more likely to invest in the long-term project. The broader point is that interventionism, to the extent that it results in unpredictable or overly burdensome interference in economic activity, poses a threat to the entrepreneurial dynamism of the market process.

An appreciation of the problems posed by interventionism—the knowledge problem and unintended consequences—is at the core of the Austrian critique of standard welfare economics. Welfare economics studies how resource allocations affect social well-being. Standard welfare economics, which serves as the economic rationale for government intervention, concerns itself with finding the best use of available resources under the assumption that all the relevant information concerning preferences and production techniques is known and given.

The economic problem, under such circumstances, is a simple computational problem of employing the right means to obtain the appropriate ends.

Adoption of policy is based on how well the market can handle the static economic problem confronting society. To the extent that the market does not approximate the ideal, it is said to fail and government is called upon to push the economy closer to the solution of the economic problem through interventionism.

Austrians argue that this is not the economic problem society confronts. The problem is rather one of discovering and using the dispersed and tacit knowledge that emerges from interactions. Thus, while mainstream economics models the competitive market as a type of supercomputer, Austrians view the market as a means of mobilizing and using the context-specific knowledge dispersed throughout society. The bias that Austrians share towards the free market, therefore, is grounded in the effectiveness of this system at using and conveying the various bits and pieces of knowledge necessary to allocate resources in a value-added manner.

The emphasis on the division of knowledge and the market process as a means of discovering and using this knowledge is the crux of the Austrian criticism of both comprehensive and piecemeal government intervention into a freely operating market. Government's inability to obtain the knowledge necessary to plan or regulate the price system is the fundamental economic criticism of intervention into the market order. We emphasize the term "economics" to highlight that this is not an ideological argument in favour of markets, but rather a subtle argument in technical economics about the type of knowledge, and the source of that knowledge, necessary to use scarce resources in a way that improves human welfare.

It is important to note that the Austrian analysis of interventionism assumes the best of motives on the part of the policymakers responsible for initiating interventions into the market. If policymakers say that they plan to adopt rent controls in order to make housing more available to the least well-off in society, the analysis of interventionism takes them at their word. In taking the stated ends as given, focus is placed on whether the proposed means—the rent controls—are suitable for achieving the policymakers' goal. While this assumption is unrealistic, it offers an important benefit. By assuming the first-best regarding policymaking intentions, the Austrian analysis of interventionism engages the hard case by granting extremely favourable conditions to the proponents of interventionism.

Even under these favourable conditions, where government officials genuinely seek to improve economic conditions in the name of the public interest, economic analysis demonstrates that interfering with the competitive market process produces results that are often contrary to the betterment of the public. This is not limited to the recognition of the problems with basic wage and price controls, but instead applies to all areas of government interference with the market process. Although the specifics will vary from case to case, the general economic result is the same—interventionism undermines the dynamism of the market process by curtailing the ability of economic actors to engage in competition, discovery, experimentation, learning, and voluntary exchange. This has perverse consequences for human well-being, which stands at odds with the well-intentioned goals stated by policymakers to justify interventions into the market.