ECONOMICS IN A NUTSHELL

THE MACMILLAN COMPANY
NEW YORK · BOSTON · CHICAGO · DALLAS
ATLANTA · SAN FRANCISCO

MACMILLAN & CO., LIMITED
LONDON · BOMBAY · CALCUTTA
MELBOURNE

THE MACMILLAN COMPANY
OF CANADA, LIMITED
TORONTO

ECONOMICS IN A NUTSHELL

By

LEWIS H. HANEY
PROFESSOR OF ECONOMICS, NEW YORK UNIVERSITY

Author of *Business Organization and Combination*
The Business of Railway Transportation
History of Economic Thought, and
Business Forecasting

NEW YORK

THE MACMILLAN COMPANY

1933

Set up and printed.
Published November, 1933.

PRINTED IN THE UNITED STATES OF AMERICA
NORWOOD PRESS LINOTYPE, INC.
NORWOOD, MASS., U.S.A.

To Hope,
My daughter, whose
clear young eyes tell me that
in the future
bunk may not
prevail.

CONTENTS

INTRODUCTION

It has been a great adventure, this attempt of mine to apply economic principles, and especially to invite the public into the sometimes cloistered recesses where the economic theorist is wont to dwell.

This series of short discussions, which might be called "Lessons in Economics," is born of the trials of 1929–1933. Doubtless numerous imperfections and shortcomings are one result; but the work has been absolutely sincere, and, if rough, it represents my best thought. In fact, these little chapters contain a condensed statement of the principles of economics as I teach them to my classes in New York University.

There is an acute and special need these days for straight thinking, especially in the field of Economics.

The condition of Economics itself is pitiable. Never have economists been in less good repute, and unfortunately they have themselves to thank for it. It is little short of a pathetic spectacle, the signing not long ago by 150 "economists" of a petition to inflate the currency. Some economists seem ready to "advocate" anything, from greenbacks to national isolation.

The situation today both in the economic world and in economic thought resembles in many ways that which existed following the Napoleonic Wars in the early part of the nineteenth century. I believe that now, as then, economic science will arise from the ashes of its failures, and that the reign of law will be reëstablished.

Meanwhile, as in recent years, too many of our "leading economists" consist of young men without any mature philosophy or adequate experience or observation; extreme idealists who recognize no law but their own wishes, and fancy that economic institutions make economic life; publicity-seeking schemers who adopt any notion or doctrine which is "new," or has a popular appeal; men who are virtually retained by special interests, including farm groups and organized labor, as well as "corporations"; radical revolutionaries; and stand-pat reactionaries.

Under such circumstances, the public is apt to consider one economist as good as another, the chief test lying in the question whether his "views" are in line with the wishes or the interests of the individual or group which makes use of them.

Latterly in this depression, the lure of the new and the different has been strong, and this is not unconnected with the fact that such foreign prophets as Keynes and Cassell have had such a vogue. This not unusual psychological phase, coming along with the "emergency" of the depression, has facilitated a dangerous mixture of short-time policies designed to relieve or stimulate, with long-run policies which are supposed to promote a sustained recovery.

Doubtless relatively few of the prevailing measures which have been advocated by various economists would have received so much attention had it not been for this confusion between the immediate emergency and permanent recovery. Nor could a Federal Court hold constitutional the "NRA" save by magnifying the "emergency," and at the same time overlooking (1) the truly radical revolution involved, and (2) the lack of reasonable certainty that the new means are well calculated to attain their end.

Thus in a period in which Tom Thumb golf and Technocracy have flourished, and with a "stock-minded" public to work on, we have seen the waxing and waning of Federal Farm Boards, domestic allotment plans, Reconstruction Finance Corporations, and National Recovery Administrations. The cry of "buy now" has been a constant refrain.

The strange, but all too common, readiness of the people to accept some general statement of purpose or goal without questioning the means used to attain the purpose, is a salient feature. Someone arises and says, "I stand for prosperity and putting people back to work." Everybody desires these broad ends; and when some "plan" is coupled with the mere statement of the purpose, it is widely accepted.

Underlying much of the current thought is a profound pessimism. This is the pessimism of those who believe that if we subject men to as little coercion as possible we will have chaos ultimately.

And it is the more harmful in that it is combined with their ill-considered optimism in accepting panaceas as good for tomorrow. It is alleged that capitalism has failed, that the anti-trust laws are obsolete, that the gold standard has broken down, and that the Constitution is dead. We are told that if this, that, or the other plan is not adopted, there will be chaos. To my mind, the various institutions referred to have been functioning poorly, not because they are inherently unsound or unworkable, but chiefly because they have been tampered with and obstructed. Individual initiative has been so hampered by all sorts of restraint, misinformation, and propaganda that it could not work well. More and more, price maintenance and restraint of trade have been tolerated under the guise of stabilization and proration. Unwise policies concerning war debts and a portentous development of nationalism have, of course, made any real monetary standard impossible.

There has also been a wide-spread break-down in the morale of many people, and this has appeared in the prevalence of many doubtful notions. Few will deny that our people are too generally obsessed with "stock-mindedness" and too much given to speculation. In such a soil, the notion that the way to make money is to spend it has found a rank growth. Credit has been greatly abused, until it would seem that both the people and statesmen believe that one can borrow himself out of debt. For nearly a decade, individuals and nations have been trying to pull themselves over the fence of debt by their credit bootstraps. An exaggerated importance is attached to the way people feel about things from day to day, which is the thing called "sentiment."

Then, too, we are all too prone to consider "the government" as though it were something entirely distinct from ourselves and different from the people who maintain it. We think of the "government" as something either to give us doles, or something which we can "beat" in one way or another.

Get-rich-quick ideas and the quest for an inflated "American standard of living" are all too common.

But it is still true that credit means debt, and that the enormous debts which were piled up during and following the war in connection with the usual war and post-war inflation constitute the great economic problem, and have led to the speculation and over-spending which have underlain the chaotic conditions in this country.

We can go either one of two ways: we can adopt a rigid collectivism, which would have the government "do it" for regimented masses of citizens, paying the swollen taxes which would be one result; or we can work back to a reasonable individualism which will recognize that, after all, the government exists for the welfare of the individual citizens, and is not likely—under any form of democracy—to be much better than the average citizen.

But whatever way we take, we may be sure that we can never approach success unless we recognize that effective competitive tests must be applied in the selection of our leaders, and that the first test, insofar as economic policies are concerned, must give due recognition to the existence of economic laws.

The following little essays have mostly appeared on the financial pages of The *New York Evening Journal* and other Hearst papers, although two of them are taken from my articles in the *North American Review.* To both of these publications, I express my thanks. I should add that it is not to be inferred that Mr. Hearst is in agreement with some of the ideas here expressed, and it is a tribute to his breadth of view that they have appeared in his columns. My thanks are due to Dr. E. M. Friedman for reading the proofs and making valued criticisms.

I hope that some "roughness" of style will be accepted as the result of an effort to be both terse and pungent. It is my thought that the same qualities which have appealed to readers of my "column" may now command attention and arouse interest in Economics.

ECONOMICS IN A NUTSHELL

1

WHO ARE THE ECONOMISTS?

A QUESTION that has frequently been asked is, "Why did the economists do practically nothing to solve the problems of the depression? But another question is, "Who are the economists?"

That question is a difficult one to answer. Anyone can set up as an "economist." From the man in the street who reads about economic conditions, to the physician or lawyer who happens to be running a bank, everyone is apt to think he knows economics.

One of the worst cases in point is that furnished by the members of such allied groups as accountants, statisticians and engineers. These "professional men" may have had little or no training in economic science. Their work, however, brings them into touch with certain economic problems, so they pose as "economists."

You see, anyone can talk the language of economics, for unfortunately economics uses the common terms of business. It has few peculiar technical terms. In this, it differs from such sciences as chemistry and astronomy. Even such arts as medicine and law are sealed books to most men, partly because of the words they use. But anyone can talk like an economist.

Again, economic problems are so mixed up with private business problems that many confuse economics with business. Thus we are prone to treat men who have knowledge of business as though they knew economics.

And the more success a man has in his business, the more we consider him an economist. This is the "business leader" complex.

The science of economics takes a public or social point of view. It is concerned with the general welfare in so far as economic values are concerned. In dealing with the tariff question, for example, the true economist considers the interests of the nation as a whole, while naturally each business man thinks first of his own business.

This suggests another point, namely, that some trained economists have special business interests which may keep them from being true scientists. To the extent that they are influenced by business employment, they become business men. Some, too, have been influenced by their speculations in stocks.

Finally, there is a good deal of "puffing" and advertising by or for various "economists." This may lead the public to attach an importance to the "views" of some economic medicine man which they do not deserve.

To be worthy of the name of economist, a man should have years of training in economic science and the history of economic developments. Probably he should have been tested by experience. He should be free from special interests which conflict with the public interest. He should have a record which will stand careful checking.

And why should one expect even that all trained economists should have an equally good grasp of economic science? Admission to the bar and a license to practice medicine do not make good lawyers and physicians. Nor are all good lawyers and doctors real authorities in their professions. Some trained economists are not good economists; many of them fall short of being authorities who really know "what it is all about."

One big trouble is that there is no test of survival among economists. They go on year after year expressing unsound views and making serious errors, yet they survive and may even be called "eminent".

It would be well if a record were made of the judgments expressed by all who pose as economists. Then this might be checked against results. Then maybe the "unfit" could be weeded out.

But we cannot expect "economists" to have much influence unless economics be recognized as a science and economists as a well trained body of scientists who survive by test.

2

WHAT IS ECONOMICS?

ECONOMICS is the social science which deals with human wants, and the means of satisfying them by production. It concerns market values, prices, money, wages, interest, rent and profits.

1—Economics is a science. This means that it seeks to determine causes and effects within its field and that it has developed a body of "laws" which state that under given conditions certain results always tend to follow.

For example, one economic law is "the law of diminishing utility." It says that at any given time, as the quantity of a product possessed by an individual increases, his desire for any unit of that product decreases.

If I have many loaves of bread I do not have so strong a desire for bread. We saw this law working in the demand for many products in 1932. It is one of the reasons why automobiles, and cotton, and many kinds of building found a weaker demand than formerly.

It applies to money, too; and if we turn out too many dollars, each dollar is desired less, so the purchasing power of money decreases.

Again, there is "the law of diminishing productivity," which states that, under any given conditions, if we increase the amount of any factor used in production, a time will come when the output per unit of that factor decreases.

We see this law working in the building industry, where the increase in capital used on certain land areas has resulted in decreased returns on the investment. In fact, it lies back of the overdevelopment of improved real estate in many cities, which is so important today, as well as in the "overcapacity" of steel plants and copper mines in 1929.

2—Economic laws are subject to exceptions. They are based on the action of "the average man under usual circumstances." Some men, however, are abnormal (say misers, crooks, and unusually stupid people). In periods of obsession people may see "new eras," and the laws of economics may not seem to be working.

3—Economics is separate from morals or ethics. It has no direct connection with "right" or "wrong." It merely says, "If you do so and so, such and such things will tend to happen." For example, it takes no sides as to the morals of the prohibition question, but is concerned only with the effects upon the wealth and income of the nation.

4—It is most important to note that economic science is very different from the art of money making, or business. The economist as a scientist can not take the point of view of the individual business man.

That is why economic teachings so often run counter to policies favored by business men. For example, to each protected individual it seems that a protected tariff is good, although the general welfare of the nation may be injured thereby.

In short, economics does not teach directly how individuals can make profits, but how the wealth of nations can be maintained or increased.

One of our great troubles is that we are prone to consider national economic problems from the standpoint of our particular businesses. We mix our economics up with private business.

Thus, because each business man figures that if he could sell for higher prices he would be better off, we are apt to want a higher average price for all goods. But one individual's price is another's cost. High prices for all products mean high expenses. The nation can be as well off at a low price level as when prices are highly inflated.

The test of all economic principles is, Can they be generalized? Can "everybody do it" with general benefit?

3

WHAT IS "WEALTH"?

ECONOMICS is often defined as the science of wealth. What, then, is "wealth"? How can millions be poor in the midst of plenty?

To an individual, wealth is anything which has economic value; that is, anything which is wanted, but is "scarce."

But to have economic value a thing must either be saleable, or be subject to appraisal on the basis of its definite income so that an estimate as to its probable value can be made. Of course, money is wealth, but only to the extent that it will buy such things as food, buildings and automobiles.

Human beings, or their qualities, however, can be considered as wealth only where slavery exists.

An individual is "wealthy" if he owns much wealth. Here we see a paradox in the making, for we have just said that a man is wealthy when he has an abundance of things which are scarce! Of course, the fact is that while the wealthy individual has plenty, others have little. If everybody had plenty of everything, nobody would be "wealthy." And the more everybody had, the less they would want.

Nothing would have any economic importance and the idea of wealth would not be significant.

Indeed, we read of tropical islands where nature provides abundantly for the limited wants of the natives. Are they "wealthy"?

These thoughts suggest the so-called "paradox of plenty," and remind us that in 1932 millions of people were in need while huge supplies of commodities and great productive capacity existed. What is the explanation?

The answer is that commodities which formerly were really scarce are now abundant and are therefore low in value; but their owners will not allow their abundance to become effective and refuse to sell them for what they will bring, thus creating an artificial scarcity in the midst of real plenty. (See p. 11.)

As larger and larger stocks of cotton and copper accumulate, these commodities lose their scarcity and approach the condition of being "free goods" such as air and water. This fact, however, is not recognized by the producers, who think of the past cost of production. The Government may even aid them in withholding the surplus.

So the cotton and copper decline in value, and the owners' "wealth" is reduced. But the abundant supplies are not made available to others. Air and water are abundant and ordinarily have no value, although we could not do without them. Cotton and copper we could do without but, despite their abundance, the owners hold them for higher prices.

Thus they grow poorer, and no one else benefits by the large supplies. Their individual wealth is reduced; that of others is not increased. The wealth of the nation is smaller.

It is an ancient criticism of the economic conception of "wealth" that as things become more plentiful so that people can consume more freely, prices fall and value-wealth decreases, while as things get scarcer and people can consume less, prices rise and wealth increases. Many critics therefore argue that "wealth" should not be measured by value.

But the justification is simple and clear. As long as we do not have enough of a thing to satisfy all wants, we must economize in its use. We therefore allow buyers to pay what they will in order to find out who wants the thing most and to prevent wasteful use by those who want it least. High prices tend to stimulate production of scarce things and increase the supply. Low prices tend to direct consumption to things which are plentiful.

Thus the system of measuring wealth in terms of economic values seems to be the best way to solve the paradox. If we allow free play to market forces, they tend to make scarce things more plentiful, and plentiful things scarcer—barring exploitation and fraud.

If in 1932 the farmers and mine owners had been willing to have sold their cotton or copper for what it would bring (say 4 cents per pound), would they not have received a larger total income than they did? And would not the rest of us have benefited by a lower cost of living? (See note, p. 11.)

The value concept of wealth limits it to things which are actually desired, and makes us choose among things according to their importance to us. We do not include "free goods" as wealth, but only things for which our wants are not satisfied—things of which we do not have enough.

This does not mean that other things (air and water) are not necessary, but that we have enough of them, and they present no economic problem. To increase their supply would not add to our wealth.

Economic life centers in economizing.

The wealth of the nation is the sum of the wealths of its citizens, with these differences:

1—Some individuals desire things which tend to destroy the individuals themselves or to injure others, or which merely take wealth from other individuals, and the means which they use (*e.g.*, harmful drugs, burglar's tools, the "goodwill" of a business), are not additions to the nation's total wealth.

2—Some desirable things are not individually owned (*e.g.*, public parks and the Panama Canal) and some would not even be of interest to an individual owner (lighthouses, rivers). Such things have to be added to the sum of individual wealths to get the wealth of the nation.

One may conclude that the failure to adjust values according to the law of supply and demand, resulting in overproduction, withholding surplus commodities from markets, and monopoly—these are what cause poverty to exist amidst plenty and make a mockery of abundance. Lack of balance between the buying power of farmers and of industrialists, is a factor, too. This, however, is partly a result of the preceding conditions, and it is certainly not to be cured by artificial price-fixing.

Note to Pages 8 and 10. By saying that farmers, as well as copper producers, "refused" to sell freely, I mean that government loans, price-fixing, and "coöperatives," led them to hold large stocks for prices which were higher than those which would have cleared the markets under free supply and demand conditions.

Someone may say that low prices and living costs do not benefit, because they bring unemployment, etc. But: (1) If farmers don't sell, they don't get income; and 6 million bales sold quickly at 4¢ net them much more than 3 million at 8¢ (with carrying charges and losses). (2) Low prices to consumers enable those who do have incomes either to buy more cotton, or to spend for other things (including the manufacturers who consume the cotton as raw material). (3) Credit is strained and taxes raised by financing "holding movements." (4) Further overproduction is encouraged. It may be better to burn excess cotton than to hold a big surplus off the market, but neither can help unless the overproduction is stopped.

4

HOW JUDGE THE GENERAL WELFARE?

ONE of the greatest needs of the nation is that its policies be governed by a truly national point of view. We badly need to look at matters from the standpoint of society as a whole and to have as our goal the greatest good of the greatest number.

I think that one of the greatest hopes that was entertained concerning the new Democratic administration in 1932, was that it would be more inclined to take such a viewpoint than the Republican Administration had been. A vague feeling of this sort probably underlay the attitude of the people.

There was much talk in 1932 about the "forgotten man." We may be forgetting all men—the country as a whole. The forgotten man may be every man, in the sense of our common interests.

Perhaps the trouble with our politics has been its emphasis on particular individual or group interests. And perhaps what Roosevelt really meant by the "forgotten man" is that no man should be forgotten, which would mean all the rest of us.

One of the best ways to test the common interest of the whole nation is to consider the consumer.

You see everybody is a consumer, and as a consumer every man has interests in common with every other man.

When you consider producers, you at once run into clashes of interest. You are forced to consider the particular interests of farmers and railways and the various manufacturing industries. Each industry wants high prices for its products. But all consumers want low prices.

This is why there is so much divergence of opinion on the tariff. Each industry wants its product "protected." But it generally does not want its raw materials "protected." And all of us as consumers do not like the high prices which protection brings.

The government's policy of fixing prices on wheat and cotton and its aid to individual railways and banks, are welcome to the individuals who seem to get the immediate benefit. But is this best for the nation?

Do the particular individuals not suffer in the long run along with the nation as a whole?

It is not at all necessary to be a Socialist in order to take a social viewpoint. In fact, the strongest argument for individualism is that, in theory, it applies to everyone and is best for all. The idea is that what is good for all individuals is good for the nation.

Individualism should mean equal opportunity for all, with no government interference on behalf of special interests or particular groups.

In my opinion, the Hoover administration did not really stand for a broad individualism or the common interest of all of us as consumers, but rather for interests of certain groups of producers.

There was some reason to hope that Mr. Roosevelt and the philosophy of the Democrats would tend to seek the common welfare of the nation through the interests of all individuals. The special interests of farmers, however, appear to have had too much emphasis.

What this country needs even more than a good five-cent cigar is some way of making us vote according to our common interest as consumers, and a strong lobby to represent that interest at Washington.

5

WHAT IS ECONOMIC VALUE?

ECONOMIC values are based on definite human wants. Unless a thing appeals to some desire, it can have no value.

For example, within the memory of persons now living, gasoline was not wanted and laws were passed to prohibit oil refineries from dumping it into rivers and killing the fish.

This reminds us that there is no such thing as "intrinsic value." The gasoline was much the same as today, but it had no value. It cannot be too strongly emphasized that values depend upon our desires, perhaps vanishing with a shift in wants. Thus they are not "intrinsic."

But, in addition to wants, another condition must exist before a thing can have economic value, and that is "scarcity." If the supply is not limited, the thing has no economic importance.

Thus we pay for ice, but the Eskimos don't. When the supply of cotton becomes as large as in 1932, that product has so little scarcity that its value is small. In a sense, we want cotton as much as ever, but if it is very abundant, we attach less importance to it, and its value falls.

Sometimes people want things just because they are scarce, as "collectors" want certain stamps.

Most things are scarce, or limited in supply, because we have to undergo labor and other costs in order to produce them. If we go ahead and produce things when they do not sell for enough to cover costs, their value falls below cost of production, and stays there until they get scarcer.

Each person has his own ideas about the relative worth of things, or his "subjective value." These differ according to individual wants, which vary with standard of living, sex, age, etc. The "scarcity" of things possessed also differs widely among individuals.

So, on the basis of their different individual valuations, men trade one thing for another and this gives rise to "market values," or values in exchange. The rate at which one thing exchanges for another is its value.

Thus economic value is purely relative. It is the power of a commodity or service to command other commodities or services in exchange. If a hat exchanges for a pair of shoes, they have the same "value."

If we actually trade the hat for a pair of shoes, the hat is the "price"; but if we use money, the amount of money is the price.

It is highly important to note that there is no such thing as an absolute economic value. Values involve choices, and are relative.

For centuries, some people have argued that "labor" has an absolute and fixed value. We can readily see, however, that any value labor has depends upon what it produces, and varies according to the want for and scarcity of the product.

We don't want labor for itself.

"A day's labor" is a variable and changing thing. It varies with the kind of labor done, the kind of man who does it, and the results produced. It may mean strong or weak laborers, artists or hod carriers, coal or jig-saw puzzles.

And exactly the same may be said of electricity. Its value varies from place to place, and from time to time, according to the cost of producing it and the things it helps to produce.

There can thus be no absolutely fixed standard of value, and the search for one is as vain as the search for perpetual motion or the fountain of youth.

A "standard of value," such as gold, or labor time, must have value itself. It could not serve as a measure of value if it did not, any more than a yardstick could measure distance unless it had "length."

But nothing has an absolute value, simply because value varies from time to time and place to place with human wants and human costs. The best we can do is to select a fixed quantity of some commodity which has the most stable value, and use it as our value "yardstick." It changes, but only gradually; and it is a definite thing.

6

IS COMPETITION "THE LIFE OF TRADE"?

COMPETITION is generally assumed in the statement of any economic "law."

This is quite similar to the assumption of the chemist that "chemically pure" materials will be used, or that his scales will be protected from disturbing influences. In commercial work these conditions may not obtain, and just so in business, competition may not exist or may be imperfect.

But by reasoning on the basis of competition, the economist simplifies the problem of dealing with complicated motives and forces. Furthermore, there is reason to believe that under favorable conditions, competition secures the best economic results which are attainable.

We may define "competition" as rivalry for the possession or control of anything of economic importance. Thus business men or laborers compete with one another for markets or for jobs.

Competition exists and is *effective* when no individual or group has control over the price of the thing in question. To the extent that any control over markets exists, we say that competition is ineffective.

When any individual or group gains power to control prices monopoly replaces competition. The monopoly may be partial or complete.

Competition varies greatly in *efficiency,* this depending upon the motives, intelligence and knowledge of conditions possessed by the competitors. When they are influenced by irrational or noneconomic motives, such as sentiment, custom, or love of power, they may not seek the most efficient methods. When they are ignorant of costs or do not know the true state of supplies or demand, they may do uneconomic things.

On the whole, however, competition is effective in most of the business world, and, although it is often inefficient, we are continually seeking to increase the knowledge and intelligence of business competitors.

We should remember, too, that under effective competition it is reasonable to expect that the least efficient competitors will lose and be eliminated from the rivalry.

The statement is often made that "competition is the life of trade," and despite much imperfection and inefficiency there is an important element of truth in it.

One can hardly deny (1) that the *average* individual usually knows his own economic interest better than any body of representatives now available as a "planning" agency, and (2) that the average individual has a stronger incentive to seek his own economic advantage than any other.

But if these statements be approximately true as generalizations, it follows that the average individual usually may well be allowed a great deal of freedom to compete, and that business as a whole benefits thereby.

Moreover, even if a "planning" agency which knew the interests of each individual best, could deal with all the conflicts of interest among individuals and classes, would class legislation, widespread mistakes, and revolutions not result?

There is little danger nowadays that we will forget that the general welfare of society is the goal, and that if competition becomes brutal or destructive it must be regulated. We know that in certain industries of the "public utility" type competition in prices cannot be made to work satisfactorily.

It seems, therefore, that the best course is to set aside certain definite fields in which we apply public regulation, and in the remainder of the business world encourage a reasoning and reasonable rivalry for the business prizes.

This we may do by laying down the rules for the business game (prescribing reasonable penalties for violations), and by constantly seeking to educate competitors to an appreciation of their common interest in the general prosperity of their trade and of the whole nation. Then pitiless publicity would help.

7

HOW DOES THE LAW OF SUPPLY AND DEMAND WORK?

THE key to economics is the Law of Supply and Demand. Upon its working depends the determination of economic values.

No law is more frequently mentioned. None is so little understood.

Generally it is taken to mean the vague idea that markets should be left to the working of free competition. Or someone with a little smattering of economics may say "prices are determined by supply and demand."

But what are the supply and demand, and how do they work?

Economic science gives us a means of precise statement. We may put the law as follows: Under competitive conditions, market values are determined at the point where the bid of the least desirous buyer equals the offer of the most resistant seller, so that the quantity bought and sold will be the largest possible without loss.

Note that there are three elements involved in this statement:

1—The level of the valuations in the minds of potential buyers (the possible bids). This depends upon the strength of their desires and their purchasing power. If people want things strongly and have plenty of good money, we say "the demand is strong."

2—The level of the valuations in the minds of the potential sellers (the possible offers). This depends chiefly upon their costs and their holding power.

3—The quantity for sale.

If buyers are willing and able to bid high, prices tend to be high. But if sellers are willing and able to offer low, prices tend to be low. The price cannot be higher than any demander will give, nor lower than any supplier will take.

Of course, some possible buyers are willing to bid very high and some possible sellers to sell very low. These, however, are not enough to provide a market for the whole quantity available, so lower bids and higher offers become effective.

The law of supply and demand says that as the quantity for sale increases, demanders who have lower and lower desires or purchasing power must be appealed to. At the same time, suppliers whose costs are greater or who are for other reasons less anxious to sell, must be induced to make offers.

Thus the less willing buyers and less eager sellers are drawn in to clear the market, until finally an equilibrium is reached. Bids and offers are equalized. The quantity supplied equals the quantity demanded.

By this process we get the price fixed at the point where the maximum volume of profitable exchanges occurs. If any more or any less were bought and sold, there would be losses. (Or if losses already existed, they would become greater.) If the quantity were larger, some of it would have to be sold to buyers who would not pay enough to cover sellers' costs. If the quantity were less, some buyers who could pay a profit-yielding price would be left out.

When we do not interfere, therefore, the law of supply and demand works to keep production adjusted to consumption at a reasonable price level.

This should give us the best possible price levels.

Monopoly usually restricts production, thus limiting the quantity for sale. So it leaves wants unsatisfied which could be supplied at some profit. That is not in the best interest of society.

Government price-fixing schemes, such as the Farm Board, are attempts to run counter to the law of supply and demand. They arbitrarily name a price higher than supply-and-demand conditions would fix, and try to reduce the quantity immediately for sale by "holding" stocks off the market.

This not only prevents equilibrium from being restored, and the ultimate establishment of profitable prices, but it actually encourages overproduction.

8

WHY DO WE NEED THE "PRICE SYSTEM," WITH A "STANDARD OF VALUE"?

ALL the 1932 talk about "energy," electricity, barter of commodities, etc., was interesting and deserves careful analysis.

In a way it is encouraging to find people getting back to the realities. We often pay too much attention to money and credit and gold and stocks and bonds.

We are in danger, however, of going to extremes in this matter. Physical realities are important, but so are economic realities. The two are not the same.

The one big economic reality is "value," which is measured by prices. Physical things, such as electricity or silver, may or may not have economic value. For example, air and water are very important physical things, but they have little if any economic value.

The value of a thing depends entirely upon how much men desire it, and how much they have to economize in their consumption of it. In other words, value is a matter of demand and supply.

If men did not desire electrical kilowatts, or if electricity were in such abundant supply that we did not have to economize in our use of it, it would have no value.

All this brings out two important points concerning money and our control over production.

1—Money, to serve as a standard of value, must have value in itself. It must be made of something, or be definitely tied to something which men desire and which is limited in supply.

That is why we always find that mere paper money is no good. It has few of the qualities which give value.

Furthermore, things which have value, but which fluctuate widely, either in supply or in demand, are bad for monetary purposes. This is why silver is such a poor thing for money. It is one of many reasons why any unit of electrical energy could not be used.

If we could make gold in any quantity we wished, it would be little better for money than electricity, although even then we could exchange it and store it as we cannot do with "energy."

2—In order to control production so that products will be adjusted to human wants, we must allow economic values to govern industry. If we keep industry free from monopoly and artificial control, and put it up to intelligent captains of industry to make what they can ethically sell to consumers, we will have the only workable system.

This is "the price system."

We can depart from the price system of business control in two ways. (1) We can try to regulate prices artificially, which of course spoils the whole system. This is what we tried in wheat, cotton, copper and oil.

Or (2) we can set up a dictator or planning board, who would decide for us what we are to have and how much is to be produced. This is what they are trying in Russia.

Neither one of these substitutes for the price system has ever worked. Personally, I don't see how they can work. The one substitutes artificial values for true economic values. The other substitutes the opinion of a few men for the wants of all men, and takes away the force of individual initiative.

Long experience indicates that no man or group of men can be wise enough to fix prices or to control total production.

If we ignore economic value in our money we will get bad money and inflation. If we ignore economic values or prices in controlling industry, we put ourselves at the mercy of some planning body which may direct the nation's energy to making shoes when we want hats, or to making black shoes when we want brown ones.

A possible substitute for the price system is a central control of production or consumption, or both. Thus crops can be curtailed. But aside from (1) the ills of coercion, and (2) the practical difficulty of foreseeing yields, who can tell in advance how much of anything we will want or what is good for us?

9

WHAT ARE THE ESSENTIAL QUALITIES IN GOOD MONEY?

THE essence of business is "buying and selling," which is exchange.

Direct exchanges by barter, however, are generally so difficult to arrange that from the earliest times men have used some medium of exchange. The Indians used wampum. Such means of exchange which circulate we call "money."

It follows that economic values, which are exchange values, are usually measured in money. When so measured, we call the value of a commodity its "price."

The primary function of money is thus its service as a medium of exchange, in performing which function it measures economic values.

Clearly these are highly important services, and we must examine carefully the qualities that anything must have which is to be used as money.

1. The first and elemental quality which money must have is value in itself.

This cannot be given to it by government order. In fact, we can not legislate value into any thing and especially not when the thing, like money, must have an equal value in exchange among all men.

In this conclusion we do not need to rely upon reason, however, for the invariable result of many unfortunate experiments proves that money must be based upon a valuable substance. It must consist of (or be based upon) something which is desired for itself, and which is so limited in supply that no danger exists of its losing its value.

This is the chief reason why men have come to use gold as money. We use gold as money primarily because that metal has always been and is now highly desired, and because it is sufficiently scarce to insure its value.

The law may recognize this fact and, in order to avoid confusion, may fix a standard weight of gold as the unit, and establish uniform rules of exchange. But the law does not give gold its value.

Paper money is used as a representative of the standard metal merely for the sake of economizing in the use of the metal, and for convenience. Having no value in itself, it serves satisfactorily as money only as it is convertible into the standard metal.

If wisely used, paper money is a desirable instrument, but there is always the danger that it can easily be produced in such large amounts that question may arise as to its convertibility into the standard metal. This sometimes causes price disturbances and panics.

2. Another important quality in any satisfactory money, is that its value should be as stable as possible. This insures that average prices, measured in the standard metal, will vary little on account of changes in the valuation of money itself.

This is one of the strongest reasons why gold is selected as the best monetary substance. Not only do men universally desire gold, but the total supply of gold varies so little from year to year that its value is subject to less change than that of any other substance which could be used.

Silver can be rapidly produced in huge quantities. Moreover, it is largely produced as a by-product with other metals, so that its supply is not adjusted according to monetary conditions.

When *average* prices rise or fall sharply, we must not think that it is caused by changes in gold money. We may be sure that the trouble lies in the paper money which has been issued in place of gold. When too much of this is issued, credit is drawn upon, and the credit in the paper money becomes weakened.

For a time, prices rise, as the large supply of paper money encourages demand for commodities, but a decline is inevitable. Prices must get back to the basis of some definite standard, and this means deflation and a fall in prices from the peak levels.

10

HOW IS OUR MONEY SYSTEM COMPOSED?

In addition to having value in itself, and being as stable as possible, it is important that (3) the commodity to be used as money should be convenient as a medium of exchange. To this end, it should be *readily made into coins which are equal in all respects*. And it should have *so much value per ounce that considerable sums can be easily carried*.

Then, too, the monetary substance should (4) be *durable*, and should be (5) *easily recognized* and distinguished from other substances.

All these features point to the use of some metal, and of all metals gold is by common consent the best suited for the purpose.

Even gold, however, is inconveniently heavy for exchanging large values; while for small values, gold coins would be too tiny to be practicable. Furthermore, gold is soft and loses by abrasion when used as coin.

Accordingly, we now use paper substitutes and minor coins of baser metals. This gives rise to numerous species of money. The money system of the United States, as it existed until March 1933, may be briefly described as follows:

It is based upon a "standard metal," gold. Gold bullion is freely coined at the mint, and full-weight coins can be melted down into bullion without loss of value. Provision is made to make other kinds of money convertible into gold—except in a great emergency. In these ways, gold coins are kept equal to the market value of gold bullion and the value of all our money rests upon gold.

The "standard unit" of our gold money is 23.22 grains of pure gold, which is the quantity in each gold dollar. This fixed weight makes the standard definite.

On this base we erect various forms of paper "currency" and subsidiary coins.

Our representative currency consists of "certificates." Gold certificates" are warehouses receipts, against which the specified amount of gold is held. (We also have issued some "silver certificates," which are backed dollar for dollar by silver.)

Then we have several kinds of "notes," which are not representative of gold, but are credit, or fiduciary, issues. These are all promises to pay made by banks or the Government, and may be secured largely by collateral other than gold. They include Federal Reserve notes, Federal Reserve Bank notes, National Bank notes and U. S. notes ("greenbacks").

The Federal Reserve Bank notes, which have recently (1933) been used as an emergency currency, are ordinarily backed by Government bonds and a 5 per cent redemption fund in gold. The same is true of National Bank notes.

The "greenbacks" are a hangover from Civil War inflation, but are now backed 45 per cent by gold.

Our "token" coins of silver, nickel, and bronze all have a face value which is greater than that of the metal they contain, so they are not melted down, and as their value is small there is little temptation to counterfeit them.

In addition to all this currency and coin, we use bank checks as a medium of exchange. Indeed, we ordinarily do about 90 per cent of our business by this means. This kind of medium is not "money" since it does not circulate, but is called "deposit currency," since checks are drawn against bank deposits. Their value depends upon the credit of the individuals who draw them and the condition of their banks.

In times of numerous bank suspensions, when checks cannot be used, we naturally find a great demand for other currency, such as certificates and notes, and a "currency shortage" is said to exist. In reality, this is chiefly a tying up or loss of bank deposits.

It remains to note that some money is "legal tender," and some not. (Money is legal tender when, by law, a debtor can tender it in payment of his debt; and even if the creditor objects, the interest ceases to run.) Our gold certificates, U. S. notes, and silver dollars are legal tender. Federal Reserve notes, bank notes and silver certificates are not.

11

WHY IS THE GOLD STANDARD BEST?

As THERE is so much talk about tinkering with the gold standard, and the silver producing interests are still pushing "bimetallism," a word about money standards may be of interest.

Most people agree that business is too complicated to allow us to trade products directly for one another, as in "barter." So the use of money seems necessary.

But we must have some standard as a basis for money. By adopting gold as a standard, and taking a certain number of grains of gold as the standard dollar, we get a definite base. This is known to all people. The composition and quality of the standard unit are fixed and definite.

We must always bear in mind, however, that values of all things are constantly changing. There are no constant or intrinsic values. The value of gold, like all other commodities, varies with changes in our wants and in supply conditions.

In short, no absolute standard of value is conceivable. The length of a yard or the size of a gallon may be kept exactly the same, but the value of a yard of cloth or a gallon of gasoline does not stay put. Values (not artificial prices) cannot be fixed.

However, we can do something to help keep the measure of value as steady as possible. We can select as our standard a commodity which is least subject to change. Thus we can establish a standard, such that changes in prices will be chiefly due to changes in the values of commodities other than money.

This is why gold has been chosen. The demand for gold is relatively steady and sure. The changes in the supply of gold from year to year are small in comparison with the world's total supply. So the value of gold changes little insofar as gold alone is concerned.

The great variations in our price levels are not due to gold, but to changes in other things. If the supply of cotton and copper becomes very large, or the demand for coal and lumber falls off, these things fall in value as compared with gold.

But the greatest factor in causing rises and falls in the price level since the war has been credit. We have substituted credit for gold and used more credit money. The juggling with credit dollars or paper money is chiefly to blame.

In this connection, I may add that our gold supplies have been unwisely used and a maldistribution of the world's gold supply exists. But this, like the other price-disturbing factors, is not a fault of the gold standard. It is just a misuse of a good thing.

At the very least, it can be said with certainty that a gold standard is important as a means of (1) maintaining confidence in a nation's system of money and credit, and (2) securing international stability of currencies and foreign exchange.

Now some people are saying that we must "remonetize silver." That would mean bimetallism, or a double standard. It would be like trying simultaneously to measure cloth with two very different yardsticks—which is impossible.

Silver is very cheap and subject to wide fluctuations in value. It would be a very poor thing to take as a standard of measure.

Futhermore, the scheme is always to set up a silver standard which would try to make silver worth more than it is in the market. That would be overvaluing silver. The result would be that everyone would want to pay in silver. We have always found that under such circumstances silver drives out gold, and that instead of bimetallism we have really a single silver standard.

All these attempts to "revaluate" the gold standard or to mix it with silver, are attempts to depreciate or debase our money—the dollar.

They are based on a misunderstanding of the nature of money and of the causes of price changes.

They can accomplish nothing but to introduce new uncertainties and possibly bring ruin to millions of our people.

12

WHAT IS CREDIT, AND HOW DO BANKS FUNCTION?

OUR money today is largely credit money, such as bank notes, and with the aid of banks a large part of business is conducted by means of "checks," which are purely credit. We should, therefore, understand the nature of credit and banking.

A credit is essentially a transfer of goods or services now, in exchange for a promise to pay in the future, usually in money. Thus credit involves (1) trust, or confidence in the will and ability of a borrower to pay, and (2) time—repayment in the future of a loan made in the present.

So large a part of business rests on credit, that we can almost say that we have passed from a "money economy" to a "credit economy." Credit in the shape of checks largely replaces money, and much of our money itself is largely backed by Government credit, the banks lending to the Government (buying Government bonds) and then issuing "notes" secured by Government bonds.

In a sense, money has become a tool of credit. Credit enables business enterprises to get possession of money and capital. Through extensions of credit, lenders direct the use of capital. We can almost say that business is as much a matter of borrowing and lending as of buying and selling.

It is thus easy to see why "confidence" is nowadays so much emphasized. Also, we see why the "money market" plays so prominent a part, for in reality the "money market" is a credit market, and reflects the factors of "trust" and "time" which credit always involves.

Like all useful and delicate instruments, credit is dangerous when abused. We abuse credit when we treat it as if it were an addition to capital. Credit is not capital, but merely a transfer of the use of capital. Credit involves debts. We cannot add such credit instruments to the real capital of the nation to get a total, for that would mean a duplication. So the real value of credit depends upon how it is used in directing the employment of capital. If through over-optimism, credit be unwisely extended, either in the use to which capital is put now or in the extent to which an over-distant future is discounted, a frozen condition results.

"Commercial banks" are ordinarily the chief agency for business credit. They are different from "savings banks" (which gather in small savings and invest them in eligible securities), and "investment banks" (which raise large funds for permanent investment, by offering securities for sale).

A commercial bank in essence is an institution for extending short-term loans to business men. Its business consists in receiving deposits, making loans and investments, and dealing in commercial paper. It may also issue bank notes.

Such banks help business secure capital by making savings available and by lending their own credit. They economize the use of gold. They provide safe places of deposit for the public.

A group of men subscribe to the stock of the bank, thus giving it its capital and surplus, and enabling it to obtain a place of business and equipment, and to start with some cash. They then receive deposits. To some extent, these are cash and represent savings, but chiefly they are the result of loans made by the bank itself.

A business man comes in and wants credit. If the bank manager decides that the loan is good, he takes the man's note and opens a "deposit credit" on the bank's books. The business man may then draw checks against the deposit thus made. This may be called a "derivative deposit."

Next, the bank (under our national banking system) may have its own promissory notes printed and duly signed. These are "bank notes." The banks can pay them out when making loans, etc., and they circulate as money. They are backed by an investment in Government bonds deposited in the U. S. Treasury.

Checks usually soon return to the bank for payment and do not circulate, so we do not call them "money"; but they take the place of money in the given transaction and are often called "deposit currency." Bank notes circulate freely, and are "credit money."

The goodness of checks depends upon the credit of the individuals who draw them, and the solvency of the bank on which drawn. The goodness of bank notes depends primarily upon the issuing bank.

The solvency of the bank, in turn, depends upon (1) its ability to keep new deposits coming in as fast as old deposits are withdrawn, (2) the wisdom with which it makes loans and investments, which will be both sound and liquid (that is, promptly convertible into cash).

Ordinarily a bank needs only a relatively small amount of "till money" to serve as a banking reserve against deposit withdrawals. It counts upon new deposits coming in, or in case of ordinary spurts in withdrawals it calls in loans or sells investment securities to get the cash required. But if "confidence" becomes badly shaken and a "run" is started, deposits may be withdrawn so rapidly that reserves become exhausted. Then, if the bank's loans or investments are bad or "frozen," it is forced to close its doors; and we realize how sensitive and even dangerous credit may be.

Thus it is evident why a bank may be called "a manufacturer of credit and a machine of exchange." Bank management, however, must be very wise to limit credit to productive business uses and to keep its deposits and notes well secured.

13

HOW DOES CREDIT WORK?

ONE of the things about which we should think most carefully these days is the nature of credit and its relation to money.

Credit is represented by a promise to pay. Usually it means an exchange of a promise to pay money in the future for commodities or services received now.

A man's "credit" is his ability to get goods or services now in return for his promise to pay in the future.

You will note that the element of time is always a factor. Credit always means some promise to pay in the future. So there is always some "discounting" of future conditions which of course means some risk.

When we have credit "inflation," we have people getting too optimistic about the future. They either extend too much credit or too long credits. People buy things "on time" that it will take too long to pay for.

The second point to note is that credit is based on the soundness of some business transaction. It assumes the ability of some borrower to pay, and the ability to pay must largely depend upon the use made of the credit.

If I get a loan (credit), I must so use the funds in my business that I will be able to repay the loan. The lender will want to know what I propose to do with the credit so that he can judge my ability to pay.

Of course, all this indicates that credit means debts. This is why, in our present debt-ridden condition, 1929–1933, we don't need more credit, but better credit.

Credit is "frozen" when borrowers find that they cannot pay, as that future date when they promised to pay, draws near.

Such being the nature of credit, we need to be reminded that it cannot be manufactured at will. Business credit is not good unless it is based on sound commercial transactions. A business man can't safely go running around asking people to take credit, that is, to borrow from him. He must consider each borrower's solvency, and how increased loans will affect that solvency.

Credit, to be sound, must be a *result* of business, not a *cause*. It must arise out of business. Credit should expand as business expands. You can't proceed to expand credit (that is, increase debts) and expect to make business expand thereby.

Credit money is money which has little or no backing except someone's promise to pay. It is apt to be worth no more than that someone's ability to pay. Bank notes and checks are forms of credit money.

If credit money is limited strictly in accord with the promissor's ability to pay, it may be good. The danger is that credit will not be limited to business uses and needs. Too much of such money may easily be issued. Those who think that credit is independent of business, and can cause business expansion, are almost sure to go ahead and manufacture a lot of credit money.

The best form of credit money is checks, because these are drawn against depositors, and their use ordinarily increases and decreases according to business requirements. Even in this case, however, banks may get too optimistic about the future and make mistakes in extending deposit credits against which checks may be drawn.

One great advantage of the gold standard, rigidly adhered to, is that it helps to keep the amount of credit money within limit. This is because a dollar must be kept worth a given quantity of gold. If on a gold basis, our dollars are always worth as much as 23.22 grains of pure gold, no matter how the business future goes or what the Government's deficit may be.

Surely that is better than worrying about the ability of banks or governments to make good on their promises to pay.

14

WHAT IS INFLATION AND HOW DOES IT AFFECT PRICES?

"INFLATION" is one of the most interesting and important subjects which comes up in the discussion of money.

Inflation may be defined as any decrease in the value of money which is due solely to an increase in its supply or a decrease in its security.

In other words, any increase in supply of money which is not required by an expansion in business, and which would therefore tend to make the supply larger in comparison with the demand for it, would have an inflationary tendency.

In popular language, if we do anything to money which affects its supply and demand, without changing anything else, we are "inflating" or "deflating" the currency. For example, if, when business is dull and prices are low (so that little money is required for business), a large amount of bank notes is issued, the currency is inflated.

This would tend to raise prices. But we must note that, as to its effect on prices, inflation may be actual or potential. The effectiveness of inflation in raising prices depends upon the demand for commodities.

If inflation comes when that demand is increasing, it may at once have the effect of stimulating the demand. If it comes in the shape of issues of a less-secure currency which cause people to distrust the future purchasing power of money, it leads them to exchange the "depreciated" currency for commodities and that causes a sort of demand.

It is probably true to say that the general level of prices is a measure of (1) the quantity and the rapidity of circulation of money of all sorts, as compared with (2) the volume of buying and selling, or the work money has to do. This is the basis of the so-called "quantity theory" of money value.

But inflationists pervert this theory by arguing that if we merely increase the quantity of money, we raise the average of prices. Obviously, if we merely increase the quantity of money, while the volume of buying and selling is declining, there need be no tendency to rising prices. The additional currency would not be used.

More than that, the circulation rapidity of money is independent of the quantity. If business is dull, the larger quantity of money is not used. And if the additional currency is regarded with suspicion, its issue may actually slow up business.

It may cause "lack of confidence."

We must ever remember that the circulation of money is normally a measure of the circulation of commodities and services in business. If business is active, money circulates rapidly. If business is dull, we must expect slow velocity of money circulation.

It is highly important to keep in mind the difference between "standard money," such as gold, and "credit money," such as paper notes.

Under usual conditions, any large increase in gold supply through mining or business exchanges among nations may reduce the value of gold, and cause a gradual rise in prices (as measured in gold). Such a rise may be long continued. It causes little disturbance.

When, however, we arbitrarily make a large increase in the supply of credit money, without there being any increase in business requirements or any increase in the gold security for such money, the thing is different.

The value of credit money depends upon the credit standing of the issuer and upon the value of any collateral such as a gold "cover." Therefore, other things being equal, the more credit money the more strained the credit of the issuer and the less the collateral per unit.

It tends to depreciate. People get rid of it by trading it for other things. Speculators buy these things "for a turn." Prices rise—until the credit collapses.

15

WHAT DIFFERENT KINDS OF INFLATION ARE THERE? HOW DO THEY AFFECT US?

INFLATION as discussed in 1932–33 is an attempt to boost prices by increasing the supply of currency artificially.

Prices may rise because of an increased demand for commodities or because of a scarcity. That would be a natural increase, according to the law of supply and demand. But inflation seeks to put prices up by merely lowering the value of money.

Manufacturing more money, or credit, when business conditions do not require it, is inflationary.

There are two kinds of inflation—the artificial expansion of bank credit and the depreciation of money. We have often tried the first kind without result. There is no way to make people use bank credit. So inflationists are turning to the second kind and urging a depreciation of our currency.

Some propose large issues of "fiat" money (paper with nothing back of it except government credit) —others propose silver dollars which would contain much less than a dollar's worth of silver and would thus be based largely on government credit.

If large enough amounts of such "money" were issued, the purchasing power of the dollar would be lowered, because of lack of confidence. This would automatically boost prices.

There would be more money. But each dollar would be worth less. Would that do any good?

To have this effect, the amount issued would necessarily be enormous. Such inflation has always got out of control, and resulted in a crash.

The average person would be definitely hurt by such inflation. All wage earners and salaried men would find the purchasing power of their pay reduced. Inflation has been favored by foreign manufacturers as a means of cutting their labor cost.

Everybody who has any money or any fixed income would suffer. Savings, insurance policies and bonds would be worth less.

Temporarily most people in a net debtor position would benefit—that is, those whose debts are more important to them than any money, fixed income, or salary they may have. And possibly a brief speculative stimulus might be given to business.

In the long run, most economists are agreed, the the great majority would be injured by such inflation.

16

WHY IS INFLATION NEVER "CONTROLLED"?

THE other evening I listened to three Senators of the United States orate on the subject of inflation. One college professor joined them.

One of the Senators discovered that a "crime" was committed in 1920, meaning the measures taken at that time by the Reserve authorities to check inflation. This "crime of 1920" is reminiscent of the famous "crime of 1873," when our currency was saved from falling to a depreciated silver basis.

Both "crimes" represent the triumph of sound money and the ending of excessive inflation.

The interesting point is that his talk about "crimes" well illustrates how impossible it is to hope for controlled inflation. Once the inflationists taste blood, they know no limits, and any attempt to check their course is denounced as a crime.

The point is further illustrated by the fact that these gentlemen do not see that anything was the matter with us in 1919 or 1929. The same was true of 1873.

They look back to the peaks of the wildest excesses of credit abuse, stock gambling and overspending, and loudly proclaim that we must manufacture enough paper money to restore such conditions.

Or the college professor simply ignores the great inflationary rise that shot us up to the 1929 level of commodity prices.

None of them will let their minds rest on the periods of relative soundness and stability which existed between 1900 and 1914, or back in the eighties. They won't see that our troubles begin with "booms," and grow out of inflations, which wreck stable prosperity and run us up to overextended peaks, from which we crash.

The "crimes" are committed before the crashes.

Not only the history of all inflation, but the present attitude of the inflationists, therefore, shows that once you allow the thing to start it is bound to go too far. You always find that the cheaper the dollar is made, the more a further cheapening is demanded.

In fact, the gist of inflation lies in changing prices by changing the value of the dollar. You get inflationary effects only as long as the change is going on.

The professor talked about gold and silver being poor measures of value.

There are two essential qualities which any practical yardstick of value must have. One is that it must have value itself. It must be something that the business world wants, and which can circulate freely without any question about the credit standing of the payer.

The other is that we must be able to know exactly what it is worth at any given time. It must have not only value in itself, but also a very *definite* value.

The value of all things changes from time to time. That is in the very nature of value, for it depends partly on demand and changing human wants. So we cannot hope for any absolutely fixed standard of value.

But we can at least have a definite standard, such as a fixed quantity of gold, and one which consists of the most stable commodity known (gold).

Paper money, as Government credit, lacks both these essentials. It never has worked, and there is no reason to think that it ever will.

17

DOES A DEVALUATION OF THE DOLLAR BENEFIT THE PEOPLE?

THE economic system in a way resembles the human body, and like the body it sometimes gets badly out of order.

At such times quacks, and well intentioned but misguided persons come forth with all sorts of diets and "remedies."

In 1932 we found two such groups loudly proclaiming their panaceas. One consisted of those who advocated what they called "Technocracy." The other consisted of those who insisted that what we need is a "revaluation of the dollar."

The former did not seem likely to get much beyond a criticism of conditions as they are and vague talk about their mysterious "ocracy." The latter became a serious and imminent danger.

This dollar tinkering scheme makes its appeal to debtors, of whom we have all too many. Of course, therefore, it is opposed to the interest of all creditors. But the debtor figures that if we cheapen the dollar he will be able to pay his debt more easily. (Some of our foreign debtors wanted us to go off the gold basis for this same reason.)

But note the reasons against devaluing the dollar.

1—Devaluing the dollar would seriously injure everyone who has dollars. You would see your savings melt away in their purchasing power.

2—It would seriously hurt all people with fixed incomes, such as come from bonds, and would take away much of the value of your life insurance.

3—Above all, devaluing the dollar would be a serious blow to the laborer.

You see it would reduce the value of the wage dollar. Nor would it give any proportionate advantages to compensate for that loss. If you are getting $5 a day, and if the value of the dollar is then cut in two, the devaluation would give you only $2.50 in equivalent purchasing power.

When foreign nations have been forced to devalue their money, the argument has been made that by doing so they would reduce their manufacturers' wage expenses and thus encourage exports.

Wages never rise as soon or as fast as commodity prices. If the dollar were devalued, prices would necessarily rise, but the laborer would get no proportionately larger number of dollars. So his cost of living would rise, while his pay envelope would be no bigger.

The whole business and financial situation would be greatly disturbed by dollar devaluation. It might even precipitate a crash if the thing were to become probable.

You can't tinker with the money standard without shaking the whole business structure.

Probably the first effect would be to make creditors clamp down on debtors, trying to get their money before it had lost its value.

And note these two facts: First, even the farm debtor would not be helped much. The injury done to other classes would hurt his market. Furthermore, the things he has to buy would rise in price, so that his net gain would not be as large as might seem.

Second, foreign nations have been forced to "revalue" only after their currencies have fallen and fallen. They have then merely recognized an already existing fact. In 1933 we were not in that condition.

Moreover, when foreign nations, like Germany, were forced to devalue, they gave the final blow to their middle classes and plunged them into ruin.

18

HOW DOES FOREIGN EXCHANGE WORK?

1—*Why do nations trade with one another? Why does each not live unto itself?*

The basic answer is that division of labor pays and foreign trade enables a "territorial division of labor" among nations. Some things, as rubber and manganese, we cannot supply; and many things can be secured much more cheaply abroad.

2—*What determines the products which it pays to trade among nations?*

The answer is found in the economic "law of comparative cost." This law states that, when guided by economic interests, nations trade the products for which they have the greatest relative advantage in production, for those in which they have the least relative advantage.[1]

For example, say that we produce automobiles and pig iron, both efficiently, but automobiles more cheaply in comparison with a European nation than iron. Say that the European nation produces both, and neither so cheaply as we do; but that it can make iron to better advantage than automobiles.

Then it would pay us to concentrate on automobiles and trade them for pig iron.

We would expand our automobile industry, while reducing pig iron production. The other nation would pay for our automobiles by supplying us with iron.

The chief obstacle to such a logical adjustment is the fact that tariffs and other national barriers are interposed. Those interested in the less advantageously situated industry object to any curtailment.

3—*What governs international trade?*

Normally, international trade is governed by the "balance of trade," including all goods and services such as shipping and travel. In the long run, a nation's exports of goods and services cannot exceed its imports of goods and services. It may seem to have a continual "favorable balance" (excess of exports), but this will be found either (1) to be misleading, because the figures do not include payments for intangible services, or (2) to be the temporary result of foreign loans.

For example, we export goods worth more than we import, but we also pay a great deal for foreign shipping and travel. We have made large loans abroad, and temporarily have forced payments in gold, but in the long run the borrowers must pay us in goods.

4—*How does the balancing of trade work out?*

The answer is, through "foreign exchange," which is the mechanism for settling international transactions.

Say an American sells cotton in Liverpool. He draws a "bill" on the buyer, which is an order to pay. He may then take this "foreign bill" to some reputable firm which "accepts" it, making it more negotiable by turning it into a promise to pay. It is then offered for sale.

The foreign exchange market is ordinarily made by the demand for and supply of such bills or other papers which mean much the same thing. Exports make the supply of bills; imports make the demand. Thus if exports are large and the supply of foreign bills great, the foreign exchange rate tends to fall.

Normally, therefore, when sterling exchange declines, it means that we are selling more to England than she sells to us, so the supply of bills drawn on English importers exceeds the demand.

When the gold standard is in force, such a condition would mean that England would have to ship gold to settle the balance of trade, and would do so just as soon as the rate of exchange fell low enough to cover the cost of shipping it (freight, insurance, interest, etc.).

The old "par" of exchange between gold dollars and gold pounds was absolutely fixed by the quantity of gold they contained, and was one pound equals 4.866 dollars. So if the exchange rate fell to something like $4.85 we drew gold from England. But if the balance of payments ran against us, and exchange rose to about $4.89, we would ship gold to

England. This illustrates the so-called lower and upper "gold points."

The par of exchange between countries off the gold standard is difficult to determine and subject to wide fluctuations. Probably the best one can do is to figure the ratio between the internal purchasing powers of their respective paper currencies. Thus if $4.86 buys as much of the same commodities in the United States as £1 buys in England, we could say that the par of exchange is about the same as existed under the old gold standard.

19

WHAT MAY A DROP IN STERLING MEAN?

An extremely sharp decline in sterling exchange means that the English pound is worth less in comparison with dollars or other sound currencies. It means that there is less demand for the transfer of funds to England than there is supply of funds seeking to leave England. This would suggest uncertainty as to the soundness of English currency or business conditions in England.

Such wide fluctuations in exchange rates are bound to hurt foreign trade, for they add to the risks and uncertainties of buyers and sellers in international transactions.

The reasons for decline in sterling such as occurred late in 1931, are often not definitely known, but we can sometimes figure them fairly well. Undoubtedly there has been some rush to withdraw funds from England. Probably foreigners having balances in England have withdrawn them. Probably, too, the English themselves have found some way to send funds out of the country. When there is considerable talk of inflationary developments in England, such as an increase in currency based solely on credit, it is apt to lead people to turn pounds into dollars or other sound currencies.

Evidence exists that the Bank of France, in late 1931, sold a large amount of sterling exchange, presumably transferring this sum into dollars. Some observers thought France did this to bring pressure to bear upon England, but no one knows.

We do know that England had made large loans in Germany and Austria, and that repayment was being endangered by uncertainties affecting German solvency. This condition naturally threatened England's financial position and caused doubt as to the value of the pound.

Of course, the last quarter is the time of year when England has to make large payments for imported raw materials, such as cotton; and her new tariff caused a rush of imports to get in ahead of the tariff. These things increased the supply of exchange bills drawn on England and tended to reduce the price of sterling exchange.

The results of such a drop in sterling should be fairly clear.

1—It tends to put prices up in England. To the extent that it is due to inflation in England, this is clear. Furthermore, it encourages speculative buying of commodities in England.

2—It tends to encourage English exports to countries which have sound currencies. England can sell goods for dollars, and then buy cheap sterling exchange. As prices in England did not rise much, the purchasing power of the pound in England was relatively great. We soon had reports of shipments of English cement to our seaboard.

3—In the same way, the English find it profitable to sell securities held here, get cheap sterling exchange, and turn it into more valuable pounds in England.

4—It tends to reduce our exports to England. She may place some orders in anticipation of further declines in the pound, but in the long run it becomes cheaper to buy in countries where the pound exchanges to better advantage.

5—There is no sense in an advance in prices here on account of a decline in the pound. Our prices are in dollars. The very fact that pounds exchanged for less in comparison with dollars, showed that the dollar was not cheaper. So why should our prices have risen? Our exports were not helped, except for a little temporary speculative buying while sterling was declining.

20

WHAT ARE THE REAL ESSENTIALS OF "PRODUCTION"?

ECONOMIC life, as it works out in the "game" of business, consists pretty largely in getting a balance between production and consumption. We are ever trying to produce enough food, clothing and other goods to satisfy our wants, or trying to deal with cases of "overproduction."

What, then, is "production"?

Production consists in making such adjustments in the materials furnished by nature as enable them to satisfy human wants.

We do not produce matter. We merely make adjustments in it, by (1) changing its form (cotton to cloth), (2) changing its location (cloth from Fall River to Chicago), or (3) holding it from one time to another (Chicago merchants stock cloth in February for Easter sale).

Thus farmers and miners are no more producers than are truck drivers or store keepers.

The only test of productivity lies in the question, Does the thing done help to satisfy a human want? The basic test is the utility created, and it may be said that production exists for the sake of consumption.

All production, however, involves more or less cost, either in labor, or saving, or risk taking. In this world few of us can satisfy our wants unless we work, save and run risks. There would be very little cloth for Chicago consumers without all of these human costs.

So the problem of balancing production and consumption comes down to the problem of balancing "costs" and "utilities." (Costs are the efforts and sacrifices made by producers, and utilities are the satisfactions derived by consumers.)

If producers' costs were in balance with consumers' utilities, we could be fairly sure that production and consumption would be in balance. This would mean that all of us, as consumers, would be getting enough "utilities" to compensate us for our costs as producers.

To be sure, we might want more, but there is no way on this earth for men, in the long run, to satisfy all wants. The best we can do is to get our wants and our efforts (utilities and costs) into balance.

Some advocate cutting down our wants, but few wish to do that. So most of us try to increase our production. This means costs, but we can and do try to reduce the costs of production so that we can get more utilities for a given cost.

How may we increase our productivity? To understand this question, we must consider several "factors of production" and their "costs."

First, there is *labor,* or direct human effort in production. Within limits we can increase production by working harder, which means more fatigue and drudgery.

Laborers can also specialize so as to become more efficient in a particular job. This we call "division of labor."

Second, we can create more labor-saving instruments, such as machinery, which economists call *"capital."* These enable us to harness the forces of nature, reduce friction, and in other ways add to the possibilities of production. The peculiar cost required in the creation of capital is "saving." Someone has to abstain from consuming things now in order to make tools, invest in factory plants, etc.

Third, we can organize and direct our production more efficiently. For this service, we have come to depend upon a distinct group of men, whom we generally call "business men," but economists call them *"enterprisers,"* or "entrepreneurs." They organize the specialized groups of laborers so that they can function under a system of "division of labor." They bring together capital and labor and land (as in farms, factories, and stores), agreeing to pay for these at stipulated rates of compensation. Then they decide what and how much to make and when to sell the products.

This service of organizing and directing production requires a special skill and much risk.

Fourth, we note that all production uses "land." All producers require some materials drawn from "the land," and all must work in some location on land. The service of land seems to come without any human cost—but of that, more later.

Clearly, production can be increased by using only the best lands required, and by seeing to it that each piece of land is used for the best purpose for which it is suited.

21

WHY IS ECONOMIC PRODUCTIVITY SO IMPORTANT?

THE other day I saw a statement which has been all too common. I think it hit at the bottom of most of our mistakes in economic policy.

It is that the depression was caused by the slow growth of consumers' purchasing power as compared with the rapid growth of productivity.

The outstanding error in this statement is the assumption of productivity.

In this world of buying and selling (exchange economy), productivity depends on values.

Unless the products made have value and can be sold for a profitable price, those products do not mean "productivity."

You might start a technically efficient ice plant at the north pole and produce ice in great quantities. Would that be "productivity?"

To make large quantities of goods which have little or no value is not production at all, in the economic sense.

As a matter of fact, productivity had begun to decrease in 1929. Manufacturers tried to keep prices up artificially, but real economic productivity wasn't there, so their efforts failed. Evasions of the Anti-trust law merely made things worse, by temporarily concealing the real condition.

Technical production, measured in quantities of automobiles, cloth, and steel, grew. But economic productivity, measured in values, decreased.

Meanwhile, consumer "purchasing power" was being artificially stimulated. The consumer was given large doses of credit to enable him to go into debt on the instalment plan. Wage rates were kept up despite the reduced productivity of labor.

If an artificial extension of credits to stimulate consumer buying could make business good, we would never have had this depression.

The real trouble was that consumer productivity did not keep pace with the consumer's purchasing power. *Consumers are not separate from producers.* Most of us have to earn by productive work all the money we have to spend.

So when we were given more credit and artificially high wage rates, the only result was that we got deeper into debt.

If they had left prices and wages and credit alone —to be determined by demand and supply—there would have been no such overproduction and decline in value productivity as has occurred.

The moral of this is very important for the present.

The same unwise persons who led the procession of errors in 1929 are now (1933) trying the same "magic." They are again trying to make purchasing power by merely manufacturing bank credit. They are again trying to raise values by raising paper prices.

One may ask, why not pass a law that the bushel shall be the size of a peck? That would give the farmer more bushels of wheat. Or would it be better to make the bushel larger in size so as to decrease the supply?

22

HOW DOES "OVERPRODUCTION" ARISE, AND HOW MAY IT BE MINIMIZED?

THERE come times, especially in periods of depression, when talk of efficiency in production seems mockery. On all sides, plenty of products exists, and ample capacity to make more, yet many people are in want. This is "overproduction."

On an isolated backwoods farm, such a condition could hardly arise. The farmer not only has simple wants, but he produces directly for his wants, our forefathers even making their own clothing. Here there is a direct balancing of production costs against consumption utilities. The same man is both producer and consumer of the same products.

Nowadays, however, most of us consume utilities we do not produce. The costs are incurred by some distant laborer or saver. And the costs we undergo in our own production are rewarded through the sale of our products to some distant consumer.

Thus the great problem of balancing production costs and consumption utilities becomes extremely complex and difficult.

For such a balance, we depend upon "the market," that is, upon the "price system." In order to consume, we buy things. In order to compensate our costs of production, we sell things. If our buying equals our selling, and prices cover expenses, we say that production and consumption are in balance and that conditions are normal.

But are we so sure? We are assuming, first, that the costs undergone by laborers, savers, and enterprises are covered by the market value of their services, and that the money expenses of production, and profits, are paid accordingly. We are assuming, second, that the degree of want satisfaction, or utility, received by consumers is measured by the market values of products, and that money prices are paid accordingly.

Finally, we assume that where the prices paid (sales) cover expenses and profits, the utilities of consumers balance the costs of producers.

Theoretically, all these assumptions might be true, but it would be difficult to prove at any given time, and there are so many disturbing conditions that the problem of "balance" has never been solved.

The necessity of using money and credit makes the thing vastly more difficult. If each could make for himself all the things he wants, or could "barter" his products for others, it would be relatively simple. There could then be no general overproduction. But we have turned production into "money making"; and our complicated buying and selling processes, and the money measure we have to use, allow great gaps between producer and consumer, so that little direct relation between cost and utility exists. Credit greatly increases these gaps. As a result, wide-spread overproduction becomes possible.

"Overproduction" has come to mean the production of more things than can be sold without loss by the producers. It does not necessarily mean that there are more products than consumers could use, but that there are more than they can buy. The only way to correct this condition, under our system—unless we destroy the products—is to allow prices to fall to such levels as will (1) reduce future production, and (2) enable consumers to buy more. The more we try by artificial means to boost the price of surplus commodities, the worse we make the situation.

Allowing market prices to govern production, whatever its shortcomings, has one great benefit: it shuts off production at the best point, namely, where costs are greatest. In other words, it begins at the "margin" of production. This means that, as wants and utilities rise with a reduced supply, the supply comes increasingly from the more efficient producers, and thus utility and cost tend toward balance again.

It is one of the weakest points in all attempts to control production by pooling, proration, or equal percentage reductions in the output of all producers, that they try to make both low-cost and high-cost producers curtail. Such attempts fail because they are unjust, and do not tend toward a balancing of cost and utility.

This is why the efforts of oil producers to keep production down, while holding prices high enough to keep everybody in the business alive and able to make a profit on sales, have failed and are bound to fail.

23

IS "SPENDING" BETTER THAN "SAVING"?

MOST interesting and important is the clash between those who tell us to spend and those who tell us to save.

The other day a professor of economics denounced saving and said that if everyone would spend money we could soon end any depression. Mr. Ford has taken much the same position.

But others tell us to save. The Federation of British Industries in 1929 made the following significant statement:

"United States prosperity has been built upon an unstable basis, due to inflation of individual expenditures and standards of living to a level much above that justified by actual earnings of American citizens."

Where does the truth lie?

We can certainly see at once that our present (1932) troubles are not due to saving. In fact, we have been spending very freely—so freely that for the first time in twenty years savings bank deposits have fallen off.

Since the present situation has come with heavy spending and decreased saving, it does not seem that more spending is the remedy, does it?

The fact is that we should all spend some and save some, according to our incomes and our living costs. For each, there is a normal and common sense proportion. When we spend so much that we can save nothing for the inevitable "rainy day" or for old age, we injure ourselves and the country.

And when we even spend more than our current incomes we may unduly strain our credit.

Of course, if we scrimp and save so much that we lose all enjoyment of life and forget how to spend and consume, that is bad.

Thus trouble comes from extremes in either direction. If you spend too much now, you will have less to spend in the future. If you save too much, you may reduce your ability to earn and enjoy life.

But the dangers of spending too much are for most of us the greater. Few people actually go to extremes in saving.

I think that during booms we generally overspend. We save too little and that soon reduces our power to spend in the future. Then comes the time when we reach the limit, and we have to go through a period of saving to recuperate.

It is rather foolish to tell us to spend more after we have bought all we can afford—and then some.

This is a fine doctrine for the wealthy. (They certainly save money or they would not now have so much.)

So let us spend, within our means, remembering the importance of health, right living and education. But also let us save to provide for emergencies, for our children and, above all, to raise our standards of living.

There is only one way to raise your standard of living and keep it raised—that is to save. Save, and you will have more to spend!

What are the arguments? We are told that spending will put money into circulation and make business good. It is urged that this will give employment to those out of work. Others say that more spending would mean the end of "hoarding" money, and that this would make credit conditions better.

Still others think that the "psychological effect" would be good.

On the other hand, some say that saving is the best thing now. They argue that so many people are in debt or tied up with "paper losses" that business is hampered. If these people would settle up, and get a little ahead of the game, they could buy and business would go ahead.

Those in favor of saving point out that savings usually go into bank deposits or into investments. When they are not hoarded, savings are put to work just as truly (and perhaps more wisely) than money spent.

It depends upon circumstances. A man who is in debt or who has not made adequate provision for a rainy day should keep his spending down. One should not spend for anything which deprives him of things he needs or which lessens his efficiency.

Neither a family nor a country can squander itself into prosperity.

As to saving, that also depends on what it is for and who does it. If it takes the shape of "hoarding" money, keeping money out of bank deposits or other active use, it is bad and hurts business unnecessarily.

Well-to-do people may well be urged to buy freely according to their usual standard of living, providing that this does not draw on their capital. But I think that most people still need to be economical and save.

The first man I asked about the spending policy said, "Well, that's all right for the other fellow."

24

CAN WE MANUFACTURE "CONSUMPTION" IN ADVANCE OF "PRODUCTION"?

TOWARD the end of the last century, and following a world-wide period of business depression, the well known English economist, J. A. Hobson, wrote *(Evolution of Modern Capital)*: "Depressions are due to an attempt to devote too large a proportion of the productive power of a community to forms of saving." That is, too much capital is saved and invested in plants and machinery of all kinds, with the result that more things are produced than can be consumed. Thus the fundamental trouble is said to be "oversaving," which, of course, means "underconsumption," for saving means withholding from consumption. Hobson is a Socialist of the more conservative kind, seeing no complete remedy of business depressions and attendant evils without a large measure of government participation in industry.

Now, a generation after Hobson's book, the same general ideas are being expressed in America; *e.g.*, by Messrs. Foster and Catchings in *The Road to Plenty* and elsewhere. Those participating in this recrudescence bring an indictment against the present business order. They point out that under present conditions we are subject to recurrent booms and depressions, though they are most concerned with deploring the depressions, and say next to nothing of the booms. The people want to buy, we are told, but cannot. Our industrial ills are laid to under-consumption. Consumer buying lags behind producer output of commodities, and then the trouble begins.

But why this unbalanced condition? In answer we are told that the consumers do not have enough money; insufficient money is paid by producers to consumers to enable them to buy the output of current production. But more than this, not only is too little money paid to the "people," but they are not able to spend even what they do get because they must save something. Saving, it is argued, reduces spending and consumption.

In the background we see the idea that it is chiefly wages which are insufficient. The reason "workers" do not consume the surplus production is that they get inadequate income. Business men are said to expect more for their products than they pay out to consumers, the suggestion being that what is needed is more wages and less profits.

Briefly summarized the suggestions made for remedying the situation are as follows:

1—See to it that people receive enough money income to allow them to save and at the same time to buy all the products put out by producers as rapidly as produced. Measures should be taken to enable our people to buy all the goods produced at home and imported.

2—To accomplish this, expand the volume of money. This may be done, (*a*) by establishing a Federal Board with power to expand and control bank credit and to initiate the construction of public works; (*b*) by expanding the capital equipment of the community faster than present consumption requires; and, (*c*) by making some change, not specified, in our practices as to saving. Thus we may call these critics "consumptionists," "more-moneyites," or inflationists.

In all this, the importance and place of consumption constitute the heart of the problem. Our chief industrial ills are attributed to a lagging in consumer buying. Consumption is thought of as coming before production, in importance if not in order.

Now economists have been over this ground. The older economists emphasized production and its problems; then the pendulum swung toward an emphasis of consumption and human wants. More recently both extremes have come to be regarded as one-sided. Is it not fruitless to inquire which came first, the hen of production or the egg of consumption? Neither can exist without the other, and the two are equally important. Producers are the consumers; consumers are the producers. Thus *it is just as logical and feasible to increase consumption by increasing production, as vice versa.* As a practical fact, production and consumption must, in the long run, be equal. And it follows that there is as much danger in having the Government tinker with one as with the other.

That the one-sided suggestion that economic maladjustments can be remedied by stimulating consumption is unsound, is shown by the following considerations:

1—Aside from the long-run impossibility of expanding consumption without expanding production, there is the danger of checking savings by encouraging spending; the part in production played by investors and capital is to be remembered. (Of course, if people were not to spend their incomes, the scheme of the more-money advocates would be defeated.)

2—Again, it is not always desirable to stimulate, and it is impossible by putting out more money to select the particular industries that are to be stimulated or retarded. (How, in the name of reason, are we to make the consumer spend the money given to him, for only those things which a Federal Board thinks he should buy?) In cases of under-production, or over-consumption, and high scarcity prices, it is unnecessary to stimulate buying, and increased consumption might add to the trouble. In cases in which we already have overproduction with an uneconomic, wasteful use of capital and labor (as in the cotton textile, coal, shipping, and oil industries), a general stimulation of buying would serve to perpetuate or ultimately to intensify the uneconomic, wasteful production. Should money be supplied by the government to support such industries at capacity?

3—The foregoing point suggests the fact that no broad general stimulus, such as increasing the money supply and inflation, can serve the purpose. Any practical remedy must be adjustable to the different conditions in different industries and as between the several factors of production—labor, capital and enterprise. Production needs to be stimulated in one case and retarded in another. Now labor needs more; again capital. The general principle is that each industry and each factor of production should be rewarded according to its productivity. *General* inflation or contraction allows no discrimination.

4—More than this, merely increasing the money in circulation would inevitably tend to bring inflation, and all experience proves that *inflation is easier to start than to stop.* Once consumption catches up with production, what is to keep production from again running ahead faster than consumption, with the eternal necessity of painful readjustment? Either we must assume ever increasing inflation, or we must admit that periods of contraction, curtailment, and depression would occur much as at present.

Under present conditions, the one may exceed the other for a time, but changes in costs and prices sooner or later restore approximate equality. If supply falls behind demand, prices rise and operate both to stimulate production and curtail consumption. This is what happened in the case of cotton in 1928. The opposite was soon illustrated by the petroleum industry. (Both these cases, too, illustrate the impossibility of eliminating periods of trouble by government supervision, for the supply of both commodities is largely influenced by "natural" conditions not subject to human control or prevision.) The notion adopted by the consumptionists is that such temporary maladjustments as arise may be eliminated by always stimulating consumption to make it always equal production. (They have little to say about contracting money supplies and reducing demand,—a process that would not be popular!)

5—Here, too, the economist would point out the difference between demand and consumption. To increase the money in circulation may increase demand and prices, but may not result in any final gain in consumption. Consumption depends on the quantity of things that consumers can get with their money. But increasing the money supply would probably increase prices and the larger incomes of consumers would buy no more than before.

Nowadays we produce things for sale and pay money for what we consume. Accordingly, the new crop of reformers, instead of saying "See to it that people get all the food, clothes, and automobiles that are available," say "See to it that people get money to allow them to buy all products as produced." The money factor has been a stumbling block to many, both before and after Bryan.

25

WHICH COMES FIRST, "CONFIDENCE" OR "GOOD BUSINESS"?

In talking with various people, I frequently hear two statements which need much closer attention than we usually give them. One is that what business needs is to "restore confidence." The other is that what is needed is to "put money into circulation."

The weakness of both these ideas is that they try to treat what is really a *result* of good business as if it were a *cause* of good business.

Why was it necessary to restore confidence in 1933? We had plenty of it in 1929. No farther back than August 1932, confidence was restored. If "confidence" is a cause of good business, why did business ever get bad? Why did it not get good and stay good in early 1933?

Obviously the answer is that it takes something more than confidence, or rather there must be a fundamental basis for confidence.

Why did we lose confidence in 1930? It was because we came to realize that values were inflated, and we found that artificial price-boosting schemes like the Federal Farm Board were no good. Then banks failed because they had been too confident and over-extended credit. Finally we lost confidence because we feared being forced off the gold standard in the summer of 1933.

You see, the loss of confidence was a result of over-extended credit and inflation. And if we want to restore confidence we must restore sound credit and get rid of inflation.

In order to make lasting confidence we must first make business conditions sound.

As regards "money circulation," we must remember three things: (1) Putting out more money is not necessarily increasing the circulation of money. You can manufacture dollars, but how can you make them circulate or stay in circulation? (2) The idea exaggerates the importance of money. You can't eat or wear money. Its importance lies in buying and selling transactions, and it is merely a convenience in facilitating business. If business is good and there is much buying and selling, we need much money. Otherwise, we do not.

(3) This suggests that the real thing in business is the circulation of commodities and the transfer of services. The circulation of money is just incidental. The most you can say is that it facilitates or helps the circulation of the things we really want. But this help can be given by a smaller quantity of money just as well as by a larger quantity.

The talk of making business good by making money circulate, is like the old wheeze about catching a bird by putting salt on its tail. If business is good, money will circulate. But if business is bad, money can't circulate much.

Or suppose we say that money is like oil in a motor, the motor being business. You would not think of trying to start the motor by increasing the oil or by doing something to the oil pump. But you would know that if the motor were in good shape you could start it by cranking it, and that then the oil would circulate as required by the motor.

Incidentally, one might add that it is more important to have a small amount of good lubricant in the crankcase than to have it full of low-grade oil.

26

IS "SENTIMENT" FUNDAMENTAL IN BUSINESS?

SEVERAL commentators on business conditions in early 1933 were remarking that "sentiment" is not so good. They said that favorable signs continued to appear in business data, but that there was an unfortunate weakening of "confidence."

This is interesting, for it seems to be one of the many illustrations which might be given to the fact that this thing we call "sentiment" is not fundamental, but is the result of business conditions themselves. As the facts about business volume and earnings, and about prices and failures, become known, the security markets weaken, and then we find that sentiment gets bearish.

So it is that attempts to make business good by manufacturing favorable sentiment are usually vain. If there is some real basis for feelings of confidence, we should have such feelings: but otherwise our confidence is not well founded; it leads us into errors. Thus the results may be worse than if most people had been cautious.

Those who are most prone to emphasize the importance of instilling confidence and optimistic sentiment, are apt to be the ones who favor inflation. They reason that inflation will put prices up, regardless of supply conditions or individual incomes, and that this will stimulate sentiment and buying.

In 1932, however, we tried a large amount of bank-credit inflation, and the results were unsatisfactory. Gold exports and hoarding of money at home were results. In fact, confidence in the American dollar was shaken by the very efforts to produce inflation.

We then began playing with the idea of an even more drastic form of inflation, namely, issues of paper money backed by nothing but government credit—"fiat money." My point here is that, even if we believe that "confidence" is a primary factor, we should realize that such schemes strongly tend to destroy confidence.

The Federal Reserve authorities did plenty to establish a basis for credit inflation. The trouble was that with an unbalanced Federal budget, and lagging business, there was no basis for confidence. We hung our financial clothes on a hickory limb, but we wouldn't go near the water.

The water in this case is business and actual use of the credit for business purposes. And it looked cold and muddy to most observers.

Then as we went ahead and actually depreciated our currency, was there any reason to think it would make things better? Can we make business swim by pushing ourselves into a sea of greenbacks?

To sum up: "Confidence" is not a fundamental thing, but if it were, nothing would injure it more than would a depreciation of our currency.

27

HOW DOES THE LAW OF BALANCE IN PRODUCTION WORK?

WE have seen that there are four fundamental "factors of production": Land, Labor, Capital, Enterprise.

If we remember that "Land" includes all natural resources (soil, climate, location), and "Capital" all produced instruments of production (plant, equipment, mercantile stocks), we can see that all production requires these factors. For example, the storekeeper uses a location, and a building and stock of goods. He employs labor and works himself. He runs the risks of his enterprise, managing it with more or less skill.

This analysis of the factors of production is important.

In the first place, it makes us think about the essential elements in all production. It does not make so much difference who owns or employs the factors of production, as what they are and how they function. It does not make so much difference how much money is paid for the factors of production, or what their "book value" is, as how much land, labor, capital and enterprise we have, and how much they are "producing."

Furthermore, no matter who owns the land and capital, or employs the laborers, or runs the business risks (whether it be the Russian state or American individuals), there are distinct problems concerning each factor. We speak of "the land problem" and "the labor problem." There are problems of saving and investment (capital), and of "management."

On the supply side, each of these factors is distinct, and each has its peculiar costs or scarcities.

In the second place, there is the big problem of their most effective organization for production. Here we come to important economic laws:

1—The law of "balance," or most productive proportion among the factors of production, states that, at any given time, there is a certain combination of the factors of production which gives the maximum net return. This is the basis of economic efficiency. The chief problem of management is to get this balance.

For example, when we see a tall building which does not pay, we know that too much capital has been combined with the land on which it stands. Or when we see a "land-poor" farmer, who has not enough capital or labor, we say he has too much land.

It is often a problem whether to use more labor and less machinery (capital), or less labor and more machinery.

Two of the problems of these times are: (1) the excessive application of capital to land—overbuilding, overdevelopment; (2) the excessive size and complexity of business enterprises undertaken by "enterprisers." Our overgrown industrial, railway and financial concerns mean too much land, labor and capital in proportion to "enterprise"—too much for the "business leaders."

2—It follows from the law of balance in production that, if the supply of any one factor is limited and the supplies of the other factors are increased, the net returns must sooner or later diminish. Or, other things remaining equal, if we increase the supply of any one factor, the time will come when the output in proportion to that factor will decline.

This is the law of diminishing productivity. It means that any departure from a certain most efficient combination of factors brings a diminishing net product.

But, you ask, how can one know how to get the most productive combination? The rule is clear. Each factor should be used up to the point where the least productive "unit" of it (acre, laborer, machine, etc.) just pays. Add building stories till vacancies or low rentals say, "stop!" Add laborers till added output fails to cover added cost. Add plant, equipment and labor force to the enterprise until business is too big for the business man.

The economist's rule is: "Use each factor so that the marginal productivities of all will be equal."

Of course, this balancing process is affected by the relative abundance of the several factors and their costs. If land is scarce, we may get the best balance by putting more labor and capital on it. If labor is scarce (or relatively high-priced) we substitute capital in the shape of labor-saving machinery. That is the principle of substitution in production.

We at once see how important it is that each factor be priced according to its productivity. If wages, or land rent, or interest be out of line, the use of the corresponding factor must tend to decline.

28

WHAT IS "DISTRIBUTION"?

When a business man pays the wages, interest, and rent which are expenses of his business, and draws his profits, he is carrying out a process of "distribution." In a sense, he is acting in part as society's paymaster, in that he registers the forces and conditions which are determining the "shares" of the total income which we receive. And the taxes he pays remind us that the Government also contributes services and imposes restrictions, which affect our incomes.

Under our system, laborers, land owners, capital owners, enterprisers and Government coöperate in production, turn out their joint product, from which we all derive our incomes. The "problem of distribution" lies in determining what share each of these groups shall receive. Or we may say, it is the problem of determining the value of the services contributed by each factor of production.

To each individual, it seems the distribution is a personal matter—how much income can he get for himself? But each gets his individual income by some contribution to production, such as the efforts of laborers and enterprisers or the use of land and capital furnished by the owners. In reality, therefore, the fundamental nature of distribution is "functional"; that is, it is what the production factors do that counts, not who owns them.

All laborers have a common interest in "wages"; land owners in "rent"; capital owners in "interest"; and enterprisers in "profits." And all persons fall into one or more of these groups.

We may think of all the productive activities of the nation as one, and as enabling the declaration of a national dividend each year, payable to the factors of production. In the last analysis, what is "distributed" is the stream of goods and services that is produced, consisting of food and clothes, hair cuts and medical service, and so on. This we may call "real distribution," and its measure is the amount of utility which consumers receive.

The immediate fact, however, is that the national dividend is distributed in money, and our real "shares" depend not only upon the quantity of goods and services available, but also upon prices.

That the total quantity of distribution in a society must depend upon the total production is clear, and this is as true in socialistic Russia as in capitalistic America.

Socialists, however, say, "Let everyone produce according to his capacity, and we will then distribute the total product according to people's needs or wants." They would pool the product, and divide it according to some theory of "social justice."

Under our system, we say, "Let everyone produce all he can, and let the total product be divided according to the amount each contributes to production." We merely try to prevent monopoly, fraud and extortion, and to guarantee subsistence to the incapacitated.

Not only does the ideal of our system seem to most of us to be fair, but it has the great advantage of stimulating production, and so increasing the size of the national dividend that is available for distribution. We also know that it can work fairly well when we do not allow speculative obsessions and inflation to produce maladjustments.

As already indicated, economics sees in "distribution" the payment of rewards for the functions or services performed by labor, land, capital and enterprise, the income of society all being distributed as wages, rent, interest and profits. Just as a figure of speech, we may imagine society as a great coöperative enterprise, paying these shares.

Thus one readily sees why economics considers the price of any product as covering the rent, wages, interest and profits involved in producing it. (This is what is meant by saying that prices tend to equal cost of production.)

This, however, is very different from the business man's way of accounting. He figures his dollar "sales," and from that item deducts his "expenses." These consist of wages, materials and supplies, and such expenses as "overhead" and "general and administrative" charges. The difference is his profit or loss.

The business man thinks of the price of his product as being above his expense, thus allowing him a profit. The economist may regard profits as a necessary reward for the cost of enterprise, but the enterpriser himself cannot keep his books that way.

In fact, the accounts of a business give us a very inadequate record of distribution. In the first place, they can record payments only for hired labor, borrowed capital, and rented land. Any capital or land owned by the business involves no expenditure for interest or rent, and any charge made therefore is arbitrarily deducted from net earnings at an estimated figure. The same is true of "executive services" rendered by proprietors.

In the second place, we cannot add the "expenses" of all businesses to get a total for the nation. The cost of materials for one business includes the profits of another business from which they were bought, while, as just stated, the business cannot charge its own profit as cost. We would find many questionable items for depreciation and depletion.

So there is no actual record of the economist's "shares" in distribution. Many a person's income is partly wages and partly interest. The stockholder's dividends may be partly interest and partly profits. But the distribution process is none the less real, and the theory of distribution is one of the most important parts of the Science of Economics.

29

HOW ARE WAGES DETERMINED?

How are the wages of labor determined? How must they be determined in the long run?

By "Labor," we mean any human effort for the purpose of production, except such as consists in the assumption of business risks. Labor may be manual or mental.

By "wages," we mean the share in the total product of industry which is attributable to labor. The wage share is what laborers as a group should receive if economic forces worked freely, without monopoly, ignorance of conditions, or exploitation. Actual wages paid may be more or less than this "share."

Money wage rates, per hour or day, are one thing; actual earnings per year are another thing, depending partly upon time worked; "real wages" is still another thing, depending not only upon money earnings per year, but also upon "cost of living." "Real wages" consists of the goods and services laborers get by their labor.

In the last analysis, we are concerned with total real wages.

The primary part of our problem is to determine what is the product attributable to labor. And we must at once get two notions out of our minds: one is that this quantity is fixed, and the other is that laborers can, in the long run, be given more or less than this quantity.

If we take for granted a fixed "wages fund," and merely divide the number of laborers into it to arrive at the wage of each, we are assuming that wages, as defined, are already determined. But if we think that laborers can be paid more than they produce, we are going to the other extreme and are assuming that there is no economic limit upon wages. The "share" of labor is neither fixed, nor is it unlimited.

Nor does it help any to say that laborers have a "right to the whole product of labor." No one denies that. The question is: What is this "whole product?" It is a varying quantity, and is determined by many changing and complicated forces.

Broadly speaking, the wages share depends upon (1) The total output of the productive activities of society, and (2) The position of labor as a claimant to a share in that product, along with capital, land, and enterprise.

To be more precise, however, we must use the analysis of demand and supply. The demand for labor is derived from the value of products which are made jointly by the coöperation of land, labor, capital, and enterprise. The maximum demand—

the most that can possibly be paid to labor in the long run—is, therefore, the total value product, minus the minimum amounts that must be paid for the services of land, capital and enterprise.

Rarely, however, is the actual demand that strong. Actually, the demand depends upon what employers are able and willing to pay. According to the principle of substitution, employers test out various combinations of the several factors of production. Thus they find out about how much additional laborers would add to the product, and how much a reduction in labor force would reduce it. They make their bids for labor accordingly.

For example, if labor-saving machinery is abundant and cheap (considering efficiency), the demand for labor will be lower than otherwise. If land is abundant and cheap, the demand for labor and capital will be greater than otherwise.

In short, the maximum wage is fixed by the total product of industry and by the necessary shares of other factors. The effective demand at any time depends upon the relative abundance of labor and the other factors, and upon their technical efficiencies in turning out products.

On the supply side, we have to deal with the "prices" at which laborers offer their services—what wage rates they are willing and able to take.

Here we find, first, an absolute minimum. No laborer can work for less than subsistence. But above the subsistence minimum, there is effective a "standard of living," and industrial productivity is such that few have to work for wages lower than will allow them a certain amount of "comforts and conveniences" to which they have become strongly accustomed.

Standards of living, however, are not absolutely fixed. Furthermore, there is often some leeway between such a minimum, and the "demand price" which the employer is willing and able to pay. So the wage may vary above or below any given standard of living.

The chief conditions which determine such variations are: (1) The cost of laboring (difficulty and complexity of the job), (2) Attractiveness of the work (pleasantness, hazard, prestige), (3) The "cost of living," and (4) The bargaining power of the laborer (organization, savings).

30

HOW DOES THE LAW OF POPULATION WORK?

WE have seen that the wage rates and short-term earnings of labor are fixed somewhere between the maximum set by productivity and the minimum set by standards of living. The point depends upon the bids of employers and the offers of laborers, according to the relative abundance of the several factors of production, their technical efficiency, and the costs and bargaining power of the laborers.

In the working out of these forces, the quantity of labor power for sale is important. It depends not only upon the number of laborers, but also upon their native abilities and training. This affects both the employers' willingness to bid, and the laborers' pressure to sell.

Finally, we may say, it is the sum of the earnings of each and every laborer that gives us the total "share" of the national "dividend" which is actually distributed among the workers of the nation.

The old economists, however, saw little besides the mere number of laborers, and, following Malthus, they accepted the theory that population tends to increase so rapidly that laborers are generally forced to accept subsistence wages.

Few, if any, now hold that idea. Yet there is a law of population, and it has an important bearing on wages. This law may be stated as follows:

At any given stage of industrial development, population tends to equal the number which can be supported according to the prevalent standard of living and distribution of income.

There can be no question as to the power of population to increase much more rapidly than the supply of the material things men need. But it does not do so, unless in such regions as China and India. On the one hand, education, diffusion of well being, and economic independence of women reduce the birth rate. Marriages are later and families smaller. And we restrict immigration. On the other hand, improvements in division of labor and industrial technique greatly increase the supply of means of subsistence.

Thus we are able to keep population within limits which allow wages much above subsistence. While it is true that little laborers are not exactly produced by their parents with the state of the labor market in mind, it is also true that marriages and birth rates vary somewhat according to business conditions, and standards of living are tenaciously maintained.

Wage rates tend to become standardized within large groups. This is due partly to inertia, partly to human jealousies, and partly to the leveling effect of collective bargaining by organized groups. Certainly wages do not differ in proportion to the differences among individual workers.

But we do find "differentials" wherever piece work or bonus methods of payment are used. Also some laborers are always the ones to be laid off first or hired last. The least productive and lowest paid laborer in each class is the "marginal" man.

The broadest groups or classes of labor are: (1) Responsible mental (superintendents, etc.), (2) routine mental (clerks, etc.), (3) responsible manual (skilled mechanics), (4) routine manual ("common labor"). To some extent, men shift from one class to another, but at any given time, the great masses within these groups are fairly separate, and they have been called "non-competitive groups." Perhaps we may think of these groups as each having a separate labor market, a distinct scale of wages, and its own "margin."

How can wage rates be raised in a way that can last? Only by increasing the demand for labor through adding to its productivity or by decreasing the supply of labor through increasing its costs or its bargaining power.

Wage rates will be at a maximum wherever we have the following conditions: Maximum total industrial product (reasonably large quantity of products and prices governed by the law of supply and demand), laborers relatively few, highly efficient and strongly organized, and standards of living high.

It is well ever to remember that laborers are human beings and make up the bulk of a nation's citizens, so that the importance of the best possible standards of living is apparent.

Monopoly or extortion on the part of enterprisers, which would withhold from laborers any of their economic share, should especially be stamped out. Education and public employment bureaus—to say nothing of much protective legislation—may be justified on economic grounds.

Except by such means as the foregoing, however, wages cannot be raised or maintained without impinging upon the minimum shares necessary to secure for society the services of the other factors of production.

31

CAN WAGES BE PAID WITHOUT REGARD TO PRODUCTION?

SEVENTY-FIVE years ago there was a burning question known as "the wages fund theory." To-day, without being given a name, a related theory is cropping up and clear signs of it appear in the ideas under discussion. Briefly, the old theory was that wages are paid out of a pretty rigidly fixed "fund" which is independent of what the laborers produce currently, and that if a particular labor organization succeeds in boosting wages it merely gets an undue share of the wages fund, to the injury of other laborers. Nowadays, on the contrary, the idea is rather widely held that by paying increased wages we can add to the laborers' buying power, increase the demand for commodities, and thus "generate" prosperity.

The immediate similarity between this idea and the wages theory is seen in their neglect of relation between *wages paid* and *productivity of labor*. Both notions imply that laborers can be paid something different from the value that laborers produce; the one, that wages cannot exceed a fixed fund, the other that wages may be paid without regard to any fund. The old doctrine involved a limited fund; the new doctrines an unlimited fund.

When people go to extremes in thinking, one usually finds that the opposite extremes are both wrong and that both involve the same fallacy. For example, extreme anarchy and extreme autocracy are both wrong, as both lead to a sort of tyranny over the individual, in that he is not safe and his property is likely to be seized by others. Extremes of wealth and extremes of poverty are equally undesirable. Just so, the notion that wages are limited by the amount of a fixed fund, and the notion that wages are unlimited and can be paid in any amount considered desirable for the purpose of stimulating consumption, are two extremes and are equally fallacious. Both are related to the truth, which is that laborers can be and should be paid all that they contribute to production, but they err in assuming that either more or less than this can be done.

What labor produces, is (1) certain physical adjustments in materials which change their shape, as when wool is turned into cloth, or cloth into suits, and (2) certain values, as when the cloth sells for more than the wool used, or the suit for more than the cloth. Unless both of these results are attained, the labor is not truly productive. If so many yards of cloth are turned out that the market is oversupplied, and cloth is worth no more than wool, the change in physical shape is of no avail, productivity declines, and wages must be reduced. Or if, in foreign countries, laborers work for less, so that a yard of cloth costs less in wages, our imports of the cheaper goods tend to increase, our cloth manufacturers lose their foreign markets, and they cannot long continue to pay the previous rate of wages.

What the consumptionists appear to forget is that wages must be paid out of product; that eggs presuppose hens. We cannot simply manufacture more money and turn it over to laborers (or other consumers), for that would mean inflation and would soon do more harm than good. Witness conditions in Germany after the war. The only alternative is to assume that too much of the joint product of labor, capital, and enterprise is kept by the last two factors in the shape of interests and profits.

Let us face the issue squarely. If any class in society is getting less income—less money, if you please—than it deserves on account of its contribution to production, we must recognize both an economic miscarriage and an ethical injustice. Such a maladjustment, however, remains to be proved. And even if proved, the remedy certainly does not lie in doling out to the people in this class certain sums of money, but in ascertaining the causes of the trouble and removing them. Doles would be but a palliative at best. By increasing prices their purpose would be defeated. There would be no way to insure that they would be expended wisely. Abuse and misuse would be a practical certainty. The underlying source of maladjustment would remain.

32

WHAT CAN BE DONE BY "SHARING JOBS"?

WHAT would be the probable results if we were to reduce the working hours of laborers by law? Some suggest six five-hour days, or 30 hours per week, for all industries throughout the country.

That would be a reduction in the working time, as compared with the usual 48-hour week of about one-third.

As a temporary emergency measure in a time of great unemployment, the point is worth discussion. If we start by assuming that we have excessive supplies, and that there is only a fixed minimum amount of work to do, then the question arises, What is the best way to divide up the work?

Is it better to compel an equal division of jobs among all? Or is it better to let employers keep on the better workers, giving "relief" to others who cannot be profitably employed?

The former course would keep more people on the payroll, and it is desirable that people be kept from idleness and dependence upon doles. It would, however, prevent the maximum efficiency of production, since the less efficient workers would be retained. The latter course would have the advantage of getting the limited amount of work done with the least cost. It would, however, require that "relief" be given to a larger number of people.

Thus the choice lies between the two difficulties. Probably some compromise is best. Personally, I doubt the wisdom of forcing all industry by law to adopt a uniform scheme of spreading work over more people by reducing hours for that purpose.

As to a thirty-hour week as a permanent policy, there is much less to be said for it.

Why not twenty hours? or ten hours? Will the time not come when laborers will have to work more than thirty hours to produce all the things we want—and be glad to earn the wages such work would bring?

In the long run wages are paid out of the products of their labor, and laborers can be paid no more than they produce. But is it not probable that most men will produce less in 30 hours than in 48 hours (per week)?

As a long-run matter, then, it seems practically certain that wages could not be as high with a 30-hour week as with a 48-hour week.

If you reduce the total production, and then divide the smaller total among the same number of laborers you get a smaller average product. But a smaller average product per laborer makes it impossible to pay as high a wage as could be paid with a larger product.

Some may say, "Well, we would use more machinery." But—barring many complicated changes and the lapse of much time—more machinery means less labor, and less labor means less total wages.

When the demand for products picks up again as business recovers, what would happen if labor time were cut one-third, but wages were held up? The answer is plain: more "labor-saving" machinery would be used. Wage rates would be so high compared with labor products that strenuous efforts would be made to employ as few laborers as possible.

If the thirty-hour week were enforced, but wages were not fixed, we would probably see a considerable reduction in average annual wages—certainly in "real wages," which is what a laborer's money wages will buy.

In conclusion, we should remember that in a real sense shorter hours mean less employment. Part-time work is part-time employment. We can't increase total employment (in labor hours) by reducing the hours worked!

The whole answer is that the work-week must be of such a length that (1) the labor force of the country can help produce all the things which (2) consumers so desire that they will pay enough for them to afford to laborers a wage (3) according to the laborers' standard of living.

Human wants are probably practically unlimited, and when we satisfy existing wants—which we have not yet done—desires for new things will surely arise. If we could satisfy all present wants by working less than eight hours a day, should we conclude that we had gone far enough and that "progress" should cease? Or should we not then direct our energies toward greater abundance and security for all, and toward new and higher fields of production?

Is work a curse? Is idleness a blessing?

33

WAS THE FORD POLICY A SOLUTION OF THE WAGE PROBLEM?

WHEN Ford in 1929 raised his wages to a $7 minimum, he made a typical Ford move.

This move raises two questions: Does it suggest a remedy for the labor problem? Does it provide a remedy for business recessions?

As to the former, we must note that Ford happens to run a very profitable business. He gets the idea that a certain standard of living should prevail among laborers. So he issues the edict that workers in the Ford plants shall be paid a certain sum of money to conform to his notion.

He decides to give to his labor force a part of his profits. It is a sort of profit-sharing scheme, but one that is entirely arbitrary and dependent on the whim of a single employer or capitalist.

The Ford wage is not determined by competition in the labor market. It is not even forced by the demands of organized labor.

Why do not other motor manufacturers boost wages? Because they cannot. Several of them are losing money. Several more would lose money if they paid higher wages. Of course, the same may be said of manufacturers of textiles, paper, leather, tires and others.

The simple fact is that wages can be paid only out of what labor produces in the way of values.

If laborers are poorly equipped with tools and machinery, or are poorly located, or are inefficiently managed, they may produce very little. The laborers in a badly equipped and located coal mine or mill may produce nothing. They may *work* as hard as any other laborers, but the coal and yarn they turn out won't *sell for enough* to keep the business alive.

Under such conditions, wages could not be paid, to say nothing of raising them.

Many businesses today barely earn enough to pay present wages, and maintain the necessary plant and equipment and management.

Business recessions usually come because more products have been manufactured than can be sold at a profit. Of course, the real remedy is to prevent such overproducing from arising. But once it has developed, it does not seem that raising wages can help.

A single company may be able to dip into surplus profits and raise wages, but the general problem is to keep production down so as to limit losses. And most companies are doing very well if they do not reduce wages, in such circumstances.

34

WHAT IS "CAPITAL"?

LABOR can produce little without the aid of tools and machinery and the materials and subsistence which may be required during the process of production. Such things make up what economists call "capital," and the one who furnishes them is, properly speaking, the "capitalist."

Capital has been concisely defined as the "produced instruments of production." It includes only instruments of production; that is, things which are not wanted for themselves but only as a means of producing other things. Of such instruments, it includes only those made by man, and which are thus dependent for their existence upon human costs. Accordingly, it excludes "land."

The chief kinds of capital are: tools and machinery, buildings and furnishings used for production, transportation agencies, mercantile stocks and money. The basic test is the function. If I use an old spinning wheel for ornament, or take a box of candy home from my store stock, or spend my money for a theatre ticket, I am not using them for "production," and they are not capital. If I use my delivery car for Sunday drives with my family, it is partly a pleasure car, and a "consumer's good." Capital includes only "producers' goods."

This concept of capital differs widely from the business usage. To a business man his capital is the "investment" in his business, or the "net worth." It is either the sum of money he has put in, or the difference between his assets and liabilities. Thus business capital is measured in money, and may include not only land, but goodwill, franchises, and legal claims and credits.

We note that this way of considering capital is valid only from a purely individual point of view, and that it begs the question as to prices and interest. In estimating his "value capital," as we may call it, the individual assumes an annual return in dollars, and capitalizes it at an assumed rate of interest. The economist must go deeper than that.

From a social point of view, capital cannot include credit or credit instruments (unless these circulate freely as "money"). Such things cancel out. They involve offsetting debits.

All capital originates in "saving." If all products were consumed as they were produced, there would be no capital. Furthermore, the supply of capital is kept up only by continued saving. Unless the owner saved a "replacement fund," the produced instruments of production could not be replaced as they wear out.

Under the conditions of today, the typical process of capital formation is as follows: I am receiving a salary of $3000. I forego theatre tickets, expensive clothes and travel in order to save, and I have $1000 in the bank at the end of two years.

I then decide to invest, and, after study and advice, I buy a bond. My money thus goes to a corporation which is buying some new machinery; it becomes invested capital; my funds become embodied in capital instruments. I then wait for interest payments. I may worry a little about them, though not much if my investment decision was carefully made.

Thus there are several "costs" involved in the process by which the plant and equipment of our business corporations are produced. The funds must be saved. Investment supervision must be exercised. Waiting for returns is undergone. Risks of losing the capital or the interest, wholly or in part, are run.

By saving, waiting, and investment supervision and risk, capital is called into existence, and along with labor becomes one of the great factors of production.

The primary cost, however, is the saving. The average individual must sacrifice in order to save. We could not possibly have the great mass of capital instruments which exists in this country without the savings of millions of individuals. The millionaire may save without cost, but the "marginal saver" is also required. He is the one whose cost of saving is so great that he is just barely induced to save.

The cost of saving arises from the fact of man's tendency to value things more highly in the present than in the future. "A bird in the hand is worth two in the bush." This has been called "time preference." So when a person foregoes something now, and waits for a future benefit, he makes a real sacrifice.

Saving must, therefore, be rewarded else there will not be enough of it to provide the capital which is required for efficient production. As we shall see, "interest" is this reward.

35

HOW IS "INTEREST" ON CAPITAL DETERMINED?

"INTEREST" is the earnings of invested capital. It is one part of the total joint product of all the factors of production. It is the share of the total product which goes to those who supply the capital. It *can* be paid, because capital instruments contribute to this joint product. It *must* be paid, because otherwise the supply of capital would cease to exist, and the total product would be reduced.

When a value is attached to capital instruments, such as plant and equipment, and we divide that value into the interest "share" which they earn, we get the interest "rate." A machine which costs $1000 and produces $60 worth of products per year, earns 6 per cent.

What determines the interest share?

1—We can at once say that a *maximum* is set by the total joint product of industry, minus the minimum shares which must go to labor, enterprise and land. If the total product is 90 billion dollars, and 50 billions must go as a bare minimum to support the other factors of production, then capital can get a *maximum* share of 40 billions. Clearly this maximum depends upon (1) the total production, (2) the relative abundance of the several factors of production, and (3) their relative technical efficiencies.

For example, if the total value of beer produced is great, while bottle-making machinery is relatively scarce, and is at the same time highly efficient in turning out beer bottles, the machine, or capital, can get a large share, as "interest."

These are the things which affect the demand for capital.

It should be noted that the technical efficiency of "capital" lies in the ability it gives us to harness the forces of nature (as by dynamos and engines), to reduce friction, and to perform mechanical or chemical operations more precisely and continuously than we could do by labor alone.

2—There is also a *minimum* for interest. This minimum is, in the long run, set by the cost of creating capital. At the least, there must be enough interest to cover all costs required to create and maintain the capital that is required for producing any valuable products.

These things affect the supply of capital.

We have seen what these costs are, emphasizing the cost of "saving." They depend largely upon "time preference," and that, in turn, depends upon two sets of conditions: (1) All things outside ourselves which affect our certainty as to the future; (2) All things which affect our own attitude in comparing the present with the future.

If business and monetary conditions are stable, and if we ourselves are thrifty and foresighted in disposition, the costs of saving and the risk of loss of capital are small, and the *minimum* for interest may be low.

Of course, we must consider the least willing, or "marginal," saver.

In the long run, there is no great difference between the maximum and minimum of the interest share. This is true because capital can usually be readily produced or retired. If interest does not cover costs, the supply of new capital is reduced. If it exceeds costs, new capital is apt to be created. Thus the law of supply and demand works to determine interest.

For short periods, however—say a year or two—the interest share may rise above its normal maximum, as when business expands rapidly while plant and equipment are unchanged, or when laborers' wages are forced down to subsistence. Or interest may temporarily fall below the minimum, as when excess plant capacity has been stimulated by artificial credit policies, or when wages are so artificially maintained as to take an uneconomic share of the joint product.

Such maladjustments require changes in the supply and in the value of capital goods. They work out through changes in the "interest rate."

The basic interest rate is the "yield" on invested capital. It is normally the ratio of the annual product attributable to capital, to the cost of producing the capital. Say an engine costs $50,000 and lasts ten years. Assume that its operation brings in $150,000, or an average of $15,000 a year, of which $5000 goes to labor, $5000 to a replacement fund, and $5000 is left as interest. The rate is then 10 per cent ($5000 divided by $50,000).

The annual product depends upon the technical efficiency of the engine, the value of its services, the relative abundance of other factors (in this case we mention only labor), and the life of the engine. The cost of the engine breaks down into labor and enterprise, and the cost of the funds required to produce it, including "saving."

Of course, if there were a surplus stock of engines on hand, that would make it possible to get the engine for a smaller sum, perhaps below the cost, and thus raise the rate of interest, or yield on this capital instrument temporarily.

Short-term "money rates" tend to swing around the basic interest rate. Their chief peculiarity is that money is used not only for investment in capital, but also for speculation and for consumption purposes, so that the demand for and supply of "funds" are affected by other conditions than the productivity and cost of invested capital.

36

IS CREDIT A PART OF A NATION'S CAPITAL?

"Is credit "capital"?

Credit lies at the bottom of many problems today. We should, therefore, attempt to understand clearly just what credit is and how it works.

There is no better way to do this than to study the ideas of John Law, and the outcome of his credit-money schemes.

Early in the eighteenth century, France found herself insolvent, and the Scottish adventurer, Law, saw his chance. He began with the proposal that land is a better base for money than gold or silver, and that paper money in the nature of mortgage notes should be issued.

But his underlying idea was that credit is real capital, and that nothing but credit is really necessary as a basis for money. Law thought that, on the basis of debts, good credit money can be issued safely.

Accordingly a sort of central bank was set up in France and its unsecured notes were made the national currency. This was in 1716–1718.

A great speculative fever developed, particularly in connection with Louisiana land, and finally the crash came in 1720. Law fled the country and died, a poor man, in Venice.

Both the practical outcome and economic logic prove that Law's ideas and schemes were unsound. Let us examine them.

Of course, the facts that land itself cannot circulate, and is so lacking in uniformity of value, make it quite unsuitable as a monetary base. This Law seems to have finally realized. But how about sheer credit—government credit?

The essence of a credit transaction is that a lender transfers goods or services to a borrower who promises to pay off the loan at a future time. The soundness of the credit depends entirely upon the ability of the borrower to pay, and that, in turn, depends upon the use he makes of the loan.

If the borrower uses the loan for consumption or for business purposes which prove to be unprofitable, there is no assurance he can pay up, or that the credit is good.

Thus we can see that credit cannot be capital. It is merely a transfer of capital that already exists, and its soundness depends on the direction and use of such capital.

The credit, in the shape of a "note" or a demand for payment, may circulate and serve as "money," just as bank checks do, until the debt falls due, providing the debtor keeps in a strong position meanwhile.

Thus "credit" used as currency depends in the last analysis upon the use to which the debtor puts the loan he receives. It depends upon the efficiency and wisdom with which the credit is controlled and the direction which is given to the nation's capital.

Back in 1718, following the death of Louis XIV, France followed the great inflationist of that time, John Law, and tried to pay her debts with more debts. She tried to borrow herself out of debt. The result was a terrible crash.

Is there not a lesson for us in all this? We find many people who have the notion that credit is real capital and that credit money in the shape of government paper notes is good. They see no way to meet debts except to make more debts. They do not ask whether the R.F.C. is directing all the credit it issues into productive uses.

Might it not be well to send our John Laws to Venice before, rather than after?

37

WHAT DOES BUSINESS ENTERPRISE DO?

THE enterpriser is the individual or group of individuals who organizes and directs the functioning of the factors of production in a business. He is the one who has the ultimate responsibility for business decisions. Business risks are directly borne by him. We call him a "business man."

The enterpriser may be an individual or the members of a partnership. "He" may be the stockholders of a corporation, represented by a board of "directors."

He may exercise other functions, as does the farmer or storekeeper who is laborer, capitalist and land owner, as well as enterpriser. It is the function that counts. The part of the farmer or storekeeper which makes business decisions is the enterpriser.

Salaried persons (no matter how high the pay and how much the enterpriser's decisions are delegated to them) are not enterprisers. Mere capitalists or land owners are not, as such, enterprisers.

The function of the enterpriser may be divided into (1) organization (bringing together the other factors of production for the purpose of develop-ing business opportunities); (2) direction ("operating" the organization by maintaining an efficient balance among the labor, capital and land he directs, and by adjusting production to the market); (3) speculation (by taking chances on price changes).

Thus we may call those who exercise the first two functions the price-making or business-control enterprisers. The others are price-controlled or trading enterprisers. When a cotton manufacturer "goes long" of cotton, he is both.

"Profits" is the "share" of the total product of industry which is attributable to enterprise. As the result of organization and direction, we produce more than we could without them. Business brains on the whole direct production so as to increase it. At the same time, we may consider profits as covering the costs undergone by the "marginal" enterprisers.

In short, we may say that profits are the reward for the services of enterprisers and the compensation for their costs.

As to their services, something has already been indicated. They can "earn money" or "make profits" either because they add to production by efficient organization and direction, or because they speculate successfully.

As to their costs, they lie, first, in the risks of responsible direction, for they "undertake" to pay wages, interest and rent, and run the risk of not being able to sell the product for enough to make those payments. This involves the ability to deal with changes in demand and supply conditions—in markets and in production processes.

Second, they run the risks of price changes, both in materials and products.

They must meet competition, which is ever tending to whittle down profits and eliminate the less skillful.

So we may say that profits depend upon the ability of enterprisers to deal with business risks.

Normally, most profits are competitive. Considering such profits, we find them rising out of the dynamic changes in business, which always have existed and always will. So profit levels fluctuate.

But there is always a necessary *minimum,* which, in the long run, is just enough to cover the costs of the least efficient enterprisers who can keep their businesses going. This is the compensation required for undergoing the non-insurable risks of business. Anything less is apt to drive the individual enterpriser to work for someone else on a "salary."

Above this minimum, different enterprisers get larger "differential" profits according to their abilities in organizing or directing or speculating.

Of course, too, there is at any given time an element of pure-luck profits. This, however, is a matter of chance, and in the long run such profits are offset by losses.

Finally, there are "monopoly profits," due to artificial control over supply and price.

The *maximum* profit "share" is fixed by total product, minus the minimum shares of labor, capital and land. The minimum we have seen. In between, the profit level varies according to the number and ability of enterprisers, the supplies of the other factors, and the general condition of business risks and opportunities.

It is important to consider the size of the business enterprise. A large-scale business is one in which great quantities of labor and capital or land are combined by one enterpriser. An enterpriser gets his maximum profit when his business is as large as his ability enables him to direct efficiently. Beyond a certain point, the size of his business may become so great that the profits of the enterpriser decrease, and we say that the business is overgrown.

38

CAN BUSINESS GET TOO BIG?

AN interesting and important question is: have not many business enterprises become overgrown and unduly centralized?

The relative success of some small enterprises, while some of the giants have gone backward, lends point to the inquiry.

A man who was a $9000 salesman in the 1920–1930 decade states that as far back as 1928 a centralization of buying was started. Retail merchants began to send their buyers to New York and Chicago.

He sees, as results, irregularity in business, higher costs, price wars, unemployment among salesmen and loss of business by railways and hotels.

He relates that until 1928, "all salesmen would leave at the same time and orders would come in regularly, and merchandise was manufactured cheaper. Today, one buyer comes to New York one week, another the next week, and such orders require a separate make up because no manufacturer can tell whether he will be lucky enough to see the buyers as they come."

With the advent of the "all too-familiar dog-stall commonly known as the New York buying office," he states that the art of salesmanship has greatly deteriorated.

I find myself in sympathy with a good deal of what this man says, as I have long felt that American business has gone too far in building up overgrown managements and centralized sales organizations. I think that this has made our depression worse.

There has been too much desire and effort to control prices (often called "stabilization") and too much of the notion that business risks can be eliminated by a policy of centralized management and "diversification" of business activities. All this has gone along with the "mass production" and mass sale of highly standardized products.

This system, I think, has meant a lack of detailed supervision, an inability to make adjustments readily, and a concentration of risks. Just a word about each of these points.

Smaller manufacturers soliciting through salesmen the business of wholesalers and retailers, can specialize in production. The proprietors can give it more detailed supervision. They do not rely so heavily upon an army of underpaid and mechanically selected employes.

As this depression has proved, the smaller and simpler business concerns can make quicker and more localized adjustments to changing conditions. Their expenses are often under better control, and they can cut the coat to the cloth.

The big concerns have suffered from a concentration of risks. Many thought that by acquiring control of both raw material production and marketing outlets for finished products (complete "integration") they could reduce risks. Instead, they found that they had doubled their risks by taking on the functions of raw material brokers and jobbers, and of finished goods wholesalers and retailers.

You can't get rid of the middleman's function by doing the job yourself!

Other big concerns have sought to reduce risks by diversifying their lines and spreading all over the business map. Some are learning, like the investment trusts, that "diversification" can't take the place of detailed and specialized management. It may merely diversify grief!

So I think my salesman friend touches a sore point. If we are to preserve the system of individual initiative, we certainly need more division of labor and specialization in management and in business risks.

Maybe we have gone too far in eliminating independent middlemen and skillful personal selling.

39

WHAT IS "CAPITALISM"? CAN BUSINESS RISKS BE ELIMINATED?

AT times a good many business men or their representatives declaim against "destructive" competition, and urge the adoption of measures to restrict competition. They "hail" the proposed suspension of anti-trust laws.

Some of these are tired business men or weak sisters who can't stand the pace. Others are strong men who figure that they would be able to dominate their industries more effectively if not restricted by law. Others are just "too proud to fight."

I judge from some utterances that many little fellows yearn for "safety" and see in industrial control a guarantee of profits. They figure that the terms of business will be so adjusted that all business men will be kept alive, so that their worries would be over.

Surely it is a strange concept of business that leads one to seek to relieve business men of business risks and uncertainties. Why have any business men at all, if they are to perform no business functions? For example, if government is to run business, and thereby assume the risks, why not merely pay government salaries to corporation officials?

Business risks are inherent in business, and will exist as long as business is business. If business men are not going to assume these risks, why should they expect to get the profits which are the reward for skilfully meeting such risks?

"Safety" and profits do not go together.

Anyhow, if wages are to be determined by law and raw materials are to be legislated up in price, and if at the same time consumers are going to be protected against high prices, where are the profits to come from?

It looks very much as if some of the "capitalists" are seeking to have their cake and eat it too. They appear to want the benefits of "capitalism" without the responsibilities of being capitalists.

I wonder how many of us know what "capitalism" really is? It is the way of organizing and directing business which depends upon individual initiative whenever possible. It means a large amount of freedom for individual enterprise, and private property. It means that most business is run for profits and is controlled by market prices.

Under capitalism, business men try to make profits by selling to the customer what he wants and is able to pay for. The capitalist may make as large a profit as he can under competition, and if he loses that is his misfortune.

Capitalism spurs efficiency among producers by offering rewards according to productivity, and by eliminating business men who are inefficient. It allows individual producers to develop their especial capacities, and individual consumers their own tastes.

This is the system which some of our capitalists now appear to be willing to discard. Let them not deceive themselves. If they give up their leadership and responsibilities, they will also have to give up their "profits." (The capitalistic system is the profits system.) We may be sure laborers and consumers, under any system of "democratic social control" of the instruments of production, would have ideas about wages and prices which would differ from those of "profit" receivers. And they would have the votes.

It is not necessary to take an extreme position or to say that capitalism has been either all good or all bad. Certainly capitalism, as it has worked much of the time, has been attended by important evils. These include not only wasteful duplication and overexpansion of plants, but also the abuse of power acquired by "business barons," and much exploitation of consumers and workers. But it does not follow that a revolution is required, or a resort to Socialism or a political dictatorship. Why not just remove the occasions for the wastes and abuses practiced by "the capitalists"? Why not make a wiser use of the principle of individual initiative? (See Chapter 58.)

40

HOW DO STOCKS AND SPECULATION DIFFER FROM BONDS AND INVESTMENTS?

A FUNDAMENTAL error, I think, lies in jumbling the two distinct factors, "capital" and "business enterprise." Capital represents investment. Invested capital is found in plant, equipment, and inventories. Business enterprise, however, lies in the organization and direction of the operations of the corporations, and finds expression in policies concerning purchases and sales.

Capital, as such, runs no business risks. It has a prior claim recognized in contracts and mortgages. But the essence of enterprise is risk-taking. It gets only what is left after the wages of labor and interest on capital are paid.

Accordingly, invested capital, because of the nature of its function, expects and receives a relatively fixed return, called interest. This, in recent years, has run from 4½ per cent to 5½ per cent. On the other hand, business enterprise, or "management," gets "profits," which vary with the success of the management. For successful concerns, profits have perhaps averaged around ten per cent. Other concerns show losses.

The old-line corporation was wont to issue bonds in amounts roughly corresponding to the value of its secure, invested capital, and to sell common stocks on the basis of earning power. Thus, bond interest was largely "interest" on invested capital, and dividends on stocks were largely the "profits" of business enterprise.

Now suppose that such a corporation were to retire its bonds and issue stock in their place. Stock would then represent both invested capital and enterprise. The dividends on the stock would be composed of two parts, one the return on capital, or interest, and the other, the profits of enterprise.

The point is that, while the stockholder would then receive in dividends that part of the corporation's earnings which had formerly gone to bonds, and which was relatively secure, he would still run the enterpriser's risks as to the remainder. He would be part investor and part speculator.

It is characteristic of what we may call the "stock superiority complex" that the stockholder has sometimes come to believe that his dividends are as safe as interest on bonds, and that they may accordingly be capitalized at as low a rate as bonds yield. Thus, in 1929, we found stocks selling at prices such that their dividends gave an average yield of only 3.7

per cent, while high grade bonds actually yielded over 4.5 per cent.

Already the reader is objecting that this is not the point, but that the advantage of "investing" in stocks is that they will so rise in price that the increase in their value will make the current dividend yield of minor importance.

This brings us to the heart of the matter. To forego a fair normal current return for the sake of hoped-for enhancement of principal, is speculation pure and simple. It is not investment, for it takes a chance on the future at the expense of safety in the present.

But it is as true as ever that business profits by their very nature can not have the certainty and security of interest on invested capital. The essence of enterprise is risk-taking. And it follows that the application of a lower capitalization rate to stock dividends than exists for bond interest, can not persist. In some ways, a good many stocks may be better than bonds, but, even granting that, it does not follow that their value can normally be based on as low a rate.

Three points are stressed by those who favor stocks for investment: "careful selection," "soundly managed companies," and "diversification." Stripped of confusion, this means that if one is able to determine what companies are honestly and efficiently managed, and if one is able to buy their stocks when they are cheap, one can, by purchasing a sufficient number, count on holding a winner. Even so, however, it is admitted to be highly desirable to pay for the services of "investment counsel" or to resort to some investment trust, whose management (for a charge) will wisely shift from the less profitable issues to the more profitable ones.

In short, even the devotees admit that successful stock market operations require a good deal of skill in risk-taking. The idea really comes to this: We now know how to beat the game—we can win in the stock market.

We find a well-known professor of economics writing that stock risks may be "partly" neutralized by buying ten different stocks, so that if the buyer loses on one or two, he may offset his losses by gains on one or two others. Of course, the need of such "diversification" is in itself an admission of the difficulty of forecasting price movements. But, aside from that, what particular attraction lies in merely offsetting losses with gains?

The basic notion is that stocks appreciate in value. No matter how low the current dividend yield, the thought runs, the stockholder will gain enough through advancing prices to compensate him. But a little analysis shows that there are two alternative assumptions involved in all this: (1) either we must assume that the "investor" buys the stock "right" (at some low point), or (2) we must assume that stocks in general will advance ad infinitum. If we do not make the latter assumption, we must at least believe that some stocks will always rise and the stockholders have at last become so omniscient that they can adroitly shift from stocks that reach their maximum levels to others that are cheap.

But, if the first assumption applies, it is obvious that the goodness of stocks depends upon their cheapness, and upon success in a speculative operation. It implies that stocks may not be "a good buy" at times. Incidentally, too, it implies that for everyone who is right in buying a stock, someone may have been wrong in selling it.

The second assumption can hardly be confronted squarely. No one would claim that all stocks will advance indefinitely, though even in 1929 many issues selling at from twenty to thirty times their earnings were said to be "due for much higher levels."

No, we must sell stocks when they get too high, and buy others. Any experienced trader knows that much risk is involved in attempting to pick the tops and the bottoms in the stock market. But, aside from that, the question to be emphasized is, who is going to buy those too-high stocks? Surely not any other astute "investor" of the new school! Surely it is not possible for "investment counsel" to err! Evidently, then, the new safe-as-bonds régime involves the existence of a convenient reserve supply of gullible, uninitiated persons who, when a shift is to be made, come to the rescue as shiftees.

The scheme cannot be generalized.

41

WHAT IS "LAND"?

THUS far in these discussions we have been dealing with human factors—with labor and enterprise, and the capital which results from human saving. The total supplies of these depend upon human desires and costs.

It remains to consider the materials and forces of "nature," which taken together we call "land," and the part they play in production. This will lead to an examination of land rent.

"Land" is a broad term by which economists designate all our natural resources. It includes all the supplies of matter and energy which man finds in his natural environment. Land existed before man, and before capital and enterprise were thought of. It does not depend upon labor or saving for its existence, and would exist if man ceased to be.

Ordinarily we think of land as agricultural, mineral, business and residential. Its more fundamental aspects, however, are as follows:

1. Location or site.
2. Climate (temperature, rainfall, sunlight, etc.).

3. Soil (and water).
   a. Fertility:
      (1) Chemical.
      (2) Physical composition.
      (3) Sub-soil.
   b. Foundation.
4. Sub-surface materials (minerals, etc.).
5. Topography (elevation, slope, rise and fall).
6. Water power.
7. Water transportation facilities.
8. Flora and fauna (natural vegetable and animal life).

All these things, at the least, are aspects of the concept, "land." Any one of them may be the dominant factor in deciding the desirability of a plant location or the value of a site.

Some economists have argued that man can and does make land, as by draining swamps or irrigating deserts. All man can do, however, is to make adjustments in the materials supplied by nature. He cannot add to them. He can clear away obstacles to his use of land, but that is not making it. He can make improvements on or in land, but these either remain as separate agencies of production which may be valued apart from the land, or are lost in the land.

And when all is said, what can man do about such essential aspects of land as location, climate or mineral deposits?

In a real sense, land is a gift of nature. Of course, nature does not give any land to you or to me. We have to pay for our individual lands. But she does "give" it to man or to society. Then society allows individuals to appropriate and hold land as private property. This policy is adopted not because the land owners "made" their land, but because it has seemed the best way to get the land developed according to its most productive uses.

We should freely recognize that the case for private ownership of production land, though strong, is probably not as strong as the case for private property in capital, and certainly is different.

Two of the outstanding characteristics of land, as distinguished from capital goods, are (1) its immobility, and (2) the permanent differences among different pieces of land. Capital instruments can be made where wanted, or can be shipped here and there. They are constantly tending toward uniformity. Land, however, is inseparable from "location," and the natural advantages or disadvantages of different lands are what they are.

The individual business man is apt to think of his land as a part of his "capital." This is because he has invested his money in "real estate," including land and buildings, and he is not often concerned with the difference between the "site" and the "improvements" thereon. But even in business, the great problem of plant location is a land problem, while the problem of charges for "depreciation" apply only to plant and equipment, which are capital.

The value of land is peculiar: The only way by which we can estimate land values is to capitalize the return earned by the land, or the "rent." We find out what income the land has earned, and then we divide some rate of interest into that figure, the rate varying with the certainty of the return. Thus we have to assume an interest rate determined by conditions affecting capital, and we have to assume the amount of the "rent."

Obviously this is a superficial process. In the case of machinery and buildings (capital), we can figure cost of production, and that becomes an important factor in determining their supplies and their market values.

This well illustrates the essential peculiarities of "land." It suggests the importance of studying land rent, which we will take up next.

42

HOW IS LAND "RENT" DETERMINED?

RENT is the share in the joint product of industry which is attributable to "land." It is measured as a "differential return," and is the most important of all such returns, so that we must now carefully consider the nature of a "differential."

A differential return is one which arises from the sale at a uniform price, of things which are produced at different costs owing to natural differences among the agencies of production.

For example, wheat of the same grade sells at the same price in any market. Say that three different farms, differing in fertility or location, supply this market. Of course, the cost per bushel of producing wheat is different on each farm.

On one of the farms, it costs so much in labor and capital charges that the farmer, when he sells his wheat, gets only enough to cover wages and interest. His land therefore earns nothing and there is no rent. This is a "marginal" farm, or better, it illustrates the marginal use of labor and capital on land.

The other farms, however, having lower costs per bushel, yield returns which are greater than that of the poorer farm. Their respective net returns above operating expenses and profits for the farmer's "enterprise" are "differentials," above the returns from the marginal farm. They are land rent.

Differential returns may exist among men or among machines, but these are relatively temporary and pass with death or wearing out. Land differentials persist and have generally increased with the growth of population. They cannot be changed at will, as can differences among machines, buildings, etc.

To illustrate the rent differential, we may assume an experiment in farming. Suppose that \$5 an acre is expended on any given farm for labor and capital, and that the wheat produced amounts to \$10 an acre. This net return of \$5 an acre invites further expenditures, and an additional \$5 per acre is tried. The result is a product which brings \$17 an acre, or \$7 net. A third \$5 is then tried, making total expenses of \$15 per acre. The result is an additional return of \$5, a total of \$22.50, or \$7.50 net.

Since the last \$5 just pays, it will not be worth while to put more money into cultivating this land. It is found that, with prices as they are, an expenditure of \$15 brings the maximum net return to the land, or \$7.50. That is the economic rent.

At the same time, poorer land may be used for the same crop, and some other acre may be able to produce only $5 worth of wheat when $5 in labor and capital is expended on it. It is, therefore, not worth while to do more, and we call such land "marginal."

Both the additional $5 spent on the better land (to bring the total up to $15) and the $5 spent on the poor land, represent the marginal use of land, and the differential return, or rent, may be measured from either. It remains $7.50.

Thus the amount of rent depends upon the marginal use of land, or upon how "intensively" it pays to use the better lands and how poor the poorer land is which it just pays to use at all.

This question depends, in turn, upon the demand for land and the supply. The demand is derived from the joint product to which the land contributes along with labor, capital, and enterprise. The supply, however, is a different matter.

There is, as we have seen, no cost of producing land, but only the cost of getting to it and preparing it. The supply limitations as to land depend upon "natural" scarcity of area and natural qualities of soil, climate, topography, etc.

Land rent, therefore, is high when and where physical production (crops, volume of trade, etc.) is great, prices are high, and land is scarce.

But always, rent tends to be exactly zero at the margin of land use. This no-rent margin may be found in the least desirable space in some building, in the poorest acre of farm land under cultivation, or in some use of the better farm land which barely pays.

It is important to note that the amount of land rent as here defined has no effect upon the height of prices. The price of the product must, of course, be high enough to cover the marginal cost of using the land required; but at the margin there is no rent. Economic rent varies with prices, tending to increase or decrease as prices rise or fall.

When a dealer says he can sell cheap because his rent is low, beware. If his rent is low, it is probably because his location (land) is poor. That means that his volume of business is small and his cost per sales unit high. If his location were poor enough, he would pay no rent at all. Could he then sell things any cheaper?

We must not confuse economic rent with "contract rent." The latter is the payment actually made for the use of land and may differ greatly from the rent that is earned, as many a business man who has signed a long lease knows. The economic rent of a site varies with his prices and volume of business, regardless of contract.

43

WHAT ARE "BUSINESS CYCLES"?

WHAT is the "business cycle"? We hear a good deal about it, but much of the discussion is pretty "highbrow," so that we are apt to think of it vaguely as something that happens to business once in a while. Generally it seems to be unpleasant.

When everything is going smoothly and business is booming, someone always bobs up and announces that business cycles are a thing of the past. Then comes the recession, and again we admit that the cycle is on the job.

Really all this means a very wrong way of looking at the matter. The fact is that the boom is just as truly a part of the cycle as the recession is. If we enjoy booms, then, we enjoy business cycles to that extent.

Cycles are periods of time during which a series of events occurs in regular order. Cycles are similar, in that similar rounds of events take place in each, and usually these require a similar period of time to work out.

Each business cycle goes through successive periods of expansion, boom, recession and depression. As business expands it gets out of adjustment. Too much of some things is produced, and generally credit gets strained. Finally these "maladjustments" get so bad that a "readjustment" is required. A "correction" period follows, which means business recession and credit liquidation.

We may say that business cycles are periodic maladjustments and readjustments in business. Things get out of line during booms, and have to be readjusted through depressions.

For example, automobile producers in the Spring of 1929 had expanded production away beyond the requirements or purchasing power of the country. Many more cars were being turned out than could be sold at a profit. That was a bad adjustment ("mal-adjustment").

At the same time, speculation in stocks was drawing so heavily on credit that money rates were very high. Brokers' loans got so large that the solvency of our banks was threatened. Here was another very serious maladjustment.

Overproduction of motors had to be corrected through sharp curtailment. Brokers' loans had to be reduced through liquidation and a stock market crash.

So a crash came.

Business cycles have been coming and going, with their periodic upswings and downswings, from the beginning of business. Even in the Bible, we read of series of lean years and fat years.

While such cycles are in a sense periodic, it must not be supposed that they are exactly timed or that all are the same in duration. Since the beginning of the century, however, cycles have come along every three or four years. There were business recessions in 1903, 1907, 1910, 1914, 1919, 1921, 1924, 1927. An unusually severe one began in 1929.

In between each recession, there was more or less of a boom.

But these cycles differ greatly in their severity—in the amount of rise and fall. Sometimes the expansion and boom carry business activity only about 10 per cent above normal, while other cycles run 25 per cent above. Some recessions barely go below normal, while others go more than 15 per cent below normal.

In recent cycles, prior to 1929, the depressions have been quite mild.

44

WHAT CAUSES BUSINESS CYCLES?

We have seen that business cycles are periodic maladjustments and readjustments in business. Each cycle tends to last three or four years. Usually the upswing carries business at least ten per cent above normal (often more), and the downswing runs below normal.

Now what are the causes of business cycles? This question is of the highest importance, as the only way to iron out cycles is to remove the causes.

I say "causes" because there are several things which together make business cycles.

The big underlying cause must be found in the tendency of business to expand and push ahead too far above normal. The chief question is, What makes booms?

The essential motivating force is the desire for profits—the urge to make money. Each business man tries to make as much as he can and to beat the other fellow to it. Mixed up with this is a good deal of greed and selfishness. And the gambling spirit also enters.

Whether you start business off at normal or below normal, sooner or later these things cause expansion.

Men try to produce and sell all they can. As commodity prices rise, they order ahead. They "pyramid" orders and accumulate stocks of raw materials. They expand plants. They borrow money.

Even when expansion has clearly gone very far, they try to get the last dollar. The wish is father to the thought, so they hope that business will go still higher. The government and the banks and the press often contribute to the excesses of the boom by putting out only rosy and optimistic reports.

In fact, ignorance of the true condition is an important factor. The public is fed so much bunk about the "soundness of fundamentals" that, even if they wanted to see the truth, it would be hard to do so. This helps to cause over-expansion.

Sometimes, too, weather conditions help the upswing by causing favorable crops and prosperity among farmers.

Of course, during the boom, credit is expanded and heavily drawn upon. Men borrow all they can to anticipate the rosy future that they are imagining. And the stock market plays a part by encouraging speculation. Corporations usually sell large amounts of new stock and use the cheap and abundant funds thus acquired to further expand production.

It is the expansion and boom that make the trouble. Once at the peak of a boom, nothing on earth can prevent the recession. Overproduction, inflated stock prices, and strained credit can be remedied only by contraction and liquidation.

Finally, so much is produced that it cannot all be sold at a profit. Bank credit becomes so overextended that the limit is reached. Then comes the breaking point. Sometimes a crop failure or some great disaster precipitates the decline. But it would come sooner or later, anyhow.

So the real trouble is found in the period of business expansion and bull market. The time to prevent recessions or depressions is the evening before, not the morning after.

45

WHAT CAN BE DONE TO PREVENT BUSINESS CYCLES?

BUSINESS cycles are bad. Alternate booms and depressions keep business in an abnormal condition over half of the time, and the constant fluctuation and the periodic hard times are certainly not desirable.

What can be done about it?

The chief thing is to go right to the fundamental causes and try to remove them.

The main trouble we have found is the tendency to over-expand production and credit, under the influence of greed, the gambling instinct, and ignorance. So we must try to remove or modify these forces.

Of course, human instincts are a difficult force to deal with, but much can be done through the right kind of education. One of the chief factors here is the trade association. These organizations have done a good deal to teach better business methods, but they could go much further.

Every trade association should have as one of its aims the prevention of business booms. They should keep before their members the facts about the trend of production in the industry and the accumulation of stocks of goods. They should have the data, and then bring pressure to bear upon their members to prevent overproduction.

Big business leaders, likewise, should assume greater responsibility. They should have full information and should be held accountable for sound guidance.

Personally, I think that the facts about business cycles should be taught in every high school in the country, just as we now teach hygiene.

Then, too, we need more business information and much more honesty and judgment in interpreting the information that we already have.

Every important industry should be compelled to furnish to the Government statistics covering stocks of commodities, production, and sales. Many now do. Why should others hold back? Such information would enable careful observers to size up the situation.

Then there should be much more honesty in using the facts. As long as those who analyze and write about business persist in ignoring danger signals and painting only rosy pictures, people are going to be misled.

Even when the facts are known, we are fed "optimistic statements" right up to the moment the crash comes.

A vital point is credit. Our experience shows that credit must be placed under better control. We badly need a Federal Reserve Board that will be so chosen as to be free from politics and selfish business interests. It should then have more power.

46

WHAT CAN BE DONE ABOUT EXCESSIVE SPECULATION?

NATURALLY many suggestions as to how we may prevent stock market crashes in the future are now appearing. We are always strong for locking the door after the horse has been stolen.

These suggestions we should consider carefully. We do not want to stop all speculation and investment. We can not get along without a stock exchange. Nor can there be a complete remedy except by either educating would-be speculators so that they will be competent, or by shutting the Stock Exchange doors to all the incompetent. But it is hard to believe that the worst part of speculative excesses can't be prevented. Probably the speculative machinery can be adjusted to make it run more quietly.

One of the more interesting facts about proposals for reform is that they often come from experienced and sound men. That is evidence that there is good reason to believe that much can be done.

Another point is that these proposals are often reasonable and temperate, not wild and radical. Sooner or later, the politicians and radicals get busy with destructive schemes; but there is much sane discussion.

The various suggestions are as follows: (1) Increase the influence of the Reserve Board and enforce the Reserve Act more strictly. (2) Adjust loan values of stocks to prevent pyramiding and excessive credit. (3) Limit the issuing of new stocks. (4) Require higher margins. (5) Get more detailed information about brokers' loans. (6) Remove the Federal tax on capital gains.

Clearly these remedies mostly fall into three classes:

1—Control over credit for speculative purposes.

2—Prevention of over-supplies of stocks and undigested securities.

3—Limitations on the ability of people to "plunge" and "pyramid" in their speculations.

In so far as these broad purposes are concerned, I think that we can all agree. They are sound, and, above all, they go to the causes of the trouble. The various measures proposed may not be practicable, and the methods of enforcement may be dangerous, but something should be done in these three directions at least.

A former president of the New York State Bankers' Association sees the establishment of fictitious values and excessive use of credit as the trouble. He suggests that the American Bankers' Association enforce a policy among banks according to which they would: (1) place a valuation on stocks according to their earnings, and (2) limit collateral loans to 75 per cent of such valuation. He would fix twenty times earnings as a maximum.

A director of a trust company favors the establishment of a joint committee of the New York Stock Exchange and the New York Clearing House to pass upon the listing of contemplated new securities. The committee would consider the credit situation carefully before authorizing the listing of new issues.

Senator Carter Glass suggests that we should increase the power and influence of the Reserve Board by encouraging banks to join the reserve system and strictly enforcing the law against the diverting of Reserve credit into speculative channels. Mr. Glass doubtless will desire to keep men whose interests are largely in the stock market from positions on the Reserve Board.

Meanwhile, let us close our minds to arguments that nothing can be done about it, but keep them open as to the best method of procedure.

47

WHAT IS THE STOCK MARKET PROBLEM?

Is THE Senate's stock market investigation (1932) worth while?

The most unfortunate part of much criticism of the stock market is the emphasis on short selling and "bears." Short selling is an essential part of speculation, and it takes bulls and bears to make a market. The collapse of the market in 1929 was due chiefly to bullish manipulation rather than to the bears.

There are just two big aspects of the stock market problem. One is the need of making the operations of the market honest and accurate, including both buying and selling. The other is to protect "the public."

The first problem centers in manipulation of all kinds, and particularly the manipulation of advances in the market (for these are most common and do most harm).

The second problem centers in taking the gamble out of the stock market. If we can't make it possible for an informed public to buy and sell stocks on a rational basis, then we should make it as difficult as possible for the public to trade in stocks at all.

If the stock market is in fact a place of gambling, it should be treated as such.

As Mr. M. C. Brush has truly testified, the average man's buying of stocks is "pathetic." If things cannot be so arranged that the public can trade in stocks in other than a pathetic way, then the public should be kept out of stocks. Then persons like Mr. Percy Rockefeller and Mr. Raskob could do all the losing. They can afford it.

As it is now, the public almost always loses. This is partly because it always buys, and partly because it buys on tips, rumors and the "advice" of quack "services."

Short selling has nothing to do with such losses. The trouble comes in the buying. And it is always the same old game. A group is formed and they trade in a stock in such a way as to advance the price. Tips are given out and favorable rumors are spread. Finally the public comes in and the group sells what stock it had accumulated lower down. That leaves the public holding the bag.

Of course, such groups do not always succeed, as the experience of the Anaconda pool (1929–30) shows, but often they do.

This investigation can show nothing that is essentially new. You can read all about it in books or in the records of past investigations. There will merely be new names and the relish of new scandal.

Three details, however, seem likely to be outstanding. One is the long-standing abuse of the position of the "specialist." He is a Stock Exchange member who executes orders and deals in a certain stock, in which he specializes. He keeps "the book" in which are recorded the orders to buy and sell at higher or lower prices, including stop loss orders. The information in these "books" should be highly confidential and the specialist should have a sort of fiduciary relation to the market for his stock. This is something for the Exchange authorities to work out.

Another is the relation between the directors in a company and the stockholders. That can be corrected only by corporation laws requiring directors to own considerable stock and making it illegal to trade in the stock of their own companies—directly or indirectly.

The third is the securities affiliates of the banks, which (as in the case of Anaconda) appear to have become involved in stock market operations.

The Stock Exchange has itself done something to correct the abuse of their positions by "specialists." The Glass-Steagall Banking Bill will eliminate bank affiliate subsidiaries. But much remains to be done in the way of correcting abuse of the director's position, corporations trading in their own stocks, and other corporate practices.

48

ARE PROTECTIVE TARIFFS AN ADVANTAGE TO A NATION?

THE tariff question is again alive. It behooves the American citizen to reconsider the arguments.

First, we should bear in mind that the issue concerns "protection." Low tariffs which do not shut out imports may yield much revenue, but they do not protect. We are now talking about very high tariffs which shut out imports and thus "protect" manufacturers here. Of course, to the extent they keep out imports they yield no revenue.

The big argument against protection is that it prevents the nation from specializing in the industries for which it is best fitted.

For example, we have great natural advantages for producing steel, machinery, cheap cotton cloth and many other products. In these things our natural resources are great and our people are skilled producers. Why, then, should we not specialize in the industries for which we are best fitted? In that way, our labor and capital can be most productive and profitable.

But if we try to produce everything under the sun, and undertake to "protect" all sorts of industries, we are bound to take on some for which we are not well fitted, and thus waste our energies and make less profit.

Why should we waste our time, skill, and energy trying to compete with Japan in producing grass rugs and safety matches? Why should we not buy our pocket knives from Germany, and our straw braid from Czecho-Slovakia. (Let them specialize too, and supply us more cheaply than we can ourselves.)

That is what we fail to do when we "protect" the manufacturers of these things. We encourage our labor and capital to do things that are less productive than others. Protection tends to make the nation a wasteful "Jack of all trades."

It follows from this that the total income of the nation is not as large as it might be. If we as a nation were to specialize on the industries we are best fitted for, and to trade our products for other products which foreign nations can produce more cheaply, we would be better off.

All of us could have more of the comforts and conveniences of life. The cost of living would be lower. There would be more foreign trade. Labor would be better employed and could live better.

You must remember that when we stop imports we also stop exports. We can't sell to foreigners unless we buy from them. Trade always has to be two-sided. The paralysis of foreign trade is one of the great factors in this depression, and the high tariffs which we and other nations have put up since the war have made things worse.

But, you ask, what about wages? Does protection not keep wages up? This is one of the most serious delusions that ever affected the American people. Most certainly high tariffs do not make high wages.

Wages were high in this country before we had any protective tariff. In order to get certain desirable industries started in the early days, we gave them protection. Then the manufacturers turned around and claimed that the high tariffs had caused the high wages.

Don't you know that wages are extremely low in some countries like Spain and Germany, where tariffs are very high? Wages were lower in those countries than in England when England had free trade.

It is a fact that French manufacturers have actually demanded protection from our exports. They have claimed that American high-paid labor has so much skill and efficiency that its products have hurt the low-priced French workers! That sounds strange.

How unreasonable it is to claim that high tariffs mean high wages, and then turn around and say that the high wages are such a disadvantage to American industry that we have to put on high tariffs!

One thing that most economists agree upon is that protective tariffs reduce the total real income of the nation, and do not have anything to do with high American wages.

49

SHOULD OUR ATTITUDE TOWARD PROTECTIVE TARIFFS BE CHANGING?

THE position of the United States with reference to foreign trade has changed as the years have gone by.

We now have few "infant industries" of any importance. Our numerous great manufactures are lusty adults which in normal times export to all countries.

We have become a distinctly industrial nation, with a well-diversified industrial development. Our manufacturing plants in many cases are built to produce for foreign markets.

We are a creditor nation. That means that we have a practical interest in the prosperity of our foreign debtors. It is essential to us that they should be able to pay us, and they can pay us, in the long run, only in the products of their industries. (They cannot even get gold for paying us except by selling their products to us and other nations.)

Finally, we are now confronted by rising tariff walls built by other nations. Even England has been forced to resort to protection. This is partly due to our own high tariff, which leads other nations to retaliate.

Formerly we could get away with the protective policy because other nations were more moderate. Now everybody is doing it. With other nations raising walls around themselves our selfish policy is stultified.

This is a fact, not a mere theory.

So our attitude toward protection is changing. We need foreign trade and export markets. We need outlets for products of our farms and factories. But we find that we can't export without importing. We must "trade," or in other words, swap goods for goods.

Furthermore, the cost of living is now an acute problem, and we realize that high tariffs mean needlessly high prices for steel, clothing, and hundreds of necessities.

The question now is what to do about it.

The principle is clear—we badly need lower tariffs. We should definitely turn our backs on the selfish appeals of individual corporations for more and more protection, and should head toward more freedom of trade.

But it is just as clear that the change must be gradual. A sudden, sweeping adoption of free trade would be a catastrophe. No one proposes that.

Probably the wisest policy is to begin at once to seek mutual concessions by reciprocal trade agreements with other nations. For example, we could say to England, "You reduce your tariff on our various steel manufactures and we will reduce our tariff on your wool cloth."

Such practical negotiations should be guided by a general program based upon a scientific study of the whole situation. And there should be a permanent board of real experts selected in such a way that they will represent the best interests of the whole nation, with power to make tariff rates.

The present Tariff Board draws salaries, but it has little power and has done nothing really important.

The biggest folly of the present scheme is the notion that we can adjust tariffs so as to equalize costs of production. The theory is to give our manufacturers just enough protection to offset their higher costs, if they are higher.

But it is usually impossible to find out what costs are. Moreover, we are led to the ridiculous conclusion that the higher a company's costs are, the more protection it should have! If a German company, by improved methods and economies, cuts the cost of producing pocket knives in two, we are supposed to double the tariff on pocket knives to "protect" our inefficient manufacturers.

Our taxes are too high, you admit. Well, the tariff is a tax. It is a very high tax which every consumer pays, and which goes largely to "support" a lot of uneconomic manufacturers.

50

ARE THE ANTI–TRUST LAWS OUT OF DATE, OR TOO VAGUE?

THE old game of making "the depression" the goat and using it as an argument for all sorts of schemes, is going on merrily.

When we are sick, we easily convince ourselves that things are wrong and are apt to fall a victim to new diets or quack remedies.

So it is with the attacks on our anti-trust laws. Those who don't like them are telling us that if these laws are changed we will get well.

For example, one of our big bankers testified as follows: It would be constructive to modify the anti-trust laws so that business men could "sit down and compare their views of conditions and develop a sound policy of procedure without the possibility of going to jail."

There is a good deal of bunk in these words. There is nothing to prevent business men from sitting down, or lying down if they want to. It is perfectly legal for them to compare any views of conditions which they may have. No policies which are sound economically are prohibited. And did you ever hear of a business man going to jail because he sat down, or because he developed a sound policy?

The whole question is, What is "sound policy"? The common law and the statutes say that it is unlawful for business men to agree and conspire together to restrain trade by controlling prices or pooling production. The science of economics teaches that fair competition based on a knowledge of the conditions of supply and demand is desirable and gives the best results.

The only alternative to competition in business, as required by our anti-trust laws, is government regulation. We cannot and will not tolerate private monopolies.

Business men who believe in individual initiative and private property would do well to go slow in advocating revision of anti-trust laws. Such revision might easily lead to increasing regulation and even to government ownership.

They tell us that the law is out of date. But we have heard that about the Constitution, the rules of the Reserve System, the gold standard, and about capitalism itself. If competition is out of date, and monopoly is in style, they are right; otherwise, not.

They tell us that they don't know what they can do—that the law is uncertain. What they mean is that they don't know how far they can go in breaking the law. The rule or principle of the statute is as plain and simple as can be. There is a mass of decisions which should enable any fair mind to know what can be done lawfully.

The courts have wobbled in the direction of leniency, and got mixed up on questions of "intent" and "necessary tendency." It might be well to add a section to the law to strengthen it in these respects. But the anti-trust law opponents do not want that!

Their wildest proposal is to have some commission pass on combinations in advance and absolve the combiners of liability for results. That would be like licensing an automobile driver to do anything he wanted with his car, and to free him from liability for results of drunken driving.

There is no way out except to hold individuals responsible for the results of their avoidable acts.

The anti-trust law will stand, and it should stand, —that is, unless we are to be driven into some form of State Socialism.

51

HOW DOES A "BIG" BUSINESS MAN REGARD PRICE FIXING AND "TECHNOLOGICAL UNEMPLOYMENT"?

MYRON C. TAYLOR, chairman of the finance committee of the U. S. Steel Corporation, in an address (Nov. 1931) before the International Conference on Bituminous Coal, discussed two questions of great public importance. His discussion merits close attention.

The coal industry, like the oil and lumber industries, has been clamoring for a change in the anti-trust laws. It is claimed that competition works badly in this industry and that valuable natural resources are wasted, as a result. The coal people say that the only way they can remedy the situation is to combine in ways now prohibited.

Mr. Taylor replies to them as follows: "I find it extremely hard to believe that constructive coöperative plans, sincerely undertaken for rationally adjusting production to demand in a basic industry and which avoid any attempt, artificially, to fix or control prices, can be regarded as a restraint of trade and commerce."

He says that without government action the industry can, under the present laws, make constructive plans if it acts openly with competent legal counsel and in coöperation with the government.

I think Mr. Taylor is quite right. The great trouble with our would-be combiners in business is that they are too greedy and in too much of a hurry. They want to start by fixing and controlling prices.

To fix a price by agreement is not only in violation of our statutes, but is contrary to the economic law of supply and demand. Such action is sure to fail, sooner or later.

But if the industry would start with an honest and open ascertainment of production costs (perhaps with government coöperation) and then agree that mines which produce at a loss would be closed, no one could object. That is just what intelligent competition would do.

The price would then rise in a natural way to cover cost of production.

The other point Mr. Taylor makes is that we need not fear "technological unemployment"—unemployment caused by increased use of machinery. His reasons are as follows:

1—More labor is required to make the machinery.

2—Larger consumption of manufactured products is stimulated by lower prices and costs.

3—More raw materials are required.

4—More transportation work comes from increased output and a larger consumption of raw materials.

Of course, it takes some time for these offsetting developments to occur, but they do occur.

We need not worry about unemployment due to labor-saving machinery. Our problem is the temporary one, caused by a periodic business depression.

On the one hand, the limit of human wants has never been reached, and probably never will. In normal times there will always be things for labor to make. On the other hand, we have shut off immigration, and the size of the laborers' families is being gradually reduced. Once we get out of this depression, the problem of "technological employment" will soon disappear.

52

CAN TRADE CODES SUPPLANT THE ANTI-TRUST LAWS?

We are now told that the anti-trust laws are to be replaced by "trade codes." This means that instead of conducting their business independently and competing with one another, business men are to be forced to get together and be subjected to government regulations.

At once we note that there are two features of the scheme to consider:

1—There is really to be no "letting down of the bars" as to what business men can do.

2—There is to be a great deal more of government in business.

Competition is to be largely eliminated, but, on the other hand, monopolistic practices are not to be allowed. Presumably production and prices are to be so regulated that profits are to be held in check.

All this is to be accomplished by drastic government regulation, involving a war-time system of "licensing" and control over wages, hours, etc. Government "partnership" with business, under the circumstances, seems to be a misnomer.

Aside from all questions concerning the desirability of individual initiative and other old ideals, it seems to me that we should reflect that government participation in business does not get rid of business problems or business risks.

The government as a business man has to supply labor, raise capital, and adjust production to consumption. Such functions and problems are inherent in economic life and industry.

Would the labor problem be any easier to solve under government management, complete or partial?

Is there no problem of raising capital when the government comes in? As I see it, capital must always be supplied by individual saving and government must either sell bonds to savers, or tax savers to raise adequate capital.

If the price system is to be retained, the problem of adjusting production and consumption (which has been so difficult in Russia) comes to a head in prices. High prices tend to stimulate production at the same time that they tend to curtail consumption. We know how the law of supply and demand can work under competition.

But if competition is to be abolished, and prices are to be fixed arbitrarily, how are production and consumption to be determined and adjusted to one another?

The government as a business man proceeds to "plan" production by "regimenting" producers into a sort of industrial army. But once this is done, it is found that here and there shortages and surpluses arise. Wants and consumption change. The production "plan" breaks down at points.

Then the tendency is always to simplify the problem by standardizing consumption. Consumers are told what and how much to consume. Rationing supplements regimentation.

This works in war-time emergencies and in periods of revolutionary fervor. Perhaps this is one reason why there has been so much talk of a "war on depression," when industrial control and licensing systems are being proposed.

One thing seems clear: To the extent that government is entering into business, one who must buy securities in the field affected, may well consider whether the government's bonds are not safer than its equities.

It is no reply, to say that we have had "industrial anarchy," and that social control "could do no worse" than oil, sugar, and other producers. Part of the trouble has been international. But insofar as domestic conditions are at fault, any "anarchy" has been due to the toleration of monopolistic practices, bad corporation law, unsound speculative customs, ignorance, and unwise or inadequate government interference. Which of these would be removed merely by having the government run business?

53

WHY DO BUSINESS "STABILIZATION" SCHEMES FAIL?

In 1932 there was introduced in the Senate a bill to authorize industrial "agreements" which would otherwise be in violation of the anti-trust laws. This bill would authorize artificial restraint of trade and limitations of competition for a period of two years.

The idea is that business men should be allowed to combine for the purpose of controlling production and prices, and that by so doing they can make business conditions better.

There was at the time a bank-credit expansion scheme, which scheme failed largely because there is no demand. But the business combination scheme actually proposes to give our business "leaders" the power to defeat the forces of demand and supply. It would give them power to attempt by concerted action to control supply, and that necessarily means to fix arbitrary prices.

Such schemes have been tried over and over again, and have always failed—after a period of futile manipulation. We may well remember copper.

What reason have we to think that individual business men know enough about market conditions and the fundamental forces of demand and supply to allow any group of them to decide how much an industry shall produce and at what price?

Such power would only magnify their mistakes. Just think of the ghastly experiments in copper and oil made during the period of 1926–29!

If an individual business man does not have the skill and foresight to adjust his own operations to free and open market conditions, or if statistics are lacking, why should we think that a combination of them would do any better in running a monopoly?

And what about us consumers?

These schemes have this in common—they are attempts by artificial man-made plans to control economic forces. (Or they may represent a notion by some that no "natural" economic forces exist.) It is this sort of thing which so greatly postponed the beginning of recovery in 1930–1932.

Will we never learn that wise business leadership consists in understanding economic conditions and laws, and in making prompt and intelligent adjustments thereto?

We don't try to control or "stabilize" the wind and the tides. We try to adjust ourselves to them. So it should be with economic forces.

54

WHEN IS GOVERNMENT INTERFERENCE WITH BUSINESS A GOOD THING?

WHAT is the logic of government participation in business affairs?

A safe general principle to start with is this: The burden of proof is on anyone who advocates that the government undertake any business operations which individuals could perform.

This is true because a government is merely a potentially perpetual association of interrelated individuals, and exists for the welfare of those individuals and their posterity. The only beings who feel wants and who undergo costs are individuals. Furthermore, the wants and the costs of the citizen individuals are different in each case, hardly any two men being alike in tastes or capacities. Several points follow from these facts:

1—Any government interference in business means that some individuals (whether a majority or not) are doing something to or for other individuals. Almost inevitably this is the same as saying that government action means the enforcement of some people's opinion (say of prohibitionists, or farmers, or debtors) as to what is good for other people (say "wets," or city dwellers, or creditors).

2—It is impossible through government action to balance directly the satisfaction of human wants and the costs involved; for the persons who pay most for the improvement of some watershed may live thousands of miles away, and most of those who vote taxes pay none themselves.

3—Government action must be broad and general, dealing with the whole nation, or at most, with broad classes. This inevitably leads to "regimentation" and to standardization, and thus runs counter to individual differences in many ways. Especially, it prevents the allowance of differences in rewards according to different productive capacities, and differences in services and products according to differences in the tastes of consumers.

Governments pay too little for big men, and too much for little ones. Shippers still remember their dissatisfaction with railway service under post-war government operation.

We may add that individual initiative has the great merit of educating individuals. To the extent this source of "education" is taken away, the character of the individuals who compose the society is likely to suffer. Experience indicates that the spur of individual necessity and the hope of individual profit are generally most conducive to economic progress.

Unquestionably, the government has certain advantages in power and scope, and in certain fields its positive functioning is justified.

We may say that the government may wisely step in:

1—Whenever there is no motive for individuals to perform adequately a service of fundamental and general importance.

2—Wherever individuals are led by self-interest to do things which run counter to the interests of the majority so as to reduce the total net welfare. (Of course, we take for granted that fraud, business piracy and practices injurious to public health will be prohibited.)

Supplying pure water, sanitation, education, libraries, reforestation, postal service, highways and light-house, illustrates the first point. (In some of these cases, the inequality of individual purchasing power makes the profit motive inadequate.)

In the second case, the usual recourse has been to seek by "regulation" to prevent anti-social acts by individuals, as in (*a*) the waste of limited natural resources (coal and oil), or (*b*) the abuse of "natural monopolies" (power and light, telephones, railways, etc.). It is often an open question whether such "public service" industries may not best be operated by the government, and if the government itself were honest and efficient, the answer would generally be in the affirmative.

The provision of a system of coinage, weights and measures has long been recognized as a government function, and may be justified on both the above grounds.

We should recognize certain distinct disadvantages which necessarily characterize the government in business:

1—Government operation is rigid, and slow to adapt itself to changes. On the one hand, it lacks progressiveness; on the other, it makes very costly experiments. "Five-year plans" are adopted in a world which requires frequent changes.

2—Motivation is unfavorable to efficiency. Government officials have great powers, but inadequate responsibility for their acts. There is no close or continuous testing of their efficiency, and their rewards are not based on results secured.

3—Mistakes when made are very serious, because they involve the whole nation.

We should note carefully that government operation does not remove the occasions for discrimination and exploitation. It merely changes their form. Clashes of interest between the West and the East, or between laborers and employers, or farmers and manufacturers—all remain. "Graft" takes the place of business fraud.

In a democracy, we can hardly expect government business to be better than the business ideals of the citizens whom the government represents.

Business is business—and politics is politics.

55

SHOULD WE NOT COUNT THE COST OF GOVERNMENT PARTICIPATION IN BUSINESS CONTROL?

ONE of the most important conditions today is the number of people who have come to believe that some sort of "collectivism" is necessary. Such people see no hope of recovery except through positive Government action.

The basis for this development is, of course, the bad condition of business and the suffering of the unemployed. The "collectivism" or Government action, is the democracy's version of a dictatorship. It arises from the feeling that some "leadership" is necessary.

So we find people demanding that "the Government" take over the railways. Some want it to manufacture more money. Others want it to give a dole to the farmers by taking money away from manufacturers. Still others want a "planning" board, apparently to decide what shall be produced, how much shall be produced, and at what prices products shall be sold.

All this involves important questions of social and economic policy. The whole philosophy of individualism, or of socialism, is at stake. But as an immediately practical matter, at the present juncture, I would suggest the questions of the budget and taxes.

In view of existing facts, should we not waive theories of society and government, for the moment, and just consider the truth that no government can do the things proposed without expenses?

(Think of the expense involved in setting up and administering the "domestic allotment" scheme for agriculture.)

It almost seems strange that some of the people who are most loudly demanding a drastic reduction in taxes are proposing an expansion of Government activities. How can a man who decries our unbalanced Federal budget, and insists that above all the budget must be balanced, at the same time propose that the Federal Government plunge into a program planning relief and activities which would make a balanced budget practically impossible?

It is high time to remember that the state of government finances in 1932–33 was not due to expenditures for ordinary government functions. It was not our military forces, our organization for protecting life and property within the nation, our money and banking arrangements, education, or even the necessary public works, which caused the big deficit.

At least two and a half billion dollars of the

Government's expenses were for extraordinary purposes. Our deficit was chiefly due to such expenditures as the following: (1) to boost farm prices and otherwise aid farmers; (2) to finance the R.F.C. and thus put the Government into the banking business for the purpose of "saving" various property interests or "stimulating" business; (3) to give money to ex-soldiers; (4) to construct roads and waterway and harbor improvements, etc.

Entirely aside from the question as to how much of all this might be a good thing under some circumstances, we should reflect that it would have been possible to balance the Federal budget solely by lopping off a billion dollars of such expenditures.

That would have been one way to restore confidence.

Personally, I am not a "standpatter." I believe in many reforms (for example, in our banking system and in security issues). I believe in direct relief to all the needy unemployed.

But I also believe in economy, efficiency and the law of supply and demand. I believe that with nations, as with individuals, there are times when the coat must be cut to fit the cloth.

"Collectivism" should be limited by what there is to collect.

56

WHAT IS SOCIALISM?

At a time (1933) when one hears so much of "social revolution" and the "failure of capitalism," it is surprising how few people understand exactly what Socialism is.

The first impression one gets is that Socialism consists of a criticism of economic evils and an attack upon the existing social institutions which characterize "Capitalism," such as private property. All Socialists agree in these respects.

But most people who are not Socialists also agree that many evils exist, and they also demand reforms. Furthermore, hardly any two Socialists agree upon exactly what should be done. Socialists have no monopoly of social reform; and they differ so widely among themselves as to make one doubt their grasp of fundamentals.

As I see it, the positive earmarks of real "Socialism" are as follows:

1—It emphasizes society as a whole, and places society above and ahead of the individual. The Socialist regards the individual as existing for society, not society as existing for the individual. Instead of talking about the greatest good of the greatest number, he talks of "the collective good." The extreme Socialist sees the forest, but not the trees; while the extreme individualist sees the trees, but not the forest.

Accordingly, Socialism does not accept any presumption that individual initiative is a good thing in itself.

2—It believes in and emphasizes the similarities among individuals, insofar as economic life is concerned. It ignores fundamental differences among men.

The Socialists are forced to do this in order to deal with society as a whole. If all men were exactly alike in wants, needs, capacities, and costs, we could treat them as a unit. Collectivism would be easy. There would be no problem of weak versus strong, or the lazy versus the industrious.

Probably as fundamentally characteristic as any, is the Socialistic doctrine, "From each according to capacity; to each according to service." (Or some Socialists lean toward the formula, "From each according to labor time; to each according to wants.") But all this has two great weaknesses: first, hardly any two persons have the same wants, or are able to render the same service with a given amount of effort. Who, then, is to judge the wants and efforts of different persons, and on what basis? Second, there is no way provided for balancing the capacities or efforts of a man, either against his own wants or against the values which anyone else may attach to the resulting product. Who, then, is to decide what the services performed by any individual are worth, and on what basis are values to be fixed?

These are the reasons why Socialists seek to organize producers into "industrial armies," and to exercise so much control over consumption. In practice, effective Socialism develops into autocracy.

3—Socialists attach relatively great importance to "social institutions," which they consider as man-made and subject to control. These, they say, must be abolished in a way that is essentially revolutionary.

They see in "exploitation of labor" the great evil, and regard it as being based on such "institutions" as private property in land and capital, individual enterprise, the use of money, and the "price system." These they would abolish, and would substitute a collective direction of production and determination of prices through some form of government control.

We may, therefore, define Socialism as that theory of economic life which is based upon a concept of the welfare of society as a whole, and which would make social welfare the conscious and direct aim of industry, seeking its end through the abolition of private property in the instruments of production, and substituting therefor collective ownership, together with collective management and distribution of products.

Or we may say that Socialism is the doctrine of economic welfare which holds that the cause of economic ills lies in an alleged exploitation of labor, based chiefly on private property and working through business competition, and which, therefore, advocates the common ownership and management of land and capital and a collective fixation of values.

Socialists may and do differ as to whether their theories should be carried out by a national government or by local groups. Some favor a revolutionary seizure of government; others a gradual process of educational propaganda. But the essence of Socialism itself is as outlined above.

Government ownership of railways, government price-fixing, unemployment insurance and similar policies, may or may not be steps toward Socialism; but Socialism actually exists only when economic life is so organized and directed as to fit the foregoing definitions.

57

WHY DO MOST ECONOMISTS REJECT SOCIALISM?

EVERY normal person wants to see the greatest possible human welfare. The question is, How attain this end? Socialism offers one plan. Let us now consider the fundamental weakness of that plan.

1—Socialism, as a practical scheme, involves a change in human nature insofar as we can judge what that is from experience. It assumes more altruism or sense of duty than most of us now possess, and a greater willingness to accept an average condition of well-being. Accordingly, Socialist experiments have always been either limited to small selected groups, or have resorted to much compulsion (as in Russia).

2—Socialism puts a naïve faith in man-made "institutions" and laws, attributing poverty to them, and holding that by some change in them all economic ills can be made right. It ignores the fact that our limited natural environment, and the innate characteristics of our own physical organisms, remain the same, regardless of property or contract. Can we organize ourselves into a condition of virtue and happiness?

3—Socialism regards "society" as something separate from the individuals who compose it. So they seek, by rules laid down by someone supposed to represent society, to do things to us members of society. They appear to think that society can advance faster than the individuals who make up society.

4—Socialism thus involves a supreme egotism. A Socialist must either believe that he knows what is best for all men, or that he knows someone who does. It means nothing aside from a "plan" and a plan must be evolved by someone. What presumption is there that anyone knows enough for this?

5—Socialism presents a serious weakness as to economic motivation. It relies upon love of work, sense of duty, etc. But what work? Duty to whom? How provide for the hard work and for the different senses of duty existing among different individuals? The average man works hardest when he works for himself and family.

As to management, it would mean either a democracy, in which too many cooks would spoil the broth, or an autocratic centralization on too large a scale for efficiency.

As to capital, who would do the saving necessary for its formation? (Most Socialists hold that capital is nothing but labor.)

So, even if we were to grant that a more just distribution could be gained, it is rather probable that there would be less products to distribute.

6—Socialistic economics is based on a false theory of value. It seeks to base value on labor cost. (*a*) This leaves other costs out of consideration. (*b*) It leaves wants and utility out of consideration. Suppose that two things cost the same quantity of labor, but one is wanted twice as much as the other. Suppose it takes the same labor to paint a great picture, to make a pair of shoes, to plow a field, and to devise a Socialistic plan—are these of equal value? If not, what is each service worth?

7—Socialism presents no solution for the basic problem of economic life, namely that of getting a balance between human costs and human benefits. This is the problem of adjusting cost of production to utility in consumption.

The Socialist state must decide what its army of workers will make. That, however, would not necessarily mean what we individuals want. The state might decide what we must consume and not consume, and by a system of rationing force a sort of equilibrium between quantities of production and consumption. But that would not insure that utility or want satisfaction would be equal to costs.

After all, is there any way for us to count on getting what we want unless we can produce what we want to?

8—Socialism has never been able to work out a satisfactory scheme for "wages."

9—Socialism has no means but compulsion for distributing the labor force among different occupations.

So I reject Socialism—not because I think the economic world is perfect, nor because I was raised under "capitalism," but because Socialism is based upon a fundamentally inconsistent and illogical philosophy, and has been able to present no adequate basis for economic motivation or for determining the value of goods and services.

I reject Socialism in much the same way that I reject Individualism. Both are extreme and one-sided. The best economic life can be attained only on the basis of a synthesis of the two philosophies—upon a true social point of view, which gives more weight to individual choices than does Socialism, and attaches more importance to group life in society than does Individualism.

58

HOW CAN WE ATTAIN THE GREATEST POSSIBLE AMOUNT OF WEALTH AND WELFARE?

If we were to proceed on the basis of economic laws, instead of experimenting with idealistic and inflationary schemes, what would we do to increase the nation's wealth and welfare?

The scientific way to get the greatest possible economic well-being is as follows: (1) Attain the maximum production of economic goods and services, considering costs. (2) Distribute the products among all producers as nearly as possible according to their respective productivities, first providing decent subsistence for all. (3) Induce people voluntarily to adopt ways of consumption which would give maximum satisfaction to each from the expenditure of his income.

In order to attain these general conditions of real prosperity, economics shows the following means:

A. The basis lies in production; therefore we must achieve the maximum output of desirable things in proportion to cost. How?

1—Provide the maximum stimulus to production, by—

(*a*) Paying each producer on the basis of his productivity.

(*b*) Eliminating or redistributing unearned incomes, and keeping opportunities open. To this end, economists suggest the following means: Eliminate or regulate monopoly, eliminate corporate fraud and manipulation, eliminate "speculative" manipulation and gambling, carefully tax inheritances, carefully tax land rent.

2—Increase the efficiency of the factors of production. Begin by recognizing differences among men and instruments of production, and facilitating the shifting of the less efficient to lower-paid positions. Then facilitate and encourage "division of labor," both occupational and territorial. (Such things as vocational training, employment bureaus, and land classification are important here.)

3—Encourage the formation of capital equipment by thrift, ample savings institutions, and making investment safe.

4—Insure the most efficient use of all instruments of production. Here the great means is to preserve and perfect competition by eliminating monopoly and fraud, and by education and information concerning business conditions and cost of production. Artificial barriers to the free flow of labor and capital must be broken down. The aim is to let the economic law of balance work and to secure the most productive proportion among the factors of production.

5—Promote certainty and minimize risk by sound money and credit, and by full and true information.

B. Along with maximum net production, must go fair distribution of wealth and income. The general principle is to have rewards adjusted to productivity and to give all individuals a fair chance to develop their capacities. (See above, *A*, 1, (*b*) and *A*, 2.)

1—Here economists emphasize the adjustment of population to natural resources. To this end, intelligent education as to marriage and birth control, and means to establish the highest possible standards of living, are desirable. Reasonable minimum wage laws, training to increase the percentage of those who have business ability and labor skill, are advocated. "Defectives" require special treatment.

C. The way people "consume" should be guided by education, so that they will get the maximum utility. An important economic law is that we get such a maximum when we consume different things so that we equalize the intensity of our desires for each.

D. Minimize economic maladjustments. The big point here is to prevent "booms" and the over-extension of credit, overspending, and speculative excesses, which always accompany. This can be done by scientific, non-political control of banking, credit and security trading, backed by the steps suggested above under *A*, 4.

E. Provide wisely the appropriate place for the "public economy" and for the participation of government in our economic life. (See Chapter 22.) The government should not undertake the direction of business in which competition can work. It should regulate or manage "natural monopolies" and limited natural resources as well as carry on its usual functions. It has a wide field in education. Much remains to be done in the way of scientific taxation. In general, government should facilitate and supplement the working of intelligent competition.

Above all, there is a crying need that our representatives and executives be selected on the basis of merit, and hold office on the basis of efficiency and social-mindedness. The millennium is distant under such "politics" as ours.

To attain prosperity, it is necessary only to follow economic laws, whether individually or collectively. There is no way to do this so surely and effectively as to allow wherever possible the functioning of individual initiative, intelligent competition, and the voluntary coöperation of individuals through the exchange of their products in free markets. Any system of compulsory control, whether by a dictator or by the masses, must fail to give as good results, for the reasons which were given in discussing government functions and Socialism.

59

WHAT POINT OF VIEW TOWARD ECONOMIC LIFE GIVES THE BEST BASIS FOR ECONOMIC SCIENCE?

JUST a word about the fundamental nature of economic science and its laws.

I believe that the only worth-while way to approach the study of economics—the only one which makes it possible to draw valid general conclusions—is to deal with *functions,* not with persons. This means dealing with what is done, not who does it—with capital, not capitalists—with land, not land owners.

I see J. P. Morgan or Otto Kahn merely as a specimen of the genus "private banker," and a member of the "brain trust" as a professor who thinks that he knows how to run a collectivist state.

In much the same way, medicine is not concerned with persons, but with health. Biology cares not who the organism is but how it works.

This does not mean that the "human element" is to be left out, but that we see individual humans only as they function for the mutual welfare of the group in which they live.

No more significant way of analyzing *economic functions* ever has been developed than that which divides them into "production," "consumption" and "valuation," as carried out by and for groups of men who furnish "labor," "capital," "enterprise" and "land" use.

It follows that I must take a *"technological" point of view,* which means that I deal with labor, capital, enterprise and land as instruments. I am concerned with the nature and supply of these instruments, and the way in which they perform. What are the ultimate human costs or natural scarcities which limit their supplies? How may they be best utilized to gratify human wants?

I cannot take for granted the fluctuating market prices of these instruments, nor the money "expenses" incurred by business men. I seek to explain these prices and expenses. And I find the roots of all economic values in human psychology, and in the nature of man's physical environment. Money is only an instrument.

Finally, I take a *social point of view;* but one which recognizes duly the fact that society is composed of human persons, and exists for welfare of individuals. Society is merely a continuous association of individuals who have enough common interests, and are sufficiently conscious of that fact, to be able to coöperate for certain broad purposes.

This means a long-run point of view, and one which considers the net benefit of all the members of society. I am, therefore, concerned with such things as conservation of natural resources and with government debt; and in considering taxes and tariffs, I ask, What will be the effect upon the nation as a whole?

Economics sees no net gain in purely *"acquisitive" activities,* which acquire wealth for one while taking it away from another; and it does not recognize predatory and unlawful activities which tend to destroy the society by injuring its members. Robbery and fraud are what I have in mind.

But this is far from committing me to uniformity or collectivism. While seeing society and the common interest, I also see millions of individuals each having different wants and different capacities. And I know one of the worst tyrannies lies in the equal treatment of unequals. If prohibition is not accepted by the majority, I do not try to enforce it; and *if* inflation hurts as many as it helps, I do not favor it.

Proceeding from this functional-instrumental-social point of view, I believe in *positive economic law.*

The average man, under usual circumstances acts in certain ways. He is subject to the stimuli and to the limitations of his physical environment. His body, including his nervous system, has certain similarities to those of other men. He is very apt to imitate his fellows. In short, there is enough similarity in human instincts, wants and mental processes, and enough similarity in environment, to warrant us in generalizing and formulating laws which are valid and useful.

Such laws are "positive" in a real sense. They are not ethical in the sense of telling us what ought to be the goal of economic life. They cannot be "violated" without injury to economic well-being.

Every science has a sort of "ought," for when we know the truth about anything our minds seek to avoid error. Just so, economic laws tell us that if we want maximum results in utility as compared with costs, we must do so and so. They say, "If you want the greatest net satisfaction of wants, you must (and in that sense, ought) to follow us."

Thus they are positive as to the means to use, but leave the purpose of life open for choice or control.

So, let us seek the maximum in the field of utility and cost, by learning and following the laws of economics; and let philosophers study how to combine economic values with the values of ethics, politics, art and morals.

To treat economic life as the object of government control, and then to treat government control as a game of football, is worse than trying to "make" economic law. It is to deny the existence of economic law. It leads to lawlessness. It *destroys the basis for all real planning,* and makes society subject to continual experiments—which *means constant* *uncertainty*. Times change—yes! But we still regard the proportions of a Greek column as beautiful, the Golden Rule as a good working basis for Ethics, and the law of supply and demand as the determinant of economic value.

60

POSTSCRIPT: WHAT CAN WE LEARN FROM ECONOMICS?

PROBABLY most of us should learn from such study as we can give to Economics, (1) how to ask intelligent questions, and (2) the wisdom of considering the answers thereto given by competent economists (see Chapter 1).

Certainly our study should make us more humble in our opinions concerning complex economic questions, and less ready to form snap judgments.

What, then, are some of the questions which we should be ready to ask in 1934?

1. Are producers not consumers, and consumers producers?

2. Can we benefit a nation by helping producers and hurting consumers?

3. Is it not necessary to increase production in order that increased consumption may exist?

4. Is production really increased when supplies of commodities are enlarged to such an extent that values and prices fall in proportion?

5. And is real income increased when prices are marked up artificially—as by inflation—without any sustained increase in quantities of goods?

6. Can we permanently increase the wealth and

prosperity of a nation by taking away the wealth earned by some individuals and giving it to others—as by "processing taxes" and dollar devaluation?

7. How much total purchasing power can we create by taking incomes away from some and giving them to others?

8. Can we create sustained purchasing power by going into debt and using credit not based on assured earning power?

9. Can we create purchasing power by spending and not saving?

10. Can wages be permanently paid out of anything but the product of labor?

11. How long can wages be paid which exceed the product of labor and so impinge upon the income necessary to capital (interest) and enterprise (profits)?

12. If money is just a kind of ticket or medium of exchange, how can we change the real wealth or real income of a nation by changing the amount or kind of money used?

13. If the kind of money makes a difference, why not have the safest and most stable kind?

14. How can the average of a large number of commodity prices serve as a "standard" for stabilizing the price of each commodity in the list? (How do we know whether $2 + 3 + 4 = 9$ or $1 + 6 + 2 = 9$?)

15. How can we make money circulate without first making goods or services circulate?

16. How long can we increase employment by

doing anything which makes it unprofitable to employ labor?

17. Does all credit not involve debt?

18. Does increased credit of itself add anything to the capital equipment of a nation?

19. Can an individual or a nation borrow itself out of debt?

20. Does a government create wealth when it borrows from a bank by trading its bonds (debt) for the bank's notes (debt)?

21. Are we not drawing on the future when we "expand credit"? How far ahead can we discount the future in a period of great uncertainty?

22. Can inflation raise prices in any way except as it stimulates speculative buying or finances the withholding of excess supplies from markets?

23. Is speculative buying not essentially a "short sale" of money, which must be covered by the sale of the goods bought, which tends to cause a reaction in the price?

24. Does the withholding of excess supplies from a market, reduce the existing total supply?

25. Could there be a great depression without a preceding "boom"?

26. Can we cure depressions without curing booms?

27. Can we cure booms without eliminating the things which cause them?

28. Are not the practical causes of booms some form of inflation, overspending, and overproduction?

29. Are not "confidence" and "business sentiment" always strongest just before a business crisis?

30. If sentiment is buoyant and wages are high at the peak of a boom, why does business not remain good?

31. Can a government control the production and distribution and consumption of commodities (the supply and demand) without fixing prices?

32. Has government price-fixing of commodities ever been successful?

33. Can a democratic form of government, in which votes count, harmonize the interests of laborers and employers, farmers and industrialists, consumers and producers?

34. Would the clashes of economic interest of different sections, classes, and industries, be any less under Socialism than under our present form of government?

35. If no business man knows how to run his particular business, where will we find the man who knows how to run all the businesses of a nation?

36. Can long-term business plans and investments be made when the value of money and credit conditions are indefinite and uncertain?

37. Can business prosper when business men cannot make long-term plans and investments?

38. Can a nation prosper when business does not prosper?

39. Granting that we can control our economic

destiny, how do we know what methods to use and what course to follow?

40. If man can make economic laws, what laws should he make?

INDEX