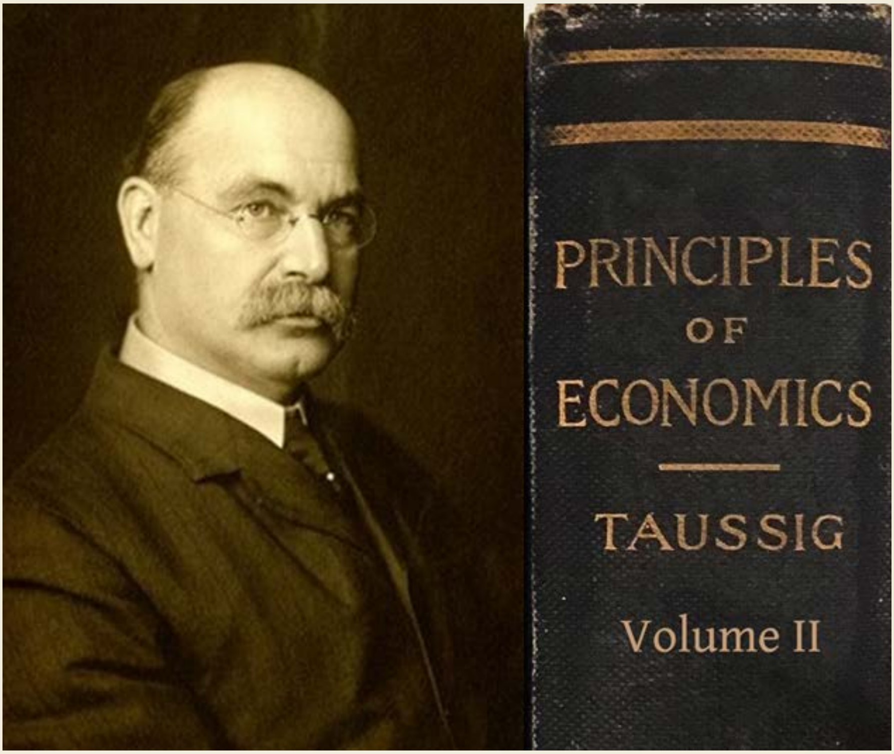
PRINCIPLES
OF
ECONOMICS
TAUSSIG
Volume II

PRINCIPLES OF ECONOMICS

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THE DISTRIBUTION OF WEALTH

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INTEREST ON CAPITAL USED IN PRODUCTION. THE CONDITIONS OF DEMAND

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§ 1. THE word "distribution," in the sense commonly attached to it in economic writings, refers to the apportionment of the income of a community among its several classes and members.[1] Wherever industrial development is in any degree advanced there are owners of capital and of land; there are persons using land and capital who yet are not the owners—tenants and borrowers; there are all sorts of workers, ranging in earnings and in social position from the poorly paid day laborer to the prosperous professional man and salaried manager. What share goes to a person who simply possesses capital or land, and what share goes to an individual for his labor of whatever sort—these are among the central problems of distribution. A common division of the subject is into four heads, corresponding to four groups in the community whose income is supposed to be governed by different causes: capitalists, landowners, laborers, and finally business men or active managers of industrial affairs. The capitalists are said to receive interest, the landowners rent, the laborers wages, and the

[1] The word obviously is used in quite a different sense when we speak of the "distribution" of commodities thru wholesale and retail dealers until they reach the hands of consumers—a common meaning in business parlance.

business men profits or earnings of management. We need not at present consider how far this classification is satisfactory; it suffices to indicate the nature of the new subject on which we now enter.

Neither is it necessary to explain in advance why one or another of these subjects should be selected for first consideration. They are closely connected, and no full understanding of any one can be had until the others also have been examined. We shall begin by considering interest—that share which goes to the owner of capital.

It has already been explained [1] that capital results from saving and investment. It has been explained, too, that investment is closely connected with the successive division of labor—with the series of stages thru which production proceeds and with the factor of time in the organization of production. It has been intimated, further, that the special form which investment takes in modern communities—the hiring of laborers by a separate body of capitalists—is a consequence, and indeed perhaps the most important single consequence, of existing inequality in the distribution of wealth. All these propositions bear on the analysis which follows on the subject of capital and interest, and in turn are illustrated and further explained by that analysis.

First, what do we mean by the "capital" on which interest is obtained? It is best to begin by still using the term in the sense of producer's capital—concrete tools made by man and used for the production of consumer's goods. Such are factories, warehouses, raw materials and goods in dealer's hands, railways and steamships, agricultural implements. For the present we shall set aside consumer's wealth, such as dwellings and household furniture. Land and like agents provided by nature without application of labor may also be excluded for the present from the discussion of capital. In order to break up the complex problem into its several parts, we shall proceed piece by piece. Producer's capital made by man, or producer's goods, are what we shall begin with.

Some distinctions and some questions of terminology call for further preliminary consideration.

[1] See Chapter 5.

An individual usually thinks so much of his property to be capital as yields him an income; but there is an obvious distinction between that which is capital for the community and that which, in this usual sense, is "capital" to the individual.

Stocks, bonds, and securities yield an income to the owner, and are regarded by him as part of his capital. In themselves these are simply evidences of ownership or of indebtedness. A stock certificate states that the holder has certain fractions of ownership in a given concrete thing or set of things. A bond is a mere promise to pay. Bonds are commonly issued as the result of operations of saving and investing which have to do with the making of capital. But (for instance in the case of government borrowing for war expenditure) the things which emerge may be quite wasteful. Tho capital to the individual, bonds may or may not signify the creation or the existence of real capital.

Consumer's wealth is not commonly regarded by an individual as part of his capital. A factory; a stock of materials or goods used in business operations; money on hand or in bank, not in the nature of spare cash for current expenses but a fund or reserve for business purposes—such things he thinks of as capital. Household furniture, clothing, horses and motors he does not so reckon, since these yield him no income. Possibly a dwelling, tho occupied by the owner and yielding no direct income, would still be regarded by him as part of his capital; for he might reflect that, if he did not own it, he would have to hire one at a rental, and hence might conclude that his own was equivalent to income-yielding property. Dwellings not occupied by the owner but let to tenants would unquestionably be regarded by the individual as capital.

The term "capital," like others imported from everyday speech and constantly used in economics—such as profits, wages, rent, money, taxes—has varying connotations and associations. Every person who writes or thinks on economics will find himself attaching to any one of these words sometimes the meaning, or one of the meanings, which it has in ordinary usage, and sometimes the sense which he has assigned to it for the purposes of rigorous analysis. Usually the context of a given passage will show in what way it is used. In speaking of the capital of a bank, for example, we mean obviously the capital reckoned in terms of money; and so in speaking of the capital and surplus, the income account and capital account, of a business or corporation. Sometimes, it is true, ambiguity still slips in; the most careful writer may be tripped up in his exposition and even in his own thinking by the absence of an accepted scientific terminology. In the following pages and in general thruout these volumes the endeavor is made to denote by "capital" the concrete things or capital goods which constitute the material equipment of the community. We shall have in mind real things, not rights to things; and we shall have in mind producer's capital—those goods which make up the apparatus of production.

§ 2. Some writers have distinguished between "capital" and "capital goods." By the latter term they mean the concrete apparatus of production—just that to which, in the present discussion, the single word "capital" is affixed. But by the word "capital" alone these writers mean the *value* of the concrete apparatus; and they sometimes speak as if there were a sort of distillation or essence of capital, distinct from the tangible capital goods in which it is embodied.

It is often convenient to measure and record capital in terms of value and price—as so much money. In that way alone can the various constituent elements be reduced to a common denominator. An individual usually states his capital as being so much in money value. His capital obviously consists not of the stated sum of money but of factories, machines, buildings, merchandise—stocks and bonds, if you please—the various things which make up an individual's "capital." He simply measures it in terms of the price for which the whole would sell. Similarly, we can reckon the community's capital in terms of the price for which the whole would sell. If the total prices, at current rates, of the various factories, railways, ships, machinery, tools, materials, goods in stock, were added together, the sum would give an idea of how much capital the community possesses. It would give a very imperfect idea. Statistics of this sort, occasionally collected by public officials for census purposes, are in many ways misleading. Yet if we wish to measure total capital or total wealth at all, we can proceed only in this unsatisfactory way. Tho some forms of capital can be measured in other terms—machinery, for example, in terms of horse-power, or textile mills in terms of spindles and looms—the only measurable element common to all forms is that they have value and price, and the only way of reaching a quantitative statement as to the whole is in terms of value and price. But it is not to be supposed that there is any such thing as capital distinct from the capital goods. The only actual and existent thing is the concrete apparatus of production. Its value or price is merely a relation to other things, a mode of measuring it.

§ 3. Having disposed of these questions of terminology, we may proceed to the substance of the matter now in hand, interest on capital.

The essential problem concerning interest can be stated in simple terms. Why should an individual who borrows from another a given quantity of commodities—represented, in any except primitive communities, by a given quantity of money—engage to return, after a fixed time has elapsed, not only what he has borrowed but something in addition? That the amount borrowed should be returned seems sufficiently easy of explanation. But why can the lender get the premium also? That premium, as is familiar enough, usually is expressed in terms of a percentage paid each year. The borrower engages to pay back not only the principal but five per cent or thereabouts in addition for each year that elapses, and a proportional percentage for each fraction of a year. To ascertain why this additional percentage is paid is to solve the problem of interest.

The fact that the transaction in modern communities takes the form of a loan of money and a repayment of money with interest has often led to the notion that it is peculiarly connected with money and arises from the nature and functions of money. Usually this notion takes the form of reasoning in a circle. People are familiar with the everyday practice of lending at interest; they say that money is "worth" so much, meaning that it can be lent at some annual rate; and they argue that the borrower must pay this rate in order to get the money. What more simple? Or they say vaguely, with Shylock, that money "breeds" interest; which again is a statement of the problem, no solution. A little reflection shows that here as elsewhere money serves simply as the medium of exchange. What the borrower wants is not the money itself but that command over commodities and services which money gives. He wishes to buy commodities, either for his own immediate use or for use in operations of production. In the latter case (the one to which the present discussion is more immediately directed) he wishes to procure machines, materials, and the means by which the laborer whom he hires shall be enabled to buy consumer's goods. And when he returns the money, plus the premium, he gives back to the lender the same command over commodities which he had received, and something in addition; he gives back more commodities than had been lent him. If there were no such thing as money, transactions of the same sort would take place; precisely as, given the division of labor, the exchange of different sorts of commodities would take place under barter in fundamentally the same way as with the use of a medium of exchange. Under barter both transactions obviously would be managed with much greater difficulty. The medium of exchange makes borrowing easier, as it makes exchange easier, and it makes possible much borrowing and much exchanging which otherwise would be impracticable. The explanation of both sets of phenomena, however, is not to be found in the use of money but in the nature of the operations which it facilitates.

We may brush aside not only the notion that interest arises from the use of money but that the rate of interest depends on the quantity of money. More money makes higher prices, not lower interest. The connection which does exist between the rate of bank discount and the rate on all short-term loans and the quantity of money held by banks has been already noted.[1] This bank rate oscillates above and below what may be called the true rate of interest—the return on steady investments. In the exposition which follows, this underlying rate of interest will be had in mind.

[1] Chapter 29, especially § 5.

§ 4. Interest, then, appears as the result of an act of exchange by which a quantity of money (or commodities) now in hand is given for a greater quantity of money (or commodities) to be returned in the future. The excess or surplus thus emerging seems to be got for nothing; there is no obvious equivalent for the premium or interest. Yet the fact of interest stands, and an exchange of something for nothing going on year after year, decade after decade, century after century, is not to be expected. Two questions present themselves: on the one hand, why is the borrower, whom we may regard as the purchaser, willing to pay this excess; on the other hand, why is the lender, or seller, able to secure it? In other words, what are the conditions of demand, represented by the borrowers, and what the conditions of supply, represented by the lenders? These questions we shall consider, in the order stated, in the present chapter and those immediately following. We begin by examining what lies behind the demand and supply of those surplus funds which are used by borrowers for purposes of production—what leads to interest in connection with producer's capital.

Some indication of the conditions of demand has already been given. In a previous chapter [1] the nature and functions of capital were described. It was pointed out that the use of capital means production spread over time. Production with capital has been aptly described, in Böhm-Bawerk's phrase, as indirect or roundabout production. Labor is first applied to making tools, collecting materials, perfecting means of communication; finally, at the close of preparatory steps which may be long and arduous, the enjoyable product emerges, and emerges in much greater abundance than if labor had been applied directly. The mine, the railway, the steamship, the iron works, the factory, the warehouse, the wholesale and retail store, all stand for a prolonged and time-requiring process of production.

Further, production in the advanced communities of modern times is "capitalistic" in another sense: there is a class, separate in the main, of capitalists. The long-maintained application of labor in successive steps is possible only if at the outset there has

[1] See Chapter 5.

been a surplus—if there has been saving and accumulation in some form. The persons who do the saving and possess the surplus are the capitalists; commonly, tho not necessarily, a different set from those who do the labor. They hire the laborers in the various stages of the productive operations. The creation of capital and the emergence of interest as a distinct element in distribution are alike the consequences of the double process of surpluses saved and of labor applied in roundabout ways.

We have now to note more explicitly that this process means an increase in the productiveness of labor. The great modern flour mill is more efficient than the modest grist mill of former times. Per unit of labor applied, more is accomplished. To make an accurate comparison of labor product between two such cases would call for intricate computation. On the one hand, the modern mill stands for much more of preparatory labor. On the other hand, it is usually more durable and the labor applied to making it continues to play its part thru a long period, until the mill is finally worn out and discarded. The later labor in the series—that done by the current workers in the modern flour mill, who turn out their thousands of barrels a day—seems much more effective than that of the old-fashioned miller, because we do not ordinarily bear in mind that the preliminary labor embodied in the plant is engaged in milling. That the efficiency of all the labor engaged, of earlier as well as of later date, is greater is shown by the simple comparison of prices: flour is vastly cheaper (that is, the excess in the price of flour over that of grain) than in former days. So in the railway: there has been an enormous application of capital—that is, of previous labor—with an outcome of transportation rates so low as to prove that, taking account of all the labor of construction, maintenance, and operation, its efficiency is immensely greater than that of the simpler instruments of pack horse and wagon.

This consequence has sometimes been stated by saying that capital is productive; a phrase which must be used with care. The strictly accurate statement is that labor applied in some ways is more productive than labor applied in other ways. Tools and machinery, buildings and materials are themselves made by labor and represent an intermediate stage in the application of labor. Capital as such is not an independent factor in production and there is no separate productiveness of capital. When in the following pages the productivity of capital is spoken of, the language must be taken as elliptic, expressing concisely the result of the capitalistic application of labor.

All this analysis of the relation of labor to capital and to savings leads again to the proposition that all the operations of capitalists resolve themselves into a succession of advances to laborers.[1] Some persons have a surplus and set it aside for investment—they are the capitalists pure and simple. Still other persons borrow this surplus (very likely using also available means of their own) and hire laborers to make tools and materials, to carry on all the stages of production, and so produce in the end more consumable commodities than have been turned over to the laborers. The laborers as a whole produce more than they receive. Those who borrow and thereupon hire the laborers can afford to pay back more than they have borrowed. This is the process by which interest on capital used in production comes into existence.

§ 5. Let it be supposed now that at any given time the capitalistic ways of production—the applications of tools, machinery, materials and the like—have been so settled and established as to become familiar to all. Let it be supposed also that they are equally available for all; that no one has a monopoly of any particular form; that all who wish to use them are in unfettered competition with each other. No borrower, in getting control of any particular kind of capital, will then be able to secure a greater advantage than any other from the use of savings. Competition will bring the return in all channels of investment to the same level. What will determine that uniform level?

All the constituent parts of capital, tho they will yield the same return to those applying them, will not necessarily affect to the same degree the productiveness of labor. Some may be, and almost surely will be, more helpful in production than others. Imagine that a community, once in possession of a stock of tools and appliances, were compelled to part by successive steps with parts

[1] See Chapter 5.

or installments of this capital. Clearly it would first relinquish those parts which contributed least to the productiveness of labor and then, as more and more had to be given up, would relinquish others in the inverse order of serviceableness. It would reserve to the very last those constituents of capital—that is, those means of roundabout production—which added most to the output. These means, the last to be given up under existing conditions, the first to be used, would probably be on the one hand such as were essential for the agricultural processes which, in the temperate climate, involve seasonal operations—seed and farming tools, and about a year's surplus of food—and on the other hand the metallurgical apparatus which yields iron, the prime requisite for almost all tools. These, the most effective forms of capital, have not necessarily been the first historically. The progress of invention may have brought them in at a later date than others of less serviceableness. But given various appliances that have come to exist side by side, some will be more effective than others, and in case of inevitable curtailment would be the longest retained.

Under these conditions the gain, or premium, or interest, which the owners of capital will secure, will be determined by the least productive use of capital or, to be quite accurate in language, by the addition to the ultimate consumable product of labor which results from the least effective phase of the roundabout or capital-using process. Those who use capital in ways more effective than the least cannot retain the superior gain for themselves. Since all who have capital at command can turn to these more effective ways, competition will prevent any one set of persons from securing especially high gains from them. It is the effectiveness of the last installment of capital (last in the order of productiveness) that determines the rate of gain for all capital. Or, to put the same proposition in other words, the return to capital depends on its marginal productivity. "Productiveness" and "productivity" are used, to repeat what has just been said, in the elliptic sense already explained.

It may be asked, Does the productiveness or serviceableness of *all* forms of capital descend to that of the marginal forms? An equalization of the return to owners of capital takes place; does an equalization of productivity also take place? Not necessarily. The outcome is like that which we have found, when discussing the principles of value, as to the utility and the price of the several constituents in the supply of an enjoyable commodity.[1] Tho all the units of a supply sell in the market at the same price, not all have the same utility; and there is such a thing as consumer's surplus. Similarly, tho the return to the owners of all the constituents of capital is under free competition the same, the contribution from all the constituents to the community's well-being is not the same. Some remain more serviceable than others. And the difference in serviceableness has the same consequence as in the case of the utilities from enjoyable goods—it affects consumer's surplus. The more effective uses of capital lead in especial degree to greater abundance of commodities, to diversification of the means of satisfaction, to a larger national dividend, and so to wider satisfaction of wants for the community at large.

A principle similar to that which underlies the theory of value thus underlies the theory of capital. Indeed, it is chiefly a matter of terminology, of convenience in exposition, whether we treat them as two or as one. Marginal utility determines the current value of commodities; marginal productivity determines the current rate of interest. There are utilities in goods (and services) greater than at the margin. There are contributions from different forms of capital greater than at the margin. These surpluses the individual owner cannot keep; the community at large enjoys them in the form of consumer's surplus.[2] And the same sort of difficulty which we found in measuring the consumer's surplus derived from goods would appear if we endeavored to measure the surplus derived from some of the constituents of capital. What constituents of capital would be longest retained and how great the effectiveness of this most precious remnant would be, we cannot possibly gauge. We can only rest assured that differences in the

[1] See Chapter 9, especially §§ 3–5.

[2] Compare the pregnant passage in Jevons, *Theory of Political Economy*, p. 277 A contrary view is implied in Clark, *Distribution of Wealth*, Chapter XXI.

degree of productiveness there are, and that society as a whole profits greatly thru securing all forms of its capital at the same rate that it pays for the least advantageous forms.

§ 6. This part of the theory of capital and interest has been stated in different terms, tho with a conclusion not in essentials very divergent. Briefly the view is that by a resort to more and more capitalistic or roundabout ways of production the output per unit of labor can not only be increased, but increased indefinitely and at a predictable pace. There is said to be a tendency to diminishing gain, or diminishing return; a tendency to a decline in the *rate* of increase in production. Add more tools and appliances—that is, do more and more labor of preparation, make your total process of production more prolonged and elaborate—and you will always get a larger final output. But the increase in the productiveness of labor, great in the first stages of this capitalistic way of applying it, becomes less in the later stages. There is believed to be no limit to the heightened effectiveness of labor due to marshalling it over time and elaborating machinery and materials more and more. The obstacle is like that in pulling a stout rubber band: it can always be stretched a bit more but each additional application of force means a lessened effect.

In this view, it will be seen, differences in productivity and marginal productivity appear not only on taking a cross-section of industry at a given moment but in the development of industry over the course of time. It is admitted that the tendency to a diminishing gain in efficiency may be counteracted by inventions and improvements. But in the absence of such progress the increase of gain tends to sink and so also the rate of return on capital; it sinks gradually and with some degree of regularity, and no end to the process is in sight.

It would follow as a corollary that the application of capital can be increased indefinitely without bringing complete cessation of return in the way of interest to the owner of capital. Additional installments could always be used to some advantage; there would always be some marginal productivity. Interest, in other words, would persist indefinitely, notwithstanding the utmost growth of accumulation. Whereas in a more skeptical view the indefinite increase of savings and of capital may cause the point of satiety to be reached. Unending increase in the means for applying preparatory labor may make it impossible to use savings to any advantage; and then, so far as the forces of demand determine interest, it will be brought down to *nil.*

Like other problems bearing on the distribution of wealth, this must be confessed to be unsettled. To enter on a full discussion of the trains of reasoning involved would pass the compass of the present book. I will present concisely my reasons for hesitating to accept an unqualified principle of diminishing returns in the applications of capital.

The increase of tools and instruments may be supposed to take place in two ways: either by the addition of more tools of the sort already in use or by the addition of new kinds of tools. Mere duplication of familiar tools would seem to promise little or nothing in the way of greater productiveness. Twice as many saws or planes for each carpenter, twice as many looms for each weaver, twice as many locomotives for each engineer—such a proceeding does not mean that more will be accomplished by the carpenters and weavers and engineers. It means an embarrassment of riches. Of the complicated machinery of a great factory this would seem to be true also. To run this machinery a certain staff of operatives is required, adjusted to it by nice experiment and calculation. Duplicate the whole outfit and it cannot be operated by the same staff to advantage. The staff can utilize no more than is already on hand.

More difficult is the problem as to the second way in which the additions to capital may be supposed to take place. Here it is assumed that there come to be not more tools of the same kind but tools of a more elaborate and complex kind. With greater savings and a greater possibility of applying labor in advance, capital is supposed by a quasi-automatic process to take a different form: not two saws but one larger and better saw; not two locomotives but one heavier and more powerful. The mere fact of greater present resources available for investment causes the roundabout operations to be extended, the time of the whole process to be prolonged. Plant becomes larger, machinery more complex and more nearly automatic, materials are heaped up in more varied supply. Then product ultimately becomes greater, but in the rate of increase there is supposed to be a tendency to diminution.

It is the quasi-automatic or predictable character of this process of elaboration that seems to me doubtful. The more "capitalistic" application of labor does not necessarily bring an increase in efficiency. The outcome depends on the progress of invention, concerning which no rule can be laid down.

It is true that during the period since the Industrial Revolution of the eighteenth century the progress of the arts has been precisely in the direction of making appliances which require time and labor and which also increase greatly the eventual productiveness of labor. Nor is there any clear indication that progress of this kind will cease. The history of the last few generations, and the prospects for the next few, support the proposition that the increase of savings and of capital has brought and will bring greater productiveness of labor. But there is nothing automatic, nothing predictable. The outcome has been due and will continue to be due to a host of projectors and inventors, to a succession of steps each one of which is at the outset more or less doubtful. How great such progress will be and how long it will continue cannot be predicted. The possibility of an indefinite use of savings and of an indefinitely increasing effectiveness of capital is not a tendency inherent in industry but a fact of comparatively short experience in the modern world.

To put the same problem in another way: the roundabout or capitalistic process may be supposed to adjust itself to the supply of present means (savings); or, the supply of present means may be supposed to adjust itself to the roundabout process. The first is the view of those who maintain the quasi-automatic transformation of capital as it increases and the tendency to diminishing returns as it is transformed into more complex shapes. The second seems to me the view more in accord with historical fact. The progress of invention has taken the direction of more elaborate and complex capital; hence there has been the possibility of using a larger and larger volume of savings in productive ways.

The supply of savings, as will appear in the next chapter, is highly flexible. It has taken advantage of all available opportunities for investment and will continue to do so; it has enabled factories, machinery, railways, steamships, electric appliances, to be made as fast as inventors have shown the way to the effective use of these forms of capital. It is true that in this matter, as in so many others dealt with by the economist, there has been an interaction of causes; none the less it is more nearly true to say that the progress of the arts has made possible the vast investment of savings than that the great volume of savings has brought about the progress of the arts.

But the differences in opinion on this point do not affect the main conclusion stated above—that, for any given stage and at any given period, the rate of return on capital depends on the gain in productiveness resulting from the least effective part of the capital. So far as this proposition is concerned there seems to be substantial agreement among modern economists. Whether or no it is believed that there is a really separate productivity of the capital as distinct from the labor, and whether or no it is believed that the differences in the productivity of capital show themselves thru an unfailing process of diminishing returns, it seems to be agreed that the factor which determines the rate of interest on capital used for production (so far as the rate is dependent on demand) is the gain in efficiency or output accruing with the last or marginal installment of capital.

§ 7. It has been remarked in the preceding sections that there is no necessary connection between the amount of capital and its productivity. Account must be taken of the march of invention, of the irregular course of improvements in the arts. This element of irregularity is connected with the human factor, too much neglected in the traditional discussion of interest on capital.

Each and every use of abundant present resources for the purpose of elaborate equipment means that someone must plan it and manage it. Elsewhere the utopian character of many expectations about large-scale production has been dwelt on [1]—the notion, for example, that doubling the size of establishments of

[1] See Chapter 4; compare also Chapters 49 and 68.

itself brings greater effectiveness. There must be men behind the guns. Not the mere making or mere enlargement of plant brings increase of return but the choice of the best ways of making and enlarging it. Now, in the modern organization of industry, the persons who direct the capitalistic processes and those who provide the present means needed for their expansion are not the same. Two sets—business men and investors—find between them that intensification of equipment meets with a profitable response. But the increase in output is not due merely to the lengthening of the productive process made possible by the accumulation of available present means. Dependent tho it be on these factors, it is brought to fruition only by proper management.

Hence there arises a question of the division of the gain. The larger the number of first-rate managers, and the smaller the supply of present means, the more likely is it that the savers will get the lion's share and rates of interest tend to be high; with the opposite results if savers are many and managers scarce. If there be a good supply of fairly capable managers but only a few among them who tower above their fellows in ability to handle great capitalistic enterprises, these few will reap a large harvest, which yet will not redound to the advantage either of the savers or the mass of business men. All this is connected with the theory of business profits, presently to be considered. It is one of the many indications how interdependent are the several phases of the theory of distribution. What needs to be emphasized at this stage is that the human factor—able leadership—is indispensable for bringing the capitalistic mechanism to work with success. Nothing in economics is automatic. Everywhere we have to deal with human beings, with their limitations, their habits and traditions and motives, the extraordinary differences between them.

§ 8. Much of the preceding has an unrealistic tinge. It seems to describe a structure which, tho it may be neatly put together, has no close connection with the actual world. It deals on the one hand with real capital and real income; with buildings, machines, tools; on the other hand with income in terms of consumable goods like bread and clothing. In the actual world people deal in terms of money, and their calculations, expectations, and the outcome of their doings are all expressed in terms of money. The amount of capital applied is stated in these terms; so is the amount of product turned out. True, men of affairs are much concerned with the technological processes which they manage and with the physical amount and quality of the goods they sell. But most of all they are concerned with the money amounts which these things stand for. The analysis of the meaning of it all, which has been made in the preceding pages, seems far from the ken of the men directly concerned; just as is the case with the economist's analysis of the terms of international trade.

It must be confessed that writers on economics have not been as attentive as they might well be to the way in which their conclusions on this range of subjects work out in the actual world. As regards the topics here under consideration, their tendency has been to pass at once from the physical to the monetary side of capital and interest, assuming that what holds of the first holds of the second. In the main the assumption is doubtless justified. But in working out the details differences may well appear which need explanation. In the course of the generation that has come and gone between the date of the first edition of this book and that of the present edition, a great deal has been done toward improving and advancing economic science, both in the way of more rigorous analysis and in the more fruitful comparison of the results of our analysis with the growing information, especially that in statistical form, about the facts. Tho much has been done, much remains to be done, not least in knitting together the "real" interest which emerges in the period of production and the money interest which appears at the very first glance into the financial markets. It would lead us too far into regions but imperfectly explored if an attempt were made in a book like the present to make a synthesis which would bring it all into harmony and clarity. I hope and believe that what is said here and in the chapters to follow will stand as stating the foundations on which the theory of interest will be built up to something further developed and better balanced, yet not different in the main lines.

One thing must always be kept in mind: what has been said about the "real" rate of interest relates to long-run forces and long-run results. It has only an eventual, an indirect, bearing on the money rate of interest. That rate depends proximately on the monetary situation and more particularly on the volume of cash or reserve held by the banks. It cannot indeed be permanently higher or lower than the "real" rate which emerges from the play of capital investment. The going rate in the money market is in the end but an index or outcome of that real rate; and the great abiding economic and social problems, such as those of socialism, are concerned little with the money market rate and chiefly with the real rate.

CHAPTER 39

INTEREST (*Continued*). THE DEMAND AND SUPPLY OF SAVINGS

§ 1. Accumulation of present means needs an inducement.—§ 2. The gradations in the disposition to save. Cases where the inducement needs to be slight.—§ 3. Cases where a return is sought. Possibility that a lowered return will sometimes induce larger savings. More often lowered return checks saving. The conception of marginal savers.—§ 4. Diagrams expressing the equilibrium of supply and demand. Saver's surplus.—§ 5. The steadiness of the rate of interest in modern times and its significance.—§ 6. The race between accumulation and improvement.

§ 1. We turn now to the conditions of supply for capital and to the equilibrium of supply and demand. The rate of interest, like the value of a commodity, is settled at any given period chiefly by demand. In the long run the variations in supply must have their effects also. What is the situation of those persons who have a surplus of present means—the lenders?

If the accumulation of a surplus were in no way irksome the supply of present means or savings would increase rapidly and indefinitely under the inducement of a reward in the way of interest. So long as borrowers were willing to pay a premium—to return to lenders more than had been supplied by the lenders—these latter would accumulate more and more, and their increasing savings, put at the disposal of producers, would allow greater and greater advances to laborers. Assuming the arts to remain the same and no new ways to be found for increasing the productiveness of labor by more elaborate implements, assuming too no increase in the supply of labor—the stage would soon be reached when the additional advances to laborers would bring no addition to the output. The marginal productivity of capital would then be *nil* and interest on capital would disappear. If this stage is not, in fact, reached, the reason must be either that demand is steadily increasing (the demand curve is always shifting to the right) or that accumulation and saving do not continue indefinitely unless there be some inducement offered.

§ 2. Does saving, or waiting—the putting by of present means—necessarily depend on a reward in the way of premium or interest? This question, be it observed, is quite different from one of a related sort already considered, namely, do the making and the maintenance of capital depend on saving at all? It is sometimes said, more often tacitly assumed, that capital maintains itself by some automatic process, quite independently of the dispositions or intentions of its owners; which is the same as to say that saving, tho it may be essential, involves no hardship or irksomeness or disability of any kind. This view has been held by persons quite free from any socialistic taint.[1] The socialists themselves, tho they may not quite ignore the problem of capital accumulation, usually assume that this is a matter which takes care of itself. In a highly organized modern society it may seem to do so. Plant and machinery as they wear out are steadily replaced; new plant and machinery are steadily made. But we have seen that back of all this are the processes of saving and investment; and have seen, too, that not only the creation of new capital involves saving but the maintenance of existing capital also.[2] With the constant wearing out of the productive apparatus, and the constant need of replacing it if the equipment is to be kept intact, a choice is recurrently presented to the owners as to the way in which they shall use their surplus possessions—whether they shall continue investment and maintain capital or cease investment and cause labor to be directed to making consumable goods. For any given period they may have committed themselves irrevocably to investment and cannot change the form which their property has taken. But as time passes and the process of using and renewing the various kinds of wealth goes on they have again the option which they had in the initial stages. They may save and invest or they may spend and enjoy. However considerable the length of time over which the capital of a community, when once constructed, endures in the shape which has been given it, and however slow the process by which

[1] See for example J. B. Clark, *Distribution of Wealth,* Chapter IX.
[2] See Chapter 5.

the disposition of the capitalists takes effect, it is still true that in the long run the owners' intention determines whether there shall or shall not be capital.

But, to repeat, there is the other question: granting that the making and maintenance of capital do involve saving, must there be a pecuniary inducement, a payment of interest, in order to bring people to save? It is certain that this is not universally the case. There is a considerable volume of saving which would take place even if there were no premium—if the amount paid back in the future by the borrower were no greater than the amount now supplied by the lender. Nay, a situation is conceivable under which the familiar relation would be reversed; then not the borrower but the lender would pay a premium. On the other hand there are savings which would not take place at all except for the reward which is commonly paid by the borrower as interest. These gradations in the conditions under which accumulation and lending take place call for some detailed consideration.

One extreme, just referred to, is of theoretical concern rather than of practical importance: the case of the lender who is so desirous of providing for the future that he is willing to accept at a later date, as the price of the safety of his possessions, a *less* sum than he parts with in the present. This situation might conceivably arise where means were very abundant in the present and where a future with scantier means was expected. Thus a man in his prime, with good earning power but without income-yielding investments, knowing that old age must come, might set aside a considerable amount from his present income in order to be assured at a later date of an even smaller sum. At forty, $200 might be saved from an ample income with comparative ease; and it is conceivable that it would be saved cheerfully in order to have, at the age of seventy, the certainty of $150. Hence, if no other choice presented itself, an exchange of $200 at forty for $150 to be received thirty years later would not be out of the question. There might be negative interest, so to speak. But another very simple choice in fact presents itself. The $200 may be set aside, tucked away, and kept until the later date when the need becomes greater. It may be hoarded, without being lent or invested. This, of course, is feasible only if there be some kind of commodity which does not deteriorate, which can be easily safeguarded, and which maintains its value. If men lived in primitive conditions and all incomes were received and managed in kind—if the actual bread and meat had to be put aside in order to provide for the future—a bargain for giving a greater amount of such perishable things in the present for the guarantee of a less amount in the future might conceivably be consummated. But money brings an easier and less hazardous alternative between present and future use. Given security and ordered government—given also stable value of money—then money in hand is as good as money in the future. Specie or its equivalent in paper money can be hoarded with little trouble; elaborate safe deposit boxes are to be had at a charge insignificant in proportion to what they will contain. Hence we may set aside as negligible the possibility of negative interest. The present will command at least par in the future. It is this sort of reasoning that led Böhm-Bawerk to lay down, in somewhat technical terms, the general proposition that present goods are always at least *equal* in value to future goods of like kind—because a choice exists between present and future use.[1]

But tho the cases in which interest might be negative may thus be neglected, those in which it might be zero are many. Great masses of savings are made quite without the need of stimulus in the way of premium or interest. In such cases present means might be exchanged for future means at par. A large part of the deposits in savings banks in most civilized countries are probably of this nature. Many persons have acquired the habit of providing against a rainy day. Where a secure and convenient depository is offered, they set aside something from current means as a safeguard against future emergencies. If interest is paid on such savings it is welcome enough, but the savings would be made in any case. Not only deposits in savings banks but the accumulations of life in-

[1] It is still conceivable that, with most perfect facilities for hoarding, a few highly timorous persons would pay negative interest for a supposedly unquestionable guarantee of the future; just as a few timorous investors may insist on buying government bonds bearing very low interest rather than the safest of privately issued securities.

surance companies from annual premiums partake in some degree of this character. Some provision for dependents, by annual payments thru the mechanism of insurance, would be made even if these annual payments were not augmented, as in fact they are, by the interest added to them by the insuring companies. How large is the proportion of savings bank and life insurance accumulations made with this sole motive it is impossible to measure, but the proportion must be considerable.

§ 3. On the other hand there are accumulations that will not be made except for the stimulus of a reward. Some receipt of interest is indispensable for a large part, probably the larger part, of the savings made in modern communities. Yet this stimulus does not need to be applied in its full strength over the whole range. Much saving that is done with a view to some return would yet continue even if the return were lowered. Other saving, again, requires the full current rate for its continuance. The differences between the various degrees of stimulus required (i.e. the various rates of return) are no less noteworthy than the broad difference between some return and no return at all.

Suppose the rate of interest, after having been for many generations somewhere near four or five per cent, should drop very sharply to two per cent, or one per cent. No doubt many persons would cease to save. But many others, especially those with large present means—those who have enough and to spare in any case—would maintain their accumulations unchecked.

Perhaps the most characteristic and quantitatively important case of this sort is that of the successful business man. He "makes money," in the current phrase; which means that his earnings considerably exceed his habitual living expenses and that he puts by something for the future without sensible deprivation of present pleasures. The aim of such men usually is to accumulate a competence or a fortune. In a country like England the founding of a "family" is a common aim: the transmission to children of a sum sufficient to enable them to take their place among the leisure class idlers, to attain association or matrimonial alliance with the gentry and aristocracy, and eventually, if there is money enough and a proper sort of conventional behavior, to be awarded a knighthood or even a peerage. In all modern communities the worship of "society," perhaps the most ubiquitous phase of the deep-rooted and universal love of distinction, contributes powerfully to accumulation. No doubt among leading men of affairs other motives play their part, such as the love of power, the impulse for activity, mere imitation and emulation. Certain it is that money making is impelled by very complex motives. Among these no specific *rate* of return on accumulation plays a dominant part.

It has been suggested by some writers that within a considerable range a decline in the rate of interest, so far from checking accumulation, would increase it. Many persons among the well-to-do look forward to providing a settled income for the future, either for themselves on their retirement from activity or for their widows and children. In order to provide a "satisfactory" income of say $5,000 a year, a capital sum of $100,000 must be put by if the rate of interest is 5 per cent. But if the rate is 2½ per cent, double the sum must be put by in order to bring the same income. On this sort of reckoning, the lower the rate of return the greater will be the amount accumulated and invested.

Such reasoning, however, cannot be pressed far. No doubt there are cases in which a decline in the rate prompts a wish to get together a larger capital sum. But a wish is very different from a deed. For the immense majority of men it would be a very difficult matter to double (say) the amount accumulated. Among those who have very large current incomes but still wish to accumulate a capital sum—the small number of business men and professional men whose earnings are high—it may be true that a decline in interest will increase rather than lessen savings. But most men who are accumulating with a view to building up a "competence" cannot with ease increase their savings materially, not to mention doubling them. There are constant and pressing demands of the moment, innumerable tempting ways of spending money at once. A decline in the rate of interest is quite as likely to lead to a readjustment of the scale of what is a "competency" or a "satisfactory" income as it is to induce greater savings. In the supposed case, the man who had looked forward to providing for himself or his family an income of $5,000 on a capital of $100,000 is likely to say, when the rate falls to two and one half per cent, an income of $2,500 must suffice!

On the other hand, where there are many individuals and great amounts of savings, the usual relation of price to supply appears—namely, a higher price leads to an enlargement of supply and a lower price to a lessening of supply. Stated with reference to interest and capital, the proposition is that an increase in the rate will bring more savings and more capital, a decrease less savings and less capital. No one would doubt that if the rate rose to twenty per cent, many sums would be set aside and invested which at a lower rate would be spent for immediate satisfactions. Conversely, if the rate were to fall to one per cent, or to one half of one per cent, many sums would be spent at once which at a higher rate are saved. Between these possible extremes is the current rate of something like four or five per cent; and among the various savings there are some for which that current rate is just enough to induce the sacrifice involved.

Thus we reach the conception of a margin. There are intramarginal savings and marginal savings; and also, it may be added, extramarginal or potential savings. There are the willing and almost spontaneous savers—those whose motives for accumulation are so strong that they would continue even if there were no return at all. There are the less spontaneous but still eager savers, who need the stimulus of some return but would go on even tho that return were lower than the current rate. There are the marginal savers—cool and calculating persons we may conceive them—for whom the existing rate of interest is just enough to induce the sacrifice of present for future. And finally there are the extramarginal savers, who do not now accumulate but would be led to do so if the return were to increase.

In strictness, we should speak not of more or less willing savers but of installments of savings more or less easily induced. The same person may be very differently disposed as regards different parts of his accumulations. Something he may put by in any case for a rainy day; something more he may put by from the love of social distinction or from other motives in which, tho the expectation of some return plays a part, a higher or lower rate is not decisive. Something more, finally, he can be induced to save only under the stimulus of a return at the existing rates. The gradation runs not by individuals but by installments. There are marginal savings, even tho there is perhaps no individual all of whose savings are at the margin.

§ 4. The outcome of the discussion of demand (in the preceding chapter) and supply (in the present chapter) can be stated in simple form under the theory of value. The several installments of savings are to be had at various rates, some for a small reward, some for a larger reward. The case thus is one of varying supply price, coming under the principle of increasing costs. A diagram of the familiar sort will illustrate the situation.[1]

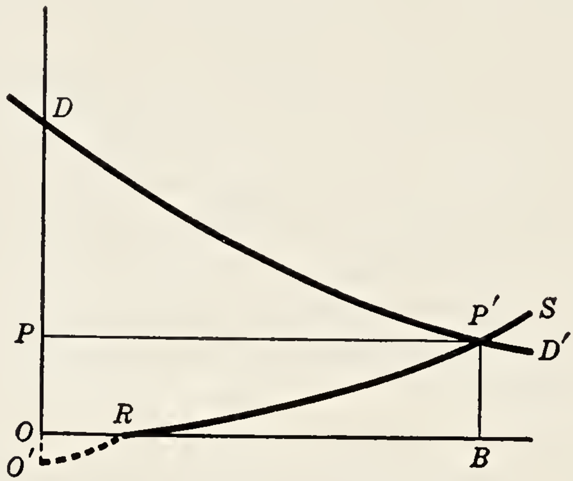

FIG. 1

The conditions of demand are indicated by the line *DD′*, whose descending slope represents the diminishing productiveness of the several installments of capital. The ascending line *ORS* indicates the conditions of supply—the increasing prices which must be paid in order to induce the several installments of savings which enable the capital to be forthcoming.[2] This line in its earlier part

[1] Compare Chapter 13.

[2] The sacrifices or disutilities involved in the installments are not necessarily measured by the prices calling them out. Those savings which would be made without interest (rainy day savings) may involve serious sacrifice. Here, as in Book II, the supply schedule relates to the matter-of-fact question of the price which must be paid in order to call out a given supply.

does not rise above the base line *OB*. That is, some savings would be made even if nothing were paid in the way of interest on capital. Nay, if we believe that the disposition and incentive to provide for the future is so great among some savers that a smaller sum in the future will be accepted by them in return for a larger sum in the present, the line in its earlier part will sink below the base line and will begin at *O′*. There would be negative interest if the rate were determined solely by the competition of these persons. As we reach installments as to which the disposition to save is less and less strong and more and more must be paid in order to induce accumulation, the line rises. Finally we reach the marginal saver at *B*. The price at which he is willing to save corresponds to the gain which is secured from the use of the marginal increment of capital. Here equilibrium is reached; the rate of interest settles at a point where the marginal productivity of capital suffices to bring out the marginal installment of saving.

Evidently those persons whom we have designated as spontaneous savers—those who are disposed to save under any circumstances—gain something in the nature of a surplus. The total amount paid as interest is indicated by the rectangle *PP′BO*. There is a large amount of saver's surplus or saver's rent, indicated by the area *ORP′P*, or possibly *O′RP′P*. For those who would save in any case, the whole of the interest which they receive is in the nature of surplus. For those who would be willing to save at a smaller rate than that current, a part of what they receive in interest is surplus.

How great now is this surplus in modern civilized communities? or, in other words, what is the conformation of the line *ORP′*? In Figure 1 it is represented as rising slowly from *OR* and approaching *P′* somewhat steeply, indicating that much saving would be done for less than the marginal or market price and that there is a large amount of saver's surplus. But it is no less possible that *ORP′* should rise steeply from *OR* and then move nearly parallel to *PP′*, as in Figure 2; indeed it may be coincident with *PP′* in the latter part of its course. In other words, a large part of the saving, or nearly the whole, may need the stimulus of the whole current rate of return, and saver's surplus may be correspondingly less in amount. And a further question arises as to the conformation of the supply line beyond *P′*. Suppose there is a general increase in demand (which would be indicated by a shifting of the demand curve to the right) —will the rate of interest permanently rise, or will the supply of savings and capital extend and bring the rate of return back to the amount *BP′*? In other words, is *BP′* capable of being continued to the right indefinitely, prolonging the horizontal line *PP′* beyond *P′* without rising in its further

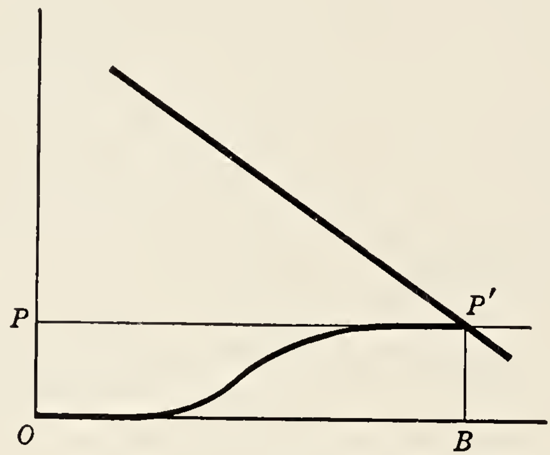

Fig. 2

course? To some of these questions our answers must be quite uncertain; and even for those which we can answer with some assurance we must rely on general observation rather than on any accurate data.

As has already been intimated, it is tolerably clear that there is much of saver's surplus; how much, it is impossible to say. One might hazard the guess that the line *ORP′* has some such conformation as is shown in Figure 2, that after lingering for a part of its length along *OB* it rises gradually to a point near *PP′*, and in the latter part of its course runs nearly parallel to *PP′* or coincident with it. Thence it would follow that a decline in the demand for capital, unless very great, would not sensibly affect the rate of return on it; since the decline in the rate would check many savings which were at the margin or near the margin and hence would bring about a decline in the supply of capital. No test of this kind, however, is likely to be applied in modern communities. The demand for capital has grown enormously during the last century or two, and there is no indication that it will cease to grow in the future. In other words, the gain from the use of more and more capital in production has been great and promises to continue great. The progress of invention and of improvement in the arts has steadily moved the line *DD′* (at least in its lower reaches) to the right; it has never shifted the line to the left. At the same time the response of the supply of capital has been rapid and sure. Notwithstanding the vast increase in demand the rate of interest has remained, on the whole, singularly even; indicating that, so far as the extension of *ORP′* toward the right goes, it has been prolonged, and probably will continue to be prolonged, without any permanent tendency to rise.

§ 5. The steadiness of the rate of interest during the vast changes since the industrial revolution of the eighteenth century is a remarkable phenomenon. Even before that era interest had fallen to rates such as we consider normal. In Switzerland during the seventeenth century the rate had fallen so far that legislation was enacted, oddly enough, to check its decline. Several cantons passed laws making void all loans at *less* than 4 per cent. Nevertheless, in the century following, the rate went down to that figure and even lower.[1] Holland and England were able to borrow in the middle of the eighteenth century at about 3 per cent. Since then the rate has fluctuated between a minimum of something like 3 per cent and a maximum of something like 6 per cent. In new countries it has tended to be higher than in old countries; and in times of activity and of hopeful investment it has been higher than in times of depression. Great wars, with their consequence of heavy public borrowing (of which more will be said presently) have raised the rate for years; then it has slowly declined as the normal conditions of peace have been gradually restored. During the first three quarters of the nineteenth century the rate in older countries was usually in the neighborhood of 4 and 5 per cent, and in newer countries 6 per cent or a trifle more. During the last quarter of

[1] Rappard, *Le facteur économique dans l'avènement de la démocratie en Suisse*, pp. 113, 114.

the nineteenth century it sank to 3 and 4 per cent in older countries, 5 per cent in newer. After the opening of the twentieth century a rise again appeared; and soon the enormous borrowings by governments for war purposes caused a further and very sharp advance. We are considering here, it need hardly be said, not the fluctuating rates of interest on short loans but the long period rate on permanent investments. The trend of this rate, to repeat, in view of the extraordinary increase alike in the demand for capital and in the supply of capital, has been remarkably even.

From this one might infer that there is a large volume of savings at the margin. The steadiness of the rate of interest thru so long a period of striking changes, both in the uses and in the accumulation of capital, would seem to point to a steadying cause—a marginal supply price to which the rate of return on the whole has adjusted itself. That supply price to be sure is likely to be affected in the future by the very fact of large accumulation, or at least by those general industrial and social conditions which accompany large accumulation. The increase in the number of persons belonging to the well-to-do classes, and in their incomes, causes saving and investment to be greater in volume and to entail less sacrifice. It is quite possible that the marginal supply price may sink in the course of the twentieth century to some such rate as 2 per cent.

§ 6. Even tho there be a steadying cause of the sort just mentioned the rate of interest depends over long periods—decades at a time—on the demand for capital in relation to a supply which is constantly and quasi-automatically increasing. It depends on a race between improvement and accumulation.

Accumulation proceeds fast and promises to continue to proceed fast. It threatens constantly to increase the supply of savings and of capital to the point where a decline in the return must set in. So ingrained is the habit of accumulation among the prosperous classes of modern society that it seems to proceed irrespective of the rate of interest. Only over considerable periods and after a long disenchantment will a lessening of the return check its unceasing march. How soon and how completely such a relaxation of its advance would take place we cannot say. Neither can we say with what gradations the decline in interest itself would take place. If there is a general and far-reaching principle of the kind discussed in the preceding chapter—that the use of added capital always brings additional product, tho at a diminishing rate—the process would be a slow one; nay, if that principle is of indefinite application, interest never would quite disappear, however vast accumulation might be. If there be not this supposed possibility of always using more and more savings in productive investment, the stage of vanishing interest would be reached at a comparatively early date. If the reasoning of the preceding sections is sound, accumulation will be relaxed long before the return vanishes; yet reluctantly and haltingly, and with a constant pressure from the continuing offerings of those who now enjoy a saver's surplus.

In one respect, as it is hardly necessary to remind the reader, there may always be an opening for the use of additional savings even with no change in the methods of production; namely, thru the increase of population. Additional laborers need to have an additional supply of the familiar kinds of apparatus. Very few modern countries have stationary numbers. France is the only large one whose population fails to grow. In most communities numbers increase. In so far there is obvious opportunity for the employment of more savings.

But in the main the way in which the increase of savings can find escape from its difficulties is thru a parallel advance in the arts, calling for more and more elaborate forms of capital. Savings in civilized communities easily outstrip the growth of numbers, even in a country of rapidly swelling population such as the United States has been. Hence, to repeat, the race is between improvements and accumulation. Given continued improvements calling for more and more elaborate plant—more of time-consuming and roundabout applications of labor—then savings can heap up and a return still be secured by the owners of capital. Such has been the course of industrial history for the last century and a half. Such is apparently to be its course for another generation or two.

CHAPTER 40

INTEREST, FURTHER CONSIDERED

§ 1. Loans for consumption introduce no new principle as to demand, but are much affected by the absence of full competition.—§ 2. Public borrowing for wars an important form of such loans in modern times. Great war borrowing gives rise to both economic and fiscal problems. The economic effects are important for the problem of interest.—§ 3. Durable consumer's goods, as a form of investment, again introduce no new principle. —§ 4. No grounds for distinguishing between producer's capital and consumer's capital, so far as interest is concerned. Exchange of present for future the most general statement of the cause of interest.—§ 5. The mechanism of banking and credit makes interest all-pervasive.—§ 6. Variations in the rate of interest in different countries and for different investments.—§ 7. The justification and social significance of interest.—§ 8. Interest and inequality.

§ 1. Spendthrift loans, tho far less important in modern times than those for use in production, continue to play a part. Individuals and public bodies still borrow great sums in order to satisfy needs of the moment, hoping to repay in the future from some extraneous resource. Pawnbroker's loans are of this sort on a petty scale; the borrowings of nations for the conduct of wars are so on a great scale.

Such loans introduce no new principle concerning the play of demand. Here also there are gradations in the demands of the various borrowers. Some have pressing needs or are much tempted by opportunities for immediate expenditure. Others have needs less pressing or more caution and foresight. If we suppose a fixed supply of present means offered by the lenders, and suppose loans of this kind to be the only ones, the rate of interest under effective competition will settle at the point determined by the least eager among the spendthrifts—by marginal utility among the borrowing consumers. If we suppose this demand for loans to be added (as in fact it is) to the demand for productive uses, the modification of the conclusions reached in the last chapter will be simply a quantitative one. There is an additional opening for the lenders but no essential alteration in the gradations of demand or in the play of the forces by which the emerging rate of interest is settled.

The most striking peculiarity in spendthrift loans by individuals is that so often there is no such thing as unfettered competition, no such thing as a prevalent or competitive rate determined at the margin. The ignorance and the necessities of borrowers, their inability to pause and inquire what terms can be got, frequently cause "unfair rates" and "extortion"—phrases which signify here, as they commonly do also when used of the prices of goods, that the rates which would result from active competition are not in fact attained.[1]

Consider pawnbroker's loans, for example. The borrowers are usually in immediate need, often timid, ignorant, and anxious for privacy. They are likely to accept hurriedly such terms as are offered at the first place where application is made. So strong is the general belief that the resulting bargains bring an undue advantage to shrewd and unscrupulous lenders that in civilized countries public authority often regulates the transactions. Sometimes the rate of interest is prescribed—that is, a maximum is set —and detailed regulations are made for the keeping of books and accounts and concerning the mode in which the eventual sale of pledges shall take place. Sometimes, as in France, public pawnbroker shops are established, where advances are available at reasonable rates (that is, at something like the competitive market rate). Allowance, of course, must be made for the risks involved and for the heavy expenses of administration. A rate of ten or twelve per cent on pawnbroker's loans, after account is taken of expenses and losses, amounts to only a moderate net rate. But much more is often charged than suffices to pay all expenses, to offset risks, and to yield a sufficient return for the lender's capital and labor; hence the occasion for regulation by public authority.

In most semi-civilized communities the village usurer who lends at high rates to the improvident or necessitous is a familiar figure. The peasant of Hindustan lives upon a very narrow margin. His crops barely suffice to feed his family until the next season's crops

[1] Compare what was said in Chapter 10 on "fair prices."

are ready, and at the end of a poor season he must either borrow or starve. Not only is he often necessitous, he is often improvident. At the marriage of a daughter or at a funeral he will squander sums quite out of proportion to his means and will borrow on any terms to raise the money—a heedlessness of the future incomprehensible to the calculating Western observer. The usurer has him in his clutches. So also it was in the old days with the fellaheen in Egypt. One of the boons which the English administration in Egypt has brought the native is the establishment of a semi-public bank which has undertaken to displace usury by offering loans at competitive rates. In many parts of Europe the lender of small sums to agricultural producers is a usurer; that is, he is removed from the influence of competition, he lends to poor and ignorant persons, and he exploits the possibilities of the case.

In medieval times the acceptance of interest by lenders was prohibited, at least for Christians (the prohibition was by church law and applied to Christians only, hence the position of the Jews as money lenders) . To receive from the borrower more than had been lent him was thought unrighteous. The explanation of this attitude, so different from the present-day acceptance of interest as a matter of course, is probably that during the Middle Ages borrowing was in the main for consumption. When the borrower uses loans for his own gainful operations the bargain between him and the lender for interest seems natural and equitable. But where the borrower is in need, and uses the loan to satisfy pressing wants, the lender's requirement of interest has an aspect of harshness. Moreover, in medieval times competition and market rates of interest hardly existed. Such loans as were contracted were often on terms fixed by the necessities of the individual borrower. As the division of labor and the use of money spread, as industry became more complex and the instruments of production more mobile, loans for production became common; and with this change came a change in men's point of view regarding interest. The exceptions to the original strict rule of the canon law, the excuses and explanations for departing from it, the nominal retention of the prohibition with growing practical relaxation, the final acceptance of interest on loans as a familiar and normal phenomenon—all this illustrates the process by which men slowly adjust their rules of conduct to new ways and new institutions.

§ 2. One form of loans for consumption remains of great quantitative importance in modern times—public borrowing for wars. Where highways or railways or irrigation works are constructed from public loans we have the phenomena of saving, investing, capital making. But where the sums advanced by investors are used for war expenditures we have saving and investing but no resulting capital. We have vast waste by contending armies, and great loans which—so far as their strictly economic consequences are concerned—are essentially of the spendthrift sort. The drain on savings for this purpose has been enormous. Every great struggle has caused thousands of millions to be borrowed and squandered—squandered, that is, so far as concerns the economic consequences.

The conditions of demand for this sort of use are highly inelastic. When a nation's blood is up the means for prosecuting a war are demanded at any price. Hence prolonged fighting often causes a rise in the rate of interest which endures for years, perhaps for a generation. The Napoleonic wars, especially because of the huge loans contracted by Great Britain to carry them on, affected the current rate of interest thru the first quarter of the nineteenth century. In the second half of that century there was a succession of wars and of consequent borrowings—the Crimean War of 1854–55, that of France and Italy against Austria in 1859, the American Civil War of 1861–65, that of Prussia and Italy against Austria in 1866, of France and Germany in 1870–71, of Russia and Turkey in 1876–78, of Great Britain with the Boer Republic in 1899. Each caused public loans to be contracted at home and abroad, and each had its effect on the investment market in the world at large. The whole series tended to bolster up the rate of interest thru the nineteenth century. During the war of 1914–18 further loans were contracted by the billion, and the public debts not only of the warring countries but of the neutrals also were swelled to dimensions undreamed of before. Under the pressure of this extraordinary demand the rate of interest was doubled the world over.

In all these periods of struggle and waste the high rate of interest probably served to bring out some savings that otherwise would not have been made. And not merely the high rate but other inducements also. Patriotic sentiment causes people to save and to invest in government securities. Such is likely to be the case most of all when an entire nation is stirred by a feeling that its existence is at stake, as during our own Civil War, and in almost all countries during the great struggle of 1914–18. So far as savings are stimulated by the very conditions of the crisis—by high interest and by patriotic feeling—they are not withdrawn from productive use. They simply add to the investments of the buyers of the public securities and swell for an indefinite period the capital in terms of money on which interest is regularly paid.

War loans and public debts have further consequences. They not only raise the rate of interest, often for a long time; they cause the supply of real capital to be less, for periods longer or shorter according to the duration of the strain. At the seat of fighting there is immediate and often frightful destruction. Elsewhere factories are pushed to their utmost and raw materials of every kind are used up at a prodigious rate. Repair and replacement are reduced to a minimum. No new plant is constructed, except when needed for military purposes; and what is constructed for such purposes usually proves unsatisfactory for the uses of peace. If indeed the war does not last very long the gaps in capital may be filled quickly and easily. But a prolonged and exhausting struggle is followed by a period of suffering and readjustment, the more trying if accompanied, as usually it is, by monetary derangement.

Once a war is over and borrowing ceases a war debt means in the main a continuing series of cross-payments within the community. It means this in the main, not always or necessarily. So far as the debt has been incurred abroad, payment of interest must be made to foreigners, and eventually (according as the terms of the loan may be) repayment of the principal also. The effects of such transactions on international trade have already been considered.[1] There is here a real drain on the country's resources. The situation is different so far as interest and principal are payable within the country. Interest charges and repayments of principal then bring no net loss, no net gain.

[1] See Chapter 32.

People often speak of a national debt as a crushing burden. But the payment of interest on the debt means simply that taxes are levied and the proceeds paid to the holders of the government securities. Persons of one set are called on by the government to make payments to another set. If the taxes are paid predominantly by the poor—if for example they are taxes on commodities of everyday consumption, such as sugar, salt, tea, coffee, tobacco—and if the holders of the public securities are chiefly the well-to-do and rich, the result will be an accentuation of inequality. Such was the consequence of the methods of finance and taxation that were common until very modern times. Of late, and markedly since the war of 1914–18, the outcome has been different. Income taxes and similar levies bearing chiefly on the prosperous classes have been used to meet the debt charges. This was strikingly the case in the financial operations of Great Britain and the United States during and after that war. So far as the well-to-do classes are also holders of the public debt (and they are the holders of by far the greatest part of it) the process is in essentials that of shifting cash from one pocket to another of the same sort. Those among the well-to-do who hold a large proportionate share of the war bonds get a net balance in the way of interest. Those, on the other hand, whose incomes are high and who hold comparatively few bonds pay more in the way of income tax than they receive in the way of interest.

It must be said, however, that this sort of cool weighing of the real effects of loans and interest plays little part in the thinking of the ordinary bondholder and the ordinary taxpayer. Almost all people have a feeling that a tax is a net loss, an interest receipt a net gain. They regard a tax as an unwelcome net burden. Let it be assumed, for example, that in a situation such as that outlined in the preceding paragraphs the amount of interest payable to each taxpayer is exactly the same as the amount of income tax payable by him (as regards that income). Then there is no loss to anyone, no gain.[1] Yet most taxpayers would probably feel that they were

[1] Of course, there will be the expense of collecting the taxes and distributing the interest; a real burden, of which the concrete form is that government officials are engaged in this task when they might be engaged on work of more substantial serviceableness. Expenses of collection and administration, however, are a small fraction of the total sums involved.

burdened. They would regard the interest receipt as a natural, proper, satisfactory income; the tax payment as unnatural, unwelcome, irritating. And if some taxpayers received less in interest than they paid out in taxes they would be even more aggrieved, whereas if the interest receipts of others exceeded their taxes they would not be at all correspondingly mollified. This state of mind is quite absurd and quite understandable. It is the natural result of the usual attitude of the possessing classes toward taxation and the government's doings, toward property and the income from property.

§ 3. Another form of savings used in investment stands midway between those for production in the stricter sense and those for consumption. This is investment in durable goods suited for immediate use, of which dwelling houses let for hire are the most important type.

The hiring of a dwelling brings about an exchange of present means for future means and the emergence of a premium, in essentially the same way as in the simplest loan at interest. The tenant normally pays as rental a sum sufficient to reimburse the owner or landlord for repairs, depreciation, and such charges as insurance and taxes; and he pays him in addition a sum which constitutes a net income to the landlord and is the interest on his investment. (We leave out of consideration for the present the land on which the dwelling stands; its relation to the gross rental will be considered in the chapters following.) The landlord at the outset has present means or savings at his disposal—the sum which he applies to building the house. If the rental which he receives were just enough to bring him back this same sum, covering the eventual return of his capital (and also repairs and other current charges), he would get from the tenant or series of tenants precisely what he gave. But this return is spread, by installments, over a long time. We may suppose the house for example to last fifty years, being worn out and useless at the end of that time. The full repayment of the capital sum will then be completed only after the lapse of half a century. A postponement of satisfactions on the landlord's part is necessarily involved and will not be accepted unless there is some inducement—unless the tenants in the course of the years pay *more* than enough to repay the sum originally invested; that is, unless interest is paid.

Where a building, or indeed any other concrete form of wealth, is expected to last a very long time, depreciation (that is, the gradual recovery of the capital sum invested) plays but a small part and the rental, over and above repairs and expenses, is made up almost solely of the interest charge. Strictly, the investor should always face the fact of depreciation. Tho some forms of durable consumer's wealth, like a few forms of producer's wealth, seem to endure indefinitely, decay and depreciation eventually set in. In many cases of such investments, however, it is probable that the distant future when the capital sum will finally have to be replaced is forgotten. The landlord in his calculations of rentals will often reckon merely on interest, with allowance for repairs and other immediate expenses but without allowance for the ultimate replacing of the initial investment. In regions where population is growing, and especially in growing cities, this sort of real or apparent miscalculation is fostered by an expectation that a rise in the value of the land will offset the depreciation of the building—a phase of the subject which is reserved for later consideration.

Turning now from the conditions of supply to those of demand, we find a situation essentially similar to that appearing in the demand for producer's capital, tho it may seem more complex. The demand for house room and the like is similar to that for other present satisfactions. House room is constantly compared with other utilities and exhibits the same gradations of demand. The dwelling yields shelter and it may satisfy the love of beauty. It ministers also in no small degree to the love of distinction, for here is one of the most familiar forms of display. The more of these gratifications are offered the lower will be their marginal vendibility and their price. Suppose that dwellings were the only available form of investment and that all the sums saved were turned into this channel; we may reason that, as a steadily increasing supply of such sources of satisfaction was offered, the amounts which purchasers would pay for successive installments of them would grow less. Still supposing them to be the only form of investment, we may reason further that the decline in rentals would not cease until investors (those building dwellings for hire) came to the conclusion that it was no longer worth while to abstain from the immediate use of their means in the process of providing house room for tenants or, to speak more carefully, when the last or marginal investor came to this conclusion. The case would again be one of the equilibrium of supply and demand.

Other forms of consumer's wealth present the same phenomenon. Pianos, the furniture in lodgings, theatrical costumes and the like—all illustrate the principle. Wear and tear and allowance for depreciation are more obvious and play a larger part in these than in dwellings, and interest forms a smaller proportion of the gross rental. The civilized man's repugnance to miscellaneous and indiscriminate use of his possessions sets limits to the spread of such hiring and letting; but anything which by custom can be passed readily from one person to another, like a dwelling or a piano, may cause a return to arise in the way of an interest payment.

Consumer's wealth of a durable and transferable kind thus offers still another way of investing present means and of securing an interest return. The whole mass of savings put aside for investment is to be compared with all the opportunities for utilizing them—in production, in loans for quick consumption, in consumer's capital. These combine to make up the total demand which is to be set against the supply of savings. No one of the various opportunities is necessarily dominant. But they are by no means of equal quantitative importance. Except for public borrowings, loans of the spendthrift type are comparatively small in modern communities. Durable forms of consumer's wealth, of which dwellings are typical, present a much ampler opportunity for the investment of savings, and one which enlarges steadily with an increase in population and in general prosperity. The operations of production, the construction of elaborate plant, the possibilities of increasing the efficiency of labor by applying it over time, form the most important of all. In this sense loans for production may be said to dominate the market in modern times and to settle the return to all kinds of capital and investment.

§ 4. We are now prepared to give an answer to a set of questions suggested at an earlier stage, which have to do with the relation of producer's wealth to consumer's wealth, and the definition of capital.[1] Matters of definition, tho not in themselves of the first importance, repay discussion because they compel reflection on the essentials of the things defined.

Producer's wealth and consumer's wealth are similar, in that they are both instruments. Both serve to provide utilities or gratifications. They differ as to the time at which the utilities will emerge. Producer's wealth brings no utilities in the present; all of its effects are to appear in the future. Consumer's wealth brings utilities in the present. But not all of its utilities are so bought: it sheds them, so to speak, continuously thruout its existence. The longer it lasts the longer will the process continue. Some of its utilities are thus also future, and the more of them in proportion as it is durable.

The most general statement of the conditions under which interest arises is that it results from an exchange of present things for things future. This proposition, more or less foreshadowed in the discussions of a long series of economists and sharply formulated late in the nineteenth century by the brilliant Austrian economist Böhm-Bawerk, applies to all the various operations in which a surplus appears for him who makes loans or advances. It applies no less to operations which involve consumer's wealth than to those which involve producer's wealth. From this point of view the one is capital as much as the other. In both cases "true" interest arises, due to the fact that the present ordinarily outweighs the future in attractiveness, and that those who have present means at command will not postpone enjoyment of them unless some inducement in the shape of premium is offered. So far as the problems of distribution are concerned, consumer's wealth and producer's wealth thus present similar phenomena. Either of them may yield interest and so lead to the emergence of a set of persons who have an income from accumulated means and who need not work for their living—a leisure class.

Tho thus similar in the essential relations of present to future, the two forms of wealth yet present differences in other respects.

[1] See Chapter 5 and also Chapter 51, below.

There is an obvious difference in the nature of the social advantage secured from the possession of present means. That advantage, in the case of producer's wealth, is found in the increase in the productiveness of labor because it is applied in the "capitalistic" way. The demand for producer's capital and the ability of the users of capital to pay interest depend on factors which do not bear on consumer's capital or on interest derived from consumer's capital. The progress of invention, the growing effectiveness of larger plant and more costly tools, the possible limits to the increase in output from more laborious preparation—all these are questions which must be considered with reference to capital in the narrower sense. They do not present themselves with regard to consumer's wealth.

§ 5. When once the payment of interest is a familiar and accepted fact, it is extended to all cases where present means are in one person's hand and are turned over to another person. He who has money to lend can always get interest on it. He who borrows must pay for the veriest fraction advanced to him and for every day of the advance. The competition and interaction of a highly developed banking and credit system is always keeping the possessor of present means in some connection, immediate or remote, with those who are the eventual users of capital and the ultimate employers of labor; and in ordinary times interest can be unfailingly secured on every scrap of disposable cash.

Here, as in so many fields of economic activity, the persons directly engaged are little aware of the significance of their doings. The professional money lender knows by everyday experience that he can always get interest on the money he has to lend and he commonly thinks of it as "earning" interest. He who borrows accepts the need of paying interest as a necessary part of the world as it is and does not stop to think that his own demand for present means —in order, say, to buy a machine or a batch of materials or wares— is part of the very situation that causes a return to the lender to arise. Just as, under the division of labor, each individual worker has no consciousness of the part he plays in the complex organization of industry; just as, in the adjustment of foreign trade, each merchant has no notion of his place in the mechanism—so neither individual lenders nor individual borrowers have the slightest understanding of what underlies their bargainings. Economists are often twitted with being theoretical and out of touch with the facts of industry. Much more unpractical is the attitude of the average business man, who is familiar with but one small corner of the industrial world, contents himself with the most superficial commonplaces, and knows so little of the essential problems that he is hardly aware even of their existence.

§ 6. The minimum rate of interest, on the best security, differs a little between different countries. For generations it was lowest in England and sensibly higher in France. Until the close of the nineteenth century it was higher in the United States than in most European countries. As a rule, it is higher in new, prosperous, and rapidly growing countries; lower in old countries that have long been prosperous. The explanation is mainly to be found in the varying conditions of supply and demand, in the race between accumulation and improvements at the time and place. In a country like England, which enjoyed complete internal peace and high industrial prosperity for two centuries, accumulation was steadily great; and notwithstanding the periodic sweeping away of large amounts thru loans for war expenditure there was almost constant pressure to find advantageous employment. France enjoyed similar prosperity only after the close of the Napoleonic wars but, tho long a rich country, it was not until the second half of the nineteenth century that she had such an overflowing supply as England. Moreover, her huge public debt withdrew from productive use a larger part of her people's savings. From both countries there was in the nineteenth century an outflow of money means for several generations, thru investments in regions where the demand for use in production was great. Germany, whose industrial advance after 1870 was extraordinary, also reached the stage of fast-accumulating resources and of overflow to other countries. From countries like these the outflow was chiefly to the newer countries, whose own accumulations were not yet great, whose resources were still not fully utilized, and whose opportunities for using capital were large and profitable. Such was the United States thruout the nineteenth century. Canada, Australia, South Africa, Argentina, Chile, and other regions offered advantageous fields for investments from older countries. Not the least striking transfer of accumulations was that from the older part of the United States, along the North Atlantic coast, to the West and latterly to the South of the country. From New England a steady stream of savings flowed to the West and enabled the latter section to provide itself with much-needed capital.

If the transfer of savings from one country to another took place without question or hesitancy, the rate of return on investments would be the same in both. But it does not so take place. A loan to a person at home or for use in an enterprise at home is made more readily than one to a strange country. Something extra must be paid by the borrower who has to deal with a lender on the other side of a political boundary. Even where no political boundary has to be crossed, but only a less familiar region entered, the same sort of inducement must usually be offered; as when an Englishman is asked to lend in Canada or Australia, or a New Englander in Texas or Oregon. If the only supply in new and rapidly growing regions were that from their own savers, the rate of return there would be considerably higher than in fact it is. The inflow from older countries brings it down, tho not to a rate as low as that prevailing in those older countries.

The same sort of difference arises between familiar and unfamiliar investments within the same country and region. A large city like Boston or New York can borrow on better terms than a small town or municipality, even tho the latter be as near and as solvent. A large railway corporation, whose securities are known favorably to a wide circle of investors, can sell its bonds (that is, contract its loans) more advantageously than a modest enterprise, even tho the latter be no less secure. The activity of bankers and traders and the publicity given by stock exchanges tend to lessen differences of this kind, as they do those between countries, but some differences still persist.

In all this process of transfer and tendency to equality, without the attainment of complete equality, account must be taken of risk. Investments in a new country, promising as they may be and likely to yield in the end returns larger than in old countries, often contain elements of uncertainty in each individual case. Hence something in the nature of an insurance premium must be paid.

Unattractiveness tends to keep high the returns from some forms of lending. Pawnbrokers' loans are usually made, as has already been remarked, under circumstances which prevent the full effect of competition from being felt. But even if made at rates resulting from complete knowledge of market possibilities by borrowers, they would doubtless be higher than ordinary loans, since such lendings are not in social esteem. Similarly, dwellings and tenements let to the poor commonly yield a return higher than the current rate, even after allowing for the risks of non-payment and the considerable expenses of management and collection. There is an aversion to dealings that involve real or seeming pressure on the necessitous. Tho "philanthropy at four per cent" has caused model dwellings in cities to be offered to the poor at rentals that yield the owners no more—possibly a shade less—than could be secured in other ways, such operations have reached but a small part of the field, and it still remains true that investments of this kind ordinarily secure a return above the current rate. For similar reasons business premises used in American cities for the retail sale of liquor seem to secure an unusual return: a certain discredit attaches to this sort of investment.

§ 7. What, in conclusion, of the justification and social significance of interest?

In the older English books on economics interest was often said to be the "reward of abstinence." The phrase has been ridiculed—a Rothschild or a Vanderbilt or a Rockefeller abstains and deserves a reward! It has succumbed to the ridicule and has disappeared. The clear-headed among the older economists probably never had in mind a moral connotation in the phrase but those who tried to popularize their theories often did. It has gone quite into disuse.

Other terms have been suggested which are supposed to have no justificatory implication. Such are preference for present goods or time preference, impatience or (by antithesis) patience, and waiting. The last—waiting—would seem the best. It merely states a fact which appears in the making as both consumer's and producer's capital. If one wishes to take a further step and reason on the basis that there is ordinarily, tho not necessarily, some initial irksomeness, something unwelcome in the choices that lead to the making of capital, "waiting" is a brief, non-committal, semi-technical label; analogous to "labor" to denote activity of a kind which is not necessarily unwelcome but is usually undertaken and maintained because it leads to an eventual pleasurable result.

No moral judgment, then, is implied when it is said that interest is the return for waiting. The person who possesses present means may have got them thru doings which are condemned alike by the law and by our moral feelings, such as outright robbery; or in ways which, while within the law, are yet repugnant to moral feelings, like sharp bargaining with the ignorant or unfortunate. On the other hand, a man may have acquired means for investment by arduous and effective work which others have gladly paid for. It is all one when we put the question what happens when he exercises his choice between saving and spending. The waiting may be of a kind deemed meritorious, as when one provides for wife and children; or it may mean an idle heaping up from superfluous income, animated by mere rivalry in money making and in ostentatious and tasteless display. It is all one, so far as the strictly economic theorem goes. The essence of this is that present possession is preferred to future, and that present resources will not be exchanged for future resources unless some inducement be offered. Here is a mere fact; whether it squares with moral desert is quite a different matter.

This cold-blooded attitude, apparently indifferent to any moral judgment, is repugnant to most people. Their minds turn first to the question, is interest right? They do not separate their moral questionings from that which is the first matter for the economist—how explain the phenomenon. And in their moral questionings they rarely apply any well-defined principle of ethics, but only general notions about even-handed justice, equal treatment, the injunctions of religion.

§ 8. Interest seems to have been an inevitable outcome of the system of private property and free exchange. It appeared in early and simple societies, and grew in volume and importance with the greater complication and efficiency of the processes of production. At the outset it arose chiefly in the simple form of loans for consumption. With the development of our modern communities loans for production have come to play a greater and greater part, until now they are the dominating form. As we survey the tangled course of economic history and the slow but accelerating advance in material welfare, it is hard to see how the private accumulation of capital under the stimulus of interest could have been dispensed with. In so far, it may be adjudged to be "just"; it served to promote material welfare.

To say that interest has been indispensable in the past is not to say that it is forever indispensable, still less to say that it was or is to be deemed welcome without qualification and in every aspect. On the purely utilitarian reasoning something is to be said against it as well as for it. Thru its concomitant effects on inequality it is not in accord with the goal of maximum satisfaction. Those who have saved and waited have usually been favored persons with means much above the average. Waiting may have been a sacrifice, in the sense that postponement of present enjoyment is commonly irksome. But it has not always been a heavy sacrifice. Until within recent times waiting and investment were possible only for a small number of persons possessed of incomes above the average and much better able to wait than the masses who had little if at all above the minimum. The beginnings of modern capitalism are not known with any certainty but it is clear that in its earliest stages and for many centuries only a few persons—traders, bankers, city folk of unusual prosperity—had any part in accumulation and investment. Tho this situation is somewhat modified in our own day by savings banks, life insurance companies, coöperative societies, and all the multiplied openings for investment by the masses, it remains true that most saving is done by the well-to-do and the rich. There is no statistical evidence to prove this with certainty but such evidence is not necessary; everyday observation suffices. Accumulation and investment remain matters of steady concern chiefly for the comparatively small circle of persons who are already members of the possessing classes or in close association with them.

Income-yielding property, thus the outcome of inequality, serves to promote and maintain inequality. Not only are those who receive it put in possession of greater present means but, what is more important, they are enabled to perpetuate their own and their children's favored position as earners of income. The social stratification of our time, the separation of the well-to-do classes from the non-possessing, is supported and strengthened by the income from existing possessions. The leisure class has emerged as the consequence of interest, and tends to perpetuate itself and enlarge itself thru the receipt of interest. The phenomenon of the leisure class has never been a self-justifying one for the unbiased observer. It may be accepted as part of a system beneficial on the whole and apparently indispensable; indispensable, that is, in the past and for the visible future. Whether private property and all that hangs thereby will last into the indefinite future raises questions which are much wider than those dealt with in these chapters. They must be reserved for later discussion.[1]

[1] Compare what is said below, in Chapter 56, on Inequality and on Great Fortunes, and in Chapters 67 and 68 on Socialism.

CHAPTER 41

THE LEVEL OF WAGES IN GENERAL

§ 1. The fundamental question on the general level of wages is raised by the case of hired laborers.—§ 2. The notion that lavish expenditure creates demand for labor and makes wages high. Consequences of investment as compared with "expenditure."—§ 3. The fallacy of "making work." Why hired laborers universally desire that employment should be created and dislike labor-saving appliances.—§ 4. Productivity of labor; of capital ("waiting").—§ 5. Discounted marginal product. The margin: discrete; conceptual.—§ 6. The margin for industry at large.—§ 7. How the margin appears in the individual firm.

§ 1. WAGES are so immensely varied that it may seem idle to aim at any generalizations regarding them. They range from the earnings of the highly paid business manager or professional man to those of the mechanic and common laborer. Not less varied are the methods by which those earnings are got. The simplest method, and that which we most commonly associate with the term "wages," is the payment of stipulated amounts by an employer. The earnings of the independent worker—whether he be business man, lawyer, farmer, craftsman—are almost always more irregular, and almost always include some elements (in the way of interest or rent) which are not return for labor. Still different is the position of the metayer tenant or "share farmer" and of the fisherman working for a share in the catch.

It will be best at this stage to concentrate attention on the simplest case—that of hired laborers, paid once for all by the day or by the piece. This mode of remuneration brings up the "wages question" in the narrower sense. It is the mode of remuneration becoming more and more common with the spread of large-scale production. It raises the fundamental questions concerning the causes determining the general range of wages.

§ 2. First, some erroneous notions may be disposed of. One of these is that lavish expenditure creates a demand for labor and is good for laborers. On this ground luxury and extravagance of all sorts have been commended, expressly or by implication. The fallacy which underlies it has often been pointed out. That which is saved is spent quite as much as that which is not saved. Most people think only of the first step in the process of saving and investment—as if it were merely a matter of putting money by and leaving it in a bank or other safe place. The money which is put by is turned over to someone else, usually to a person engaged in operations of production. It is simply spent in a different way. It leads equally to the employment of labor and is equally the means by which the employers and workmen get command of the things they wish to buy. The difference between expenditure on luxuries and investment is merely a difference in the direction in which labor shall be employed.

That difference in direction, of course, may have permanent consequences. It may mean that some sorts of labor are more in demand, others are less in demand. If we imagine that the laborers hired in constructing mansions or pleasure yachts, or in prodigal entertainment, belong to one group, and that those hired in building factories or railways belong to another, a change in the direction of demand may permanently influence relative wages. But such a permanent change is very improbable. Temporary changes in wages, on the other hand, caused by shifts in the demand for labor engaged in various directions, are not only possible but are among the most common of economic phenomena. These shifts are quite as likely to be from one sort of immediate expenditure to another sort—from horse-drawn vehicles to automobiles—as from such expenditure to saving and investment. They do not influence for better or worse the total demand for labor.

Looking not to the immediate effects but to the eventual results of investments as compared with "expenditure," we may agree with the older economists who maintained that saving was advantageous to laborers. Investment usually leads to the increase and improvement in the apparatus of production—the tools, machinery, factories, materials. The eventual result is the production of more consumable commodities than would otherwise be procured. Were tools not successful in bringing about this result they would not prove profitable and would not be made. The consumable commodities are in large part such as the laborers themselves buy and their greater abundance and cheapness bring gain to the laborers. On this ground it may be said that investment as compared with immediate expenditure is better for the laborers as a whole. In the first stages they are neither injured nor benefited; in the end they are likely to be benefited.

§ 3. Still another notion, cropping out continually in all sorts of forms, is that it is advantageous that employment be created or maintained for laborers. A great fire or a great war is sometimes thought a godsend to the workingman. A heavy snowstorm is welcomed because it brings employment. And, conversely, improvements and labor-saving machinery are thought to diminish employment; do they not dispense with the services of many workmen? Laborers themselves are almost invariably desirous of "making work." They have no question that a more difficult way of doing a thing, one that calls for more labor, is better for those who have to sell the labor. Few persons maintain views of this sort deliberately and steadily, yet there are few who do not sometimes fall into ways of speech that imply them.

It is obvious that mankind cannot be made better off by causing work to be less productive or by merely doing again and again that which has already been done. If there were constant snowstorms and a need of giving labor repeatedly to snow shoveling, so much less labor could be given to operations of a less negative kind. Where labor is given to replacing wealth destroyed by fire or war it might have been given not to mere repair of damage but to the creation of so much new wealth. The abundance of consumable commodities, on which all material prosperity is bottomed, evidently depends on getting as much done as possible with as little labor as possible. How then can people talk so persistently about the advantages of creating employment?

The explanation is to be found partly in the consequences of the division of labor, bringing as it does a difference between the causes acting on general prosperity and those acting on particular groups; partly in the necessitous position of most hired laborers.

Where there is no division of labor and no exchange, this notion can never arise. No farmer working for himself will think for a moment that it is for his advantage to choose that way of doing a thing which involves most labor. He will welcome every labor-saving appliance. But when there is division of labor and exchange every individual's earnings depend not only on the quantity of things which his labor produces but on the terms of sale for those things. It may be to his individual advantage, and still more often may seem to his advantage, to produce less and sell for more, even tho it be obvious that if all men did this all would be worse off. And similarly it may be to his advantage that his labor should be more in demand, even tho the cause be something that lessens the total income of society. A great hailstorm with many broken windows means a demand for glaziers. If this sort of destruction went on all the time the number of glaziers in the community would accommodate itself to the situation; more persons would do this sort of work and less persons would be available for doing other things. The glaziers themselves would not benefit in the end, unless indeed they happened to constitute a non-competing group and so to possess a labor monopoly. But for a time those glaziers who happened to be on hand and ready to do this particular sort of work would gain by an increase of demand for their services. Most men see only immediate effects and draw general conclusions from temporary phenomena. They suppose, or talk as if they supposed, that what is good for a limited number of workmen for a short time is good for all workmen for an indefinite time.

Most important of all, however, in explaining the common attitude of workmen is their position as hired laborers. For them it is of first importance that they be employed. Where permanence of employment is assured they are rarely opposed to labor-saving appliances. But when they are engaged on a given job, and will no longer be wanted when that job is done, they wish that it shall continue. No doubt, in the interest of general efficiency in production, it is desirable that this job shall be disposed of as quickly as possible and that their labor shall then be turned to something else. But where that something else is not immediately in sight it is natural that they should wish the existing employment to hold out as long as possible. It is the difficulty of transition to another employment that explains the desire to make work or to keep work going. It is that same difficulty of transition that goes far toward explaining the disadvantages of the workman in bargaining with his employer and constitutes one of the main justifications of labor unions.[1]

The situation is essentially the same where the workmen of a given trade are confronted with some improvement that causes labor to be more productive. For them it may mean less employment and the necessity of either accepting less wages or moving to some other occupation. The inventions of the linotype and the monotype machines greatly increased the output of labor in printing. They diminished also—for a time at least—the demand for compositors. Some of the older members of the trade who could neither operate the new machines nor turn to anything else found themselves in a sad position.

It happened in the printing trade, and indeed has often happened in other cases, that the total number of men employed in it, and so the demand for labor in its former employment, did not become less at all, or less for a short time only. The cheapening of a commodity may mean an increase in the demand such that the total sum spent on it may be as great as before, even greater than before.[2] With lower prices for books and newspapers it is entirely possible that many more will be bought and more persons employed in printing them, not less. It has been maintained that such is the common effect of inventions and labor-saving appliances. But this is quite too optimistic a view of the situation. The outcome evidently depends on the elasticity of demand for the particular commodity. Only when, with a lowering of price, demand expands very rapidly, is it likely that there will be no displacement of labor.

§ 4. Very different from the confused notions just examined is the theory, now the reigning one, that wages depend on the productivity of labor. Stated in this general form, it can hardly be questioned, even debated. Stated more carefully and explicitly, it calls for nice distinctions and raises difficult questions. Within the bounds of a book like the present only the main lines of reasoning and explanation can be indicated. What follows is a summary statement, as simple as possible, of the outcome of dis-

[1] See below, Chapters 58, 59.

[2] That is, the elasticity of demand may be greater than unity.

cussion carried on by economists thru several generations and embodied in hundreds of volumes and papers.

The simplest and roughest proposition—a preliminary to the more intricate matters that are to come—is that wages in general are high when the product of labor is high. The product of labor means the product of industry at large—again a rough statement, presently to be qualified, but to be accepted as a start. Looking over the familiar broad variations in wages between different countries we can readily explain them on the ground that labor produces more in some than in others. The "rate of wages," the general level, what is nowadays commonly called the standard of living, is higher in the United States than in England, Germany or France; and it is so because the product in physical terms is higher. So as between these Western countries and those of the East. The great outstanding differences are due to the great outstanding cause.

But this, while important and of significance for the general problem, carries us but little way for the precise problem here in hand. That relates to the *share* of the product going to labor and to other participants and more particularly the shares of labor and capital. The larger the total product the larger the amount either could get. What determines the share of the total going to each?

The answer now to be found in virtually all books on economics is that the share going to each factor is determined by its marginal productivity. That proposition also is formulated very much in the large. It points to the great underlying cause which operates in a competitive system. It ignores, at least at the outset, the peculiarities and special rates of return for particular groups of laborers and capitalists. These special rates will indeed be found in the end to be determined in a way essentially similar. But they may be regarded as given for the time being—as if they were but the detailed heights of a plateau the whole of which is in course of subsidence or elevation. The causes which lead to the broad ups and downs of the wages plateau as a whole are our primary concern at this stage.

First a word of explanation on a point already touched on yet to be borne in mind more particularly for the question of "shares."

Thruout this book and indeed thru all the literature on economics "capital" is usually spoken of as something different from labor, and indeed as an antithesis to labor. Now if capital is conceived to mean implements made by man there is in strictness no essential difference, no occasion for antithesis. Capital being the product of labor, the use of capital means merely the application of labor in a particular way—the indirect or time-using way. The essentially different element or factor which does appear when capital is used is the waiting. If we are to speak of some element or factor in production other than labor it is that of waiting. By following this terminology steadily and incorporating it into all the writing and speaking on economics we should doubtless promote greater precision of thought. But here, as on so many other matters, it has proved impracticable to depart far from the words and phrases of everyday life. It would be pedantic, and for most readers confusing rather than clarifying, to speak of "labor and waiting" rather than of "labor and capital." Moreover, in any concrete case, the man of affairs and the economist alike have before them existing concrete tools and implements which are used by present labor, have a price like that of present labor, are seen to be applied in combination with present labor. The business man's primary thought is that he needs "capital"—that is, the money wherewithal to buy tools and raw materials and to pay wages. The economist, as he goes beyond the immediate case and considers the whole series of capitalistic operations, must needs make a more searching analysis. Yet in doing this he finds it still convenient to use the familiar phrase labor and capital. The reader should bear in mind that the use of capital has two sides—it means both the application of labor and the further element of waiting; the distinctive thing in the last analysis being the waiting.

§ 5. Coming now closer to the heart of the matter I still think it helpful to start with the phrase used in the earlier editions of this book. It is that wages stand for *the marginal discounted product of labor*. These two elements—"marginal" and "discounted"—may be taken up in turn.

First, marginal and the margin. The marginal product—the addition to the output from the last unit of labor—appears in two ways. It may be the addition which comes from some specific and discrete unit of labor, or it may be that which comes from *any one* of a number of units yet from no particular one. These two variants of the margin call for separate attention. They may be called the discrete and the conceptual.

The discrete [1] unit—that marginal labor at which you can point your finger and say, here it is—appears most unequivocably in agriculture and industries of similar character. Labor is applied with more advantage on some lands than on others. There is marginal land and there is land better than that on the margin. Labor on the better land produces more but it gets no more. Supposing competition among laborers to rule (as we may for the present purpose suppose), the laborers on the marginal land and on the better land all get the same. The greater output from the labor applied to the better plots does not enure to the benefit of the laborers but goes to the owner of the land. This is the gist of the theory of the rent of land, which will be considered at large in a later chapter; for the present it is enough to point out that here marginal product can be readily visualized. And this marginal product underlies what all the laborers will get. No labor can get more than any other; no group of them can get more than any similar group.

The other marginal labor or marginal product is non-discrete. I shall call it "conceptual." It is definable and distinguishable but is not easy to discern. In a given factory, an additional laborer may add—presumably will add—something to the output. Just where and what is the product of his individual work cannot be made out. The man takes his place in a group of others and works with them; it is to be seen that somehow more is produced. Just what specific thing this individual contributes cannot be demarcated. What *can* be seen is the difference which results because of the added labor; and that difference is the marginal product. So in the converse case of there being less labor than before. Suppose a laborer to leave—to be dismissed or go out of his own accord. The output will be less. The item of product which the individual had

[1] I use the word "discrete" as signifying separate, distinguishable; without any of the connotation of "discreet," signifying wise, prudent, and the like.

turned out before and which is now gone may not be susceptible of demarcation. But the difference which it makes because he is gone can be ascertained; and this was the marginal product.

§ 6. We turn now to the ways in which the general principle holds for industry at large. It is in the wider sphere that the conceptual margin is most important. The illustration just used indicates how it appears in the individual establishment. In the wider sphere, that of the industrial set-up as a whole, it is less simple, less easily visualized, reaches much farther in its meaning and consequences. It is associated with changes in the make-up of the entire apparatus of production—in the capital structure.

Suppose that while capital increases the laborers remain the same in number or even become less; there is more capital per unit of labor. Or suppose—essentially the same case, merely inverted—that while capital increases the laborers also increase but at a smaller rate than the capital; there is again more capital per unit of labor. Suppose too the change in proportion to be great; there is much more capital per unit of labor. It is a new relation of this kind which the Western world experienced in the nineteenth and twentieth centuries and which naturally has been most in the minds of the economists of the modern period. When a new proportion of this kind arises a different adaptation must set in from that if there be a change of less range. Adaptation cannot be effected thru mere changes in the individual establishment. The make-up of the capital must be changed all around in such way that it is, so to speak, spread thicker. What this means has already been pointed out.[1] There cannot be merely more machines of the same kind. What happens is that more elaborate instruments take the place of less elaborate ones. The total product of industry becomes greater—assuming that the new instruments are more effective as well as more intricate. But the share ascribable to the last unit of added capital becomes less, while that ascribable to the last unit of labor becomes more. Wages rise, the rate of interest falls.

§ 7. The difference between the margin for industry at large on the one hand and for the individual concern on the other,

[1] See Chapter 38.

while it is to be regarded as one of degree only, is yet great in degree.[1] More time elapses in the transition to a new make-up of an entire industry, while in the end the eventual effect is much greater. Over a short time the individual establishment can add to its equipment more of the going tools and machines—say more looms—with comparative speed. But (still assuming the labor supply to remain the same) the extent of the change cannot be all-inclusive, can hardly even be great. There are not workmen enough to man a greatly increased number of looms. A wide range of effect can come only thru the other process, not that of adding more looms of the same kind but that of devising new kinds of looms—more complex, more automatic, embodying more capital. Then, while the total product is probably increased, the marginal product ascribable to a given unit of capital is likely to become less, and on the other hand that from a given unit of labor becomes more. But the process takes time; it is a long-period affair. The old looms must go, new looms must be contrived and constructed. In an ideal smooth-running course of industry the old looms would be gradually discarded as they wore out and the new and more elaborate ones would gradually take their place. In actual life, even under the most adaptable and smoothest conditions, the readjustment is not easy. Under the ordinary capitalistic régime of these modern days it is likely to take place irregularly, by spurts and stops, the newer equipment sometimes coming in too fast, the old often retained too long. A generation may easily elapse before the completion of any one of the wide-reaching transformations in concrete equipment which have come with the increase of capital per unit of labor.

The non-discrete margin for labor is easier to visualize if we assume the converse of the sort of change just considered; if there be supposed more labor but the same amount of capital. Then the change in the make-up of capital will be in the other direction, not more elaborate and expensive machines but simpler and cheaper ones of a familiar kind. And then the marginal product of labor will be less and the share going to a laborer will be smaller. Such a change, however, while its analysis proceeds on the same

[1] Compare what was said in the chapter on the Individual Firm, Chapter 16, Vol. I.

lines as that of the other and serves merely to bring out in another way what is meant by the marginal product of labor, is less important for us than the other, because it is less likely to occur in the world as it stands. This is not the general drift of the evolution of industry in modern times. It is the change in the other direction which has revolutionized industry in the countries of Western civilization and indeed in the world at large, and hence has received most attention.

CHAPTER 42

THE WAGE LEVEL (*Continued*). WAGES AND CAPITAL

§ 1. Discount, interest. Some qualifications.—§ 2. Supply price of labor and capital.—§ 3. A generalized form of statement.—§ 4. Advances again. Short-run and long-run movements.—§ 5. Bearing of the preceding on the familiar labor problems.—§ 6. Aggregate wages and interest. Inequality.—§ 7. Concluding remarks. Meaning of it all.

§ 1. We turn now to the other side of our formula, discounted product of labor: the "discount." In other words we turn to the relations between labor and capital.

"Discount" implies an advance. Production takes time. The materials and machinery needed in the time-using process are made by laborers, but time elapses before the consumer's goods which constitute real wages finally emerge. There must be waiting. As things stand in the modern world under the régime of private property, wealth is unequally distributed and the immense majority of the laborers have not the wherewithal to support themselves during the prolonged period. Their remuneration is advanced to them out of a surplus possessed by someone else. The operations of the capitalists consist in a succession of advances to laborers.[1] The capitalist class secures its gain thru the process of handing over to the laborers less in the way of consumer's goods than the laborers eventually produce. The product of labor is discounted by the capitalist employers.

This view may be stated, in the terms invented by the Austrian economists, by saying that labor is a "future" good in the same sense in which a machine or a store of material is a future good. It is a means by which "present" goods (consumable commodities or, more strictly, satisfactions) are got—eventually. To repeat what was said in the preceding chapters, the essence of the explanation of interest is that present goods are preferred to future goods; that sources of satisfaction in hand will not be exchanged

[1] Compare Chapter 5; Chapter 38.

at par for sources of satisfaction that are to accrue in the future.

In this process of discounting regard must be had to the whole series of productive operations rather than to the operations of an individual establishment. The "practical" man will readily assent to the notion of a discount as regards the particular segment of industry with which he is familiar. It will be obvious to him that the laborer cannot be paid as much as the product will sell for; otherwise nothing will be left for the employer and capital owner. But the advances to laborers are needed for a much longer period than that which must elapse until the mere stage of salability is realized. The product sold is likely to be itself a future good—some sort of "capital good"; it represents only one stage in the series of advances. The person who sells machines or materials *re*-discounts, so to speak. The capitalist who buys them (usually another employer) recoups the original employer and then, in the course of the next stage of production, makes further advances of his own to another group of laborers. Not thru one stage only—not merely in the payment of wages by the individual employer until he sells his goods—but thru all the stages, from the first gathering of materials and the first fashioning of tools up to the final emergence of satisfaction-yielding real income, advances to workmen as a whole are made by the capitalists as a whole, and discounting takes place at each successive stage. In this series of steps, the bankers play a great part, making advances to the capitalist employers. They use funds which are in part their own, in part funds borrowed by them from savers and investors, and in part created by them. Hardly one in a thousand among them is aware of the vast complex mechanism, still less of the way in which his own operations fit into the whole. Least of all does he understand how a misstep on his part, or on the part of a group of which he is one, may throw the whole out of gear.

The term period of production is used in two senses.[1] The British economists use it to designate the period of the individual capitalist or concern; the Austrian economists and their followers to designate the period of the entire capitalistic process from the very first

[1] As has already been said, see Vol. I, p. 275, note.

stage to the final emergence of a consumer's product, nay (logically) of a consumer's satisfaction. The period in the first sense is short—weeks or a few months—and is easy to measure; that in the second sense is long—years and years—and extremely difficult to measure. The first begins when the capitalist buys materials and pays wages toward making a salable article; it ends when he has sold that article, regardless whether it is a producer's good like a machine tool or a consumer's good like a loaf of bread. The second begins a long, long way in the past, when the very first step was taken in the way of fashioning tools and using them for ferreting out materials; it ends when (probably years later) consumer's goods finally emerge. In a sense it is indefinitely long, going back to the very first crude tool. The very first steps have become negligible in reckoning the total period which has significance; but how long is the length of that period—the one which does signify—is difficult to work out in theoretical terms and impossible to state empirically with any exactness. We can say hardly more than that it is a matter of years. For the fundamental problems of production and distribution it is enough to know that it is a period of that order.

The discounting which runs thru this whole period we may assume to take place at the current rate of interest. Evidently the simpler the processes and the more predictable their outcome; the more effective, too, the competition among capitalists—the more exact will be the correspondence between future product and present wages. The discount then will be easy to calculate. Where the process is complicated, long drawn out, and uncertain as to its outcome, the relation between wages and product is a loose one. Such an operation as the construction of the Panama Canal illustrates the maximum of uncertainty in the relation between product and wages. It took years to build the canal; it took further years before its effects on the ocean routes and on the cost of transportation were worked out; and still further years elapsed before these changes affected the international division of labor and the ultimate increase of product due to the increased geographical specialization. Those engaged on construction work at the canal could not receive wages determined by the discounted value of the product of their own labor. They received the current discounted value of similar labor in those routine industries where experience had indicated the output. The Panama Canal, as it happened, tho begun as a private enterprise, was carried to completion by the United States government, with virtually no regard to pecuniary profit. Under such circumstances the particular product of the laborers engaged in constructing it could have hardly the remotest bearing on the wages paid them. And even where there is private investment and the ordinary calculation of probable output and expected profit, every venturesome operation, above all if it involves the making of new plant, is conducted under the wage rates determined by the experience and the traditions of industry at large. In such operations the business man exercises his most characteristic functions and, if successful, procures his highest returns. He not only discounts, he speculates; and he pays his laborers at the rate of wages which has emerged in those operations where the discount, on the basis of the current rate of interest and of the ordinary return to the ordinary business man for his own labor, is comparatively simple and calculable.

Two things must be borne in mind in all this reasoning: one with regard to the discount, the other with regard to the margin.

First, we must be on our guard against reasoning in a circle. In previous chapters interest has been accounted for, in part at least, by the fact that there is a "productivity" of capital; it results from the application of labor in more productive ways. If this were the whole theory of interest we should reason in a circle in saying that wages are determined by a process of discount. If interest depended simply on the excess of what the laborers produce in the future over what is advanced to them in the present, the rate of interest then would *result* from the process of advances to laborers; it could not also regulate or determine the amount of those advances.

But the conception of the "productivity" of capital explains only the demand price of capital. If there is a regulator of interest in the way of a general or marginal time preference—a supply price, a minimum return necessary to induce saving and accumulation—then and then only have we an independent determination of interest, and so a tenable theory of wages as the result of an operation of discount. On this question—a crucial one—something has already been said in the preceding chapter and more will be said in the ensuing sections of the present chapter.

Second, a competitive margin is assumed, and one at which the process of discounting is carried on with some approach to predictability. At that margin there is nothing in the nature of rent or monopoly gain; nor is there exceptional profit by a business man of unusual capacity. We suppose a representative firm, carrying on its operations at the margin of cultivation, securing for its owners and managers ordinary business profits and ordinary interest on capital but nothing more. What is paid in wages here settles wages in the more profitable establishments also; and what is paid in wages here is settled by the process of discounting.

§ 2. Turn now to the question of supply—the other side of the problems of value and distribution. As regards capital this has already been considered: how far there is a supply price of capital, that is, a price of "waiting"—that element of real cost which is over and above the labor given to the making of capital goods. Perplexing as this problem is, we know at least what elements are involved —what are the varied motives and opportunities. We know that over long periods of time the rate of return on capital changes slowly, and for considerable periods may be treated as a constant.

If there be this supply price, the capitalist charge or remuneration for waiting can be described as a discount at a fixed rate. The capitalists as a body make advances to laborers thru the long production period, and a discount on these advances accrues to them. The laborers produce and hand over to the capitalists more than has been advanced to them, and that difference—discount— is at a rate determined by a marginal supply price of waiting.

This conclusion has an unmistakable resemblance to the so-called residual theory of distribution: the laborers are the residual legatees in the process of sharing. In that theory not only the capital owners but the active land owners also, and indeed managers or entrepreneurs (if these be treated as essentially different from other laborers) get shares demarcated by abiding forces. Capital owners get a rate of return that is settled; land owners too;

the managers too (the most dubious application of the reasoning). Laborers get what the others do not get, and they become more and more prosperous with the growth of industry and the advancement of material progress. The doctrine is an optimistic one. If it be accepted, the Western world appears to be in course of becoming a better place for the mass of mankind.[1] *If* it be accepted; how far it can, is reserved for consideration in the chapters that follow.

All this says nothing about an increase in the supply of labor, beyond the mere supposition that it fails to increase as fast as that of capital. What now is the situation as regards numbers of laborers? Has that a supply price, a supply schedule? This large and troublesome question, not easy to answer yes or no, will be taken up at a later stage.[2] It is enough at this point to indicate the *way* in which an answer to it bears on the broad problems of distribution.

In earlier times, say from the beginning of the seventeenth century to the second half of the nineteenth, a clear-cut answer was almost always given. There was said to be a well-defined and indeed obvious supply price for labor. The minimum of subsistence settled it. Laborers multiplied when they got more than the minimum, died off when they got less. During the eighteenth century this was tacitly assumed in most of the literature bearing on economic questions and was expressly stated in not a few. It was the basis of the first edition of Malthus's *Essay on Population* (1798). In the second edition of that famous book (1803) it was put in terms somewhat different, tho with a difference not of moment for the present purpose. Malthus's later thesis—what may be called the real Malthusian one—was that a fixed standard of living existed at any given time, was likely to persist for generations, and determined the wages of labor. If the laborers got more than the established standard, numbers increased; if less, numbers decreased. In other words, there was a fixed supply price of labor. During the first half of the nineteenth century such was the usual

[1] It is to be remembered that the doctrine refers to *rates* of return. In the case considered in the preceding pages the rate of return to laborers goes up, the rate of return to capital remains the same. The aggregate amount going to the capitalist class increases, tho the rate per unit remains unchanged; the aggregate going to laborers rises.

[2] See Chapters 54, 55, on Population.

view. It ought to be said, in fairness, that commonly there was an implication that the standard might be substantially above the minimum. In any case the established standard of living, whether higher or lower, settled the rate of wages. How much truth there was in it or is in it, I leave for later consideration. The thing significant for the present is the theory, or belief, or supposition, that there is fixity of the general level of wages; or rather, to put it more accurately, that this level is independently given.

Given this supposition, and no supposition of the kind for the supply price of capital, we are led to the same sort of conclusion as before, only with just the obverse face. Then capital is in the residual position and gets what is over and above the receipts of the laborers—all above wages. Essentially this view underlies the Marxian theory of distribution. The laborers get a settled wage, virtually the minimum for living. If more is produced by them a surplus arises which goes to the capitalists. There is nothing analogous to a settled rate of discount (interest) as regards capitalist's gains; the outcome is just a matter of how much they compel or cajole the laborers to produce. The laborers get their fixed wages, the rest is "profit."

Obviously there are other alternatives. One is that *both* labor and capital have a settled supply price. Suppose the rate of wages is determined somehow—by the minimum of subsistence or by an unchanging standard of living. Suppose interest to be determined by what was called by older writers the effective desire of accumulation, by later ones as a settled scale of preference for present things over future things and hence a settled price for the waiting during slow accrual of the consumer's goods in the future. The situation then is simple enough. Capital and labor, each gets what is necessary to keep it going. The quantity of each adjusts itself in such way that it gets its settled supply price. There is no surplus, no residual claimant. The theory of distribution becomes simplicity itself.

§ 3. Now a final alternative, the opposite of that just stated, which like the others can be readily fitted into the general theory. Suppose there is nothing in the nature of a supply price for either of the two factors; none for capital, none for labor. Each goes its way somehow, both are used together in production, each gets what it can under the conditions of the given time and the given economic set-up. The quantity of either may happen to increase or decrease; it just happens. What then? The answer is quite unqualified: each will get a rate of return settled by its marginal contribution to the output (always assuming the whole mechanism to work smoothly). That marginal contribution is the difference which is made by the appearance or disappearance of a unit of either. The rate of return will be greater if the factor is relatively scarce, less if the factor is relatively plentiful. If labor be plenty the marginal contribution of a unit is likely to be small, if scarce it is likely to be large. Marginal productivity determines the rate of wages and the rate of interest. Further, the two shares between them exhaust the aggregate product at the margin. This last theorem is not so firmly entrenched as that with regard to each factor separately considered, but the mathematical economists seem to agree that it can be proved.

This way of applying the general theorem—non-committal about any supply price or any predictability of a persisting point of equilibrium—is the form in which the generally accepted theory appears in the economic literature of the twentieth century. So widely is it accepted that in text-books, summaries, compact popularizations it is usually presented as the truth once for all and the whole truth. The discriminating do indeed take pains to point out that it is only a theory, nay only a part of a theory. It is an initial statement, a preliminary approximation, a statement of what would happen if there were a very simple, sharply defined, settled body of facts. As regards a supply price for either labor or capital, nothing is said beyond indicating how the outcome would run *if* there were a supply price. Whether there be one is a mere matter of fact, which, if ascertainable and ascertained, can be readily incorporated into any empirical application.

The literature on this subject is enormous. The matter has been argued over again and again, in many aspects and by the keenest minds. It has come to be developed by the mathematical economists with the rigorous precision which attaches more to the conclusions of mathematics than to those of any other intellectual field. But mathematical conclusions always rest on hypotheses, and are applicable in the concrete only in so far as the particular hypotheses are in accord with the facts of the particular case. So it is with the reasoning which leads to the marginal productivity doctrine. It is in the nature of a first step toward the substantive conclusion. It means different things in the concrete according as one or another of the assumptions or hypotheses are in accord with the facts.

Bearing these general observations in mind, we may return to the formulation with which we started—that wages depend on the discounted marginal product of labor—and consider how far we can apply it. This formulation implies something about a supply price of capital, but nothing about a supply price of labor. The implication about capital is cautious. The evidence about the past and present of the supply price of capital is suggestive rather than probative. As regards the past it seems to indicate that the supply price of capital (or rather the marginal supply price) has been roughly constant for some generations; as regards the future the best guess is that it is likely to decline. As regards the supply price of labor the formula implies nothing. I leave it so deliberately at this stage. It may give some satisfaction to the reader if it be said, by way of anticipation, that as regards labor, the situation, while no more easy to make out with certainty than as regards capital, does seem for the future to be one of slowly rising supply price; while that for capital seems to be one of slowly falling supply price. Taking the general formulation and this empirical application, we reach a set of conclusions about distribution which is not cheerless. In the days when the price of labor was supposed to be always the same, settled by a standard of living not much above the minimum, and when capital was supposed to reap all the gains from material progress, economics was not unnaturally dubbed a dismal science. If the present and future be such as has just been outlined there is occasion for no such despair about the prospects of mankind under private property and capitalism.

§ 4. The fluctuations of wages above and below the general level are affected by the conditions under which the advances are made.

Here, as elsewhere in the economic field, the working of the fundamental force is obscured by others which, tho in a sense superficial, are yet of the greatest immediate concern.

The employers pay wages in money. The money is used by the laborers in buying goods and services—chiefly goods. Both the extent and the continuity with which money advances are made, and the state of the supply as to the goods bought with the money, affect the fluctuations in real wages.

The store of things from which come real wages—that is, the goods bought with the money wages—reaches the laborer's hands thru a flow, as indeed all income reaches the consumers thru a flow. We may use the simile of a reservoir, constantly drawn on and constantly refilled. The stocks of the retail dealers constitute a supply immediately available. Back of these are the stocks of the wholesale dealers; back of these, again, the goods in process of manufacture among the "producers." The very buildings and machinery may be said to contain—much as the raw materials do—the potentialities of future consumable goods. The whole stock of wealth in its various stages may be regarded, in the language of Böhm-Bawerk, as one great subsistence fund, of which a part only is available at once, the larger part being gradually made available by the steady pushing of the unfinished goods toward the stage of completion. So conceived, the whole mass may be described as a reservoir, from which the community is constantly drawing a stream of finished goods (and so of satisfactions), and into which its labor is constantly replacing what is drawn off.

The flow of finished goods or available real income is evidently elastic. The rate at which the reservoir can be tapped is subject to considerable variation. In one sense, the income of the whole community may be said to be predetermined; more cannot be got during a given period than the existing apparatus of production is capable of yielding during that period. In a sense, too, the income of any particular class in the community may be said to be predetermined, in so far as the inflowing goods are already adapted to the traditional tastes of different classes. But there remains a considerable degree of adjustability—more or less rapid flow, diversion of goods and materials toward one or another set of consumers—and hence a response of real wages to variations in the money advances from the capitalists.

The money advances from the capitalist employers, again, are affected by their expectations of gain. In times of hopefulness and activity, money wages will be paid out more freely, and the available supplies of goods will be drawn on with corresponding freedom. In times of uncertainty and depression the movement will be a sluggish one. In good times, tho prices often advance faster than money wages, employment is more certain and constant and real wages on the whole tend to become larger. The business men and the investors secure between them the excess of product over and above what has been advanced to the laborers. If the excess is large, and if competition among employers and investors is active, they will be led to make larger advances and wages will gradually rise. If the excess, tho large, is secured under conditions of monopoly or with the use of limited natural resources, the capitalist class as a whole will reap extra gains, but wages will not be affected.

In the long run the amount which can be drawn from the reservoir by the laborers will depend on what has been put into it, as well as on the competition of the capitalists among themselves. A high general rate of wages for hired laborers thus depends on general high productivity of industry—or, more precisely, on high marginal productivity—and on active competition among the owners of capital. Where laborers are not hired but work for themselves the relation between their reward and the productivity of their labor is obviously more direct and certain. As regards both hired laborers and those not hired, the broad differences of wages which appear in different countries are explicable on the same ground—productivity. To repeat what has already been said: if wages are higher in the United States than in England and Germany, higher in these than in Italy and Austria, higher in all European countries than in India, China and Japan, the explanation is to be found in the varying productiveness of labor in the several countries. So it is with the great changes in wages from time to time. Since the middle of the nineteenth century there has been a rise in general wages (commodity wages) in all the countries of advanced civilization, the basis for which has been the steadily growing productiveness of labor, resulting from the manifold advances in the arts.

Hence it is that wages are high in those communities in which the accumulation and investment of capital are great and in which the total income of the capitalist class is large. Plant, machinery, huge collections of materials, an elaborate apparatus of production, are the means by which high productivity of labor has been secured and a high rate of wages attained. It is true that in new countries other conditions also may bring about high wages. Labor in them is likely to be confined largely to agriculture and other extractive industries in which virgin resources are turned to account and in which there is comparatively little use of elaborate fixed capital. Such was the situation of the United States during the first century of its history; such was that of Canada, Australia, New Zealand. But in older countries the cause by which high wages are made possible—a high productivity of industry—is the employment of much capital which brings a large return to the capital-owning class. In the Western world the forces which have made the total income of society high and the general level of wages high have also caused the proportion of total income which goes to return on capital to become larger.

§ 5. Doctrines such as are presented in this chapter will seem to many a reader abstract, remote from the problems of real life, of no service toward understanding or settling the problems which face him. And this character they have. Other parts of economic analysis are of more immediate and direct significance for almost any of the questions that have perplexed legislators and thinkers during this the twentieth century. It is easy to perceive the relevance to everyday problems of some among our theoretic disquisitions; such as those on banking and currency, on international trade and international payments, the business cycle and the complications of investment; also (among topics still to be taken up) business profits and wages in particular employments as distinguished from the general rate. One or another of these has its bearing on industrial buoyancy and depression, monetary readjustment, labor struggles and labor policy. But the theory of the wages level stands aloof from questions of the day. It might seem that the last mentioned set of problems, those relating to labor, cannot but be better understood and better handled by the aid of a well-grounded theory of wages. No doubt the problems are better understood; but it is not certain they are better handled. When it comes to such matters of immediate concern as strikes and their meaning and effects, labor unions and collective bargaining, even social insurance—the best theory of wages we can set up, and the best that there is in such a theory, goes little way toward solving the immediate problems of legislation. As regards legislation bearing on the general level, something is beyond question contributed if we have an explanation of the great broad features of the present and of the possibilities of the future. But direct advice is mainly of a negative kind, on the futility of various illusory proposals. Something positive there is, chiefly in the way of stimulus to sober reflection.

§ 6. The outcome of the preceding paragraphs—that wages are the discounted marginal product of labor—has an optimistic tinge; optimistic, that is, if a lessening of inequalities in property and income is thought to be a goal. The prospect to which it points is the reverse of that envisaged when it is said that private property lowers the welfare of the mass of mankind and concentrates the gains from material progress in the hands of a few; that it makes inequality greater, not less.

It must be borne in mind, however, what is here meant by "inequality." The *rate* of wages, we say, may be expected to go up, the absolute amount going to the laborers *per head* to become greater. The *rate* of interest tends not to go up but rather to remain steady for considerable periods, and over long periods likely to go down. The absolute amount going to capitalists *per unit of capital* will not go up, probably will become less. But these statements imply nothing about the aggregate amount going to either group. The aggregate share of the laborers may not be in process of becoming a larger proportion of the total income of society, and the aggregate share of the capitalists, so far from being a smaller proportion of the total income of society, may tend to become greater.

The aggregate income of the propertied classes depends obviously on two factors: the quantity of capital, i.e. the total of "the advances," and the rate of discount on the advances, i.e. the rate of interest. With the same rate, their aggregate income tends to be larger as production becomes more "capitalistic"—that is, as production spreads over more time with the increasing use of plant and the increasing elaboration of materials. The inequalities of income tend in this sense to become greater as total income becomes larger. Within the capital-owning class itself inequalities will not necessarily become greater, for the number of persons owning capital may increase as fast as its amount increases and ownership may be no more concentrated. But the absolute amount of income going to this class tends to increase and its share of total income tends also to increase.

As regards the laborers, each will get more. Within their ranks, too, there will be differences in the gain. Some secure more, some less; conceivably some become worse off, while others gain heavily. But in any case the laborers as a whole tend to get a less *share* of the community's entire income. All this follows if we assume that capital increases in amount very much, and that while the rate of interest is slowly declining, that rate is paid on a total volume of capital which is steadily and largely increasing. It results from the obvious fact that the unit of labor is the laborer himself, while the unit of capital is not the capitalist himself but the unit of capital, of which a greater or less amount may be in the hands of the individual capitalist. On the whole an enlargement of the leisure class and a diminution of the proportion of the total income which goes to the laborers—these are the concomitants of material progress as it has gone on for the last century or two.

This tendency, inherent in the growth of capitalistic production, becomes accentuated in the degree to which there is departure from competitive conditions. Monopolistic gains (to be dealt with in the chapters that follow) also increase the proportion of total income which goes to the possessing classes. Tho they have not become so all-pervading as to wipe out the régime of competition, they have become of wider extent in modern times. Their growth probably tends to make inequality greater *within* the well-to-do classes, as well as for the entire capitalist class in comparison with the laborers. Like the growth of interest pure and simple, their increase is a common accompaniment of large-scale production and of advancing population. They are more readily subject to regulation and curtailment than interest, and hence are not so inevitably the consequences of modern industry. The tendency toward monopoly accentuates the general conclusion just stated, that an enlargement of the leisure class income and a diminution of the proportion of income going to the laborers are natural concomitants of material progress under the system of private property.

§ 7. What has been said in these chapters on interest and wages thus relates to the great abiding currents in the industrial and social movement. We live in a restless, fast-changing, turbulent world, far removed from any ideal of repose, contemplation, indifference to worldly goods. It is a world concerned most of all with material progress and with the ways in which the results of that progress affect men's daily lives and daily satisfactions. In the countries of private property its structure has been shaped gradually, tentatively, without deliberate planning. True, there is legislation on this point and that, tentative change here and there, based on some sort of plan and purpose. But on the whole the system has been left to grow for itself, with no conscious ideal of human happiness, no prevision of what may come. What it means for the present and the future is concealed beneath the froth and foam of the immediate impact—surface movements so obtrusive and so troublesome that they alone engage attention and stir to action. The science of economics is arduously trying to discern the deep currents which lie beneath the surface, and to follow and understand both. The ordinary man, even the most intelligent, sees the surface only and is hardly aware of what may go on beneath.

It is worth while to illustrate the significance of general remarks such as these by considering one momentous question. What possibilities are there in countries like the United States and the European countries of similar conditions for a large improvement in the welfare of the mass of mankind? Take the United States as the country where the prospects are as good as anywhere. In the first decade of the twentieth century the average earnings of employed wage earners in the United States was not over $600 a year.[1] In the post-war decade (1920–29) that figure was, in terms of money, much higher—something like $1500. If the needed correction is made for the higher prices of the later period the appropriate figure—that indicating the advance in real wages between the first and the third decade—would be perhaps $720, certainly not more than $750. That is, earnings in terms of consumable goods increased by something like twenty per cent. A standard of living indicated by such earnings is vastly better than savagery, much better than what was attainable anywhere a hundred or even fifty years ago. But it gives little above the bare physical needs, little chance for leisure, for spontaneous activity, for anything beyond the barest minimum of education and culture. It represents a mode of life quite intolerable for the fortunate minority of the "well paid" and well-to-do. But it does not represent the best that can be expected under the régime of private property. We may look forward to a continuation of the upward movement which has been in progress during the last century or two and has been maintained and even accentuated in the early decades of the twentieth century. Great as has been the advance of the arts, it promises to be even greater during the generations to come; more rapid in some industries than in others, in some countries than in others, necessarily slow in spreading its effects over the hundreds of millions of men, yet persisting in a way to counteract the pessimism of those who can see in the future as well as in the past nothing but a turbid ebb and flow of human misery. It is only on this sort of expectation that we can base a sober and restrained optimism or any confidence that the essentials of the individualist system will long persist.

[1] This is the figure per wage earner employed; the average for the family income would be higher.

CHAPTER 43

OVERPRODUCTION AND OVERINVESTMENT, CRISES AND BUSINESS CYCLES

§ 1. Overproduction in the sense of output beyond the possibility of use. The extensibility of wants; leisure.—§ 2. Overproduction in the sense of output beyond the stage of profit.—§ 3. Distinction between excessive investment of capital and excessive production of goods.—§ 4. Investment and the market for goods. The flow of money in relation to new processes and varied consumer's goods.—§ 5. Consumer's purchasing power; its relation to production and distribution.—§ 6. Hoarding by consumers and investors during depressions. The rich do not spend, the poor cannot spend. "Mass purchasing power"; its sustained increase not the cure for depressions. Other ways of applying a monetary stimulant. Other ways of combating depressions. Palliatives, remedies, preventives.—§ 7. The recurrence of revival and activity.—§ 8. Regularity of the business cycle. Conclusion.

§ 1. The present chapter is in part a digression. Its subject runs across almost the entire field of economics. It is connected with problems of production, of value, and of money, as well as with those of distribution. The usual reasoning about it touches more especially on the possibility of overinvestment, on the determination of the return to capital, and so on the determination of the wages level. Hence it is conveniently taken up at this point.

"Overproduction" may mean various things. It may mean the production of more goods than people care to use—more than they will buy at any price. Or it may mean more than can be sold (will be bought) at a price *yielding a profit*. We begin by considering the first. Is such a thing possible?

The negative answer commonly given by economists rests on the extensibility of human wants. It is true that the bare physical needs of man for food, clothing, and shelter are satisfied with comparatively little. If, with a possibility of further supplies, merely more of plain food, simple clothing, dry shelter were added there would soon be an excess beyond men's wants. But by varying the supplies, satisfaction can be added almost indefinitely. Refine the food, elaborate and vary the clothes and the house, and there seems to be no limit to what can be enjoyed. As Adam Smith remarked, "the desire for food is limited in every man by the narrow capacity of the human stomach; but the desire of the conveniences and ornaments of building, dress, equipage, and household furniture seems to have no limit or certain boundary." [1] Nothing is more extraordinary than the ease with which a man who begins with a small income and modest enjoyments accommodates himself to larger means, finds new openings for expenditure which soon crystallize into "needs," and complains of a "high cost of living" which merely reflects his own habituation to growing comfort or luxury. All this is the result of variety—the stimulation of new wants and the discovery of new ways of satisfying them. The great increase of productive power during the last century or two has meant necessarily a diversification of industry and a constant resort to new things or new refinements of things familiar. Many articles which were formerly luxuries are now everyday comforts and many which were formerly comforts are now deemed necessaries.

It is true that one of the wants to whose satisfaction additional means are turned is the mere love of distinction. Many things are valued, partly or wholly, for the simple reason that they are symbols of supposedly higher social station—dress, lavish entertainment, yachts, palaces. The expenditure for these is perhaps waste: waste, that is, in the sense that the satisfaction from them is elusive. On the other hand this very satisfaction, resting on emulation and ostentation, is one of the most universally prized by mankind and has been a most powerful stimulant to activity of all kinds. So far as the problem of overproduction is concerned, it matters not how great or enduring is the enjoyment secured, how far proportionate to the expenditure involved. It suffices that, as men are, their wants of all kinds are almost indefinitely extensible—for physical comfort, for aesthetic and intellectual gratification, for variety and amusement, for ostentation and display. There is no danger of producing more than they will at least think they want.

[1] *Wealth of Nations,* Book I, Chapter 11, Part II; Vol. I, p. 165, of Cannan's edition.

It should be said that reasonings and conclusions of this kind are by no means of universal application. They do seem to hold for the men and the societies of Western Europe in modern times —those whose ways are the main subject of a book like the present. How far they hold for ancient Greece and Rome it would not be easy to say, still less easy as regards the ancient civilizations of India and China. Nor can we say whether the ideals, ambitions, traditions of men in different stages of society are chiefly the results of an environment which has developed at haphazard, or whether they rest after all on inherent biological traits. Even in some industrial operations of modern times there are experiences which show the need of caution in applying the proposition that wants are indefinitely extensible. When the modern business man "develops" tropical regions he finds that the natives by no means stand ready to work on and on, in order to be able to satisfy more and more desires. When they have enough to eat and drink, some scant clothing and the simplest shelter, these untutored folk prefer to loll in idleness rather than to keep on with monotonous labor in order to satisfy further "wants." The colonist capitalist from the temperate zone will wish to stir them to added effort and will readily pay for it; but unless somehow new wants are stirred an increase of pay may make them work less, not more.[1] They may prefer more leisure or "laziness" to more goods—a consummation which the Western man also may quite conceivably reach in the coming centuries.

§ 2. It is not in this wider sense, however, that "overproduction" is commonly spoken of. Trouble arises, it is contended, not from the production of more things than can be used but from the production of more things than can be *sold at a profit.* The difficulty, it is said, is one peculiar to our modern capitalistic society, which finds itself in difficulties because of its very achievements. More is produced than can be disposed of to the capitalists' ad-

[1] I have had conversations with men who have managed banana plantations in Central America and have exerted their ingenuity to find for their "company stores" articles that would tempt the native laborers to bring in more of the bunches of fruit for which they are paid by the piece. Cheap jewelry, cloying sweets, and droning phonographs (which seem the most effective bait), all "wake those fellows up and keep 'em at work."

vantage and loss ensues from the enlargement of the very operations which were designed to bring added gain.

Overproduction in this more limited sense, of course, is possible for any one industry and any one commodity. It is familiar experience that more bicycles or more silks may be produced than can be sold at a profit. Mistakes and miscalculations will occur. But sooner or later the remedy would seem certain to come quasi-automatically. If more is produced of any one thing than can be sold on profitable terms the production of that thing will be diminished. Sooner or later—perhaps after a considerable interval, if the operations involve large plant—some of the producers will withdraw, supply will lessen, price will rise, and the overproduction will cease.

It is maintained, however, that this avenue of escape is not available where *all* industries are pouring masses of goods on the market at the same time. True, if a few industries only are producing beyond the point of profitable sale, labor and capital can be and will be transferred to others not thus embarrassed. But there is no such remedy, it is said, if those others are in the same quandary. And a tendency there is for all industries to reach the stage of production beyond the point of profit; if not permanently, at least recurrently. Modern plant and machinery pour forth consumable commodities in huge amounts. While the machinery is in the process of making there is demand for iron, timber, and other things, and there is profit in producing these. While the machinery is in the first stages of being used there is further demand for materials like coal, wool, cotton, and the like, and again profit in producing these. But when the consumer's article—clothing, say—is finally put on the market in vast quantities it cannot be sold on profitable terms. This difficulty is all-pervading if each and every consumer's good is poured out in the same abundance. There is overproduction, stoppage, and shut-down, reaction in turn on the making of plant and materials, cessation in the industries which will produce these, and general depression. The recurrence of commercial crises in this way is to be ascribed in the main to overproduction.

In all this familiar description there is confusion between the two essentially different things: on the one hand, investment beyond the point where a return to capital can be maintained; on the other hand, production beyond the point where a market for goods can be found. There is confusion in other ways also. There is failure to distinguish between the short-run and the long-run happenings, and failure to distinguish between the effects which are the results of an ill-working and jumpy system of credit and money and those that follow from a maladjustment of the concrete capital equipment of the community. On all these matters it cannot be said that the economists—even the best of them—are in agreement. The problems range in almost every direction and involve reasoning that is hard to follow as well as matters of fact on which we are not adequately informed. In the following pages I shall try to keep separate the various turns which the debates have taken and to state more particularly the conclusions which seem to hold in the long run. On the short-run aspects there is least certainty and least agreement because, curiously enough, these phenomena, while immediately under our observation, are the most obscure.

§ 3. First, consider the proposition that accumulation, investment, production may proceed on all sides and for all goods to the point where each and every consumable article is turned out in quantities impossible to sell at a profit. Let us suppose this sort of thing to be done on a scale so great as to bring out sharply the consequences.

When accumulation (or "saving") and investment take place on a great scale an enormous flow of purchasing power or "money" is turned to the buying of plant and machinery, and of materials for making these. There is a cessation or slackening of consumer's expenditure. With this change in demand there ensues a corresponding change in the direction of production. The industries producing machines and raw materials will be profitable and the luxury-making industries unprofitable. Labor will be turned from the one to the other. Saving and investment do not mean that labor fails of employment or is less employed but merely that it is employed in a different way.

Before long, however, the plant and machinery must be used;

that is, turned to making more of consumable things. What sorts of consumable things will be in demand? Not such as are adapted to the demands of investors and savers (presumably the well-to-do). These, by supposition, no longer buy for enjoyment; they reduce expenditures on consumer's goods. The laborers, however, have passed no self-denying ordinance. For commodities adapted to their needs there is an unlimited market. Obviously, in order to induce them to buy, things must be of the sort they fancy. But there is no difficulty in disposing of the goods fancied if offered cheap enough. Until the masses of mankind come to be in a vastly more prosperous condition than has been dreamed of in all the utopias, an indefinitely extensible market can be found for goods adapted to their use.

But it is true that the things sold to laborers, as the quantity of them increases, must be offered at a lower price. If the whole process of enormous saving and correspondingly modified production is carried on relentlessly, in the end all the goods for laborers' use will be sold without profit; nay, if it be really relentless, at a loss. There will be universal overproduction, not indeed beyond the possibility of sale but beyond the possibility of sale at a profit.

The real cause of difficulty in this sort of situation evidently is overaccumulation and overinvestment. The essence of capitalistic investment is that advances are constantly being made to laborers and that the laborers are constantly producing more than has been turned over to them. The supposed increase in savings and the decline in luxurious expenditure would bring it about that greater and greater amounts were paid to laborers than before. If this heaping up of advances were carried to the limit, the amounts produced by the laborers would barely suffice to replace what had been advanced to them. To put it in another way: before the process begins part of the laborers are engaged in making commodities for the capitalists' consumption and part for the consumption of the laborers themselves. After the process has gone its extreme length all the laborers are engaged in making goods for each other. The laborers are then consuming all that they produce and there is no return to capital.

The very statement of such an outcome and of the steps by which it might be reached shows how improbable it is. The thing is conceivable, but so improbable that it may be declared virtually impossible. It assumes that saving and investing go on blindly and quite irrespective of any return. But it is absurd to suppose that accumulation would continue unabated if it resulted in no return at all. The very sort of pressure which is supposed to bring about this universal disappearance of profit would bring quasi-automatically its own relief. As interest fell more and more of the well-to-do would conclude they might as well spend as invest; would buy houses, pictures, automobiles, champagne, what not, and would cause labor to turn to making such things. A balance would in due time be restored by the making of less goods for laborers' consumption and by the reappearance of profit and interest in all branches of production.

§ 4. There is more to be said. This extreme case may indeed show that, if we follow to its logical outcome the reasoning about overproduction as the consequence of unrelenting investment, we are not brought to the alleged impasse. But the questions that perplex the observer are not thereby disposed of. We *seem* at least to be confronted by two things which we should not expect to find side by side: on the one hand, increasing accumulation and enhanced productive capacity; on the other, shrinkage of purchases by consumers. While it may be reasoned that an eventual collapse of the whole capitalistic structure is not thereby threatened, we are faced by the recurrence of jolts and breakdowns in which both phenomena appear again and again—excess of investment all around, insufficiency of consumer's purchases all around. These two we will take up in order.

Accumulation in modern times does proceed blindly and almost automatically. Savings are made and are invested largely because the habit of doing so has become ingrained among the possessing classes and because the mechanism for the first steps in investment has been so perfected—public and private savings banks, investment bankers, stock exchanges. Hence for familiar and tested sorts of undertakings "capital," in terms of money, is always available, apparently without limit. And in these undertakings (the familiar ones) there is a great and almost unceasing pressure of competition and a tendency toward "overproduction" —that is, toward putting on the market more goods than can be sold at a profit. The tendency is not peculiar to industries which produce commodities for laborers' consumption. It appears in any well-established industry, or rather in any industry conducting its operations in a well-established way. The return to capital is within a handbreadth of the minimum; there is constant danger of something like "overproduction." And this in turn threatens industrial irregularity and uncertainty. It brings stoppage because of disappearing profit; resumption after a while in the hope of restored profit; unwillingness to abandon the physical capital entirely, yet inability to maintain it with a profit.

The path of escape from the threatened impasse is easy to discern. It is by change, at once in the methods of production and in the direction of production. Change in the methods of production is often taking place even in the established industries. In this modern day it seems even to go on without pause. So long as improvements are made, of a kind involving more capital (that is, more application of preparatory labor in "roundabout" methods), there is an opening for a return on a larger investment at the same time with a cheapening of the articles. This assumes, to be sure, an elasticity of demand not less than unity—that so many goods can be sold at the lower prices as to make the total expenditure on them at least as great as before. True it is that many of the familiar articles may not find a state of demand favorable to the disposal of an increased output. Often, perhaps commonly, the goods have become so plentiful that the range of output within which demand is elastic has been approached or even passed. The point of satiety begins to be in sight,—a stage which indeed must sooner or later be reached for every article as more and more of it is put on the market. Hence it is the other kind of change that serves chiefly to fend off the danger: change in the direction of industry. This means the ferreting out of things that tempt people to new ways of spending. The novelty need not be in the arousing of new desires. It is enough if there be a new and better way of filling a familiar want, like the electric light or the electric refrigerator; or indeed mere variety, as in the case of food. Nothing is more indubitable in the increase of abiding satisfactions between medieval times and modern times than the variety in foods made possible by the new methods of transportation and conservation.

Some of the changes, on the other hand, are of a kind that almost amount to the discovery of a new want. Doubtless the elemental propensities of mankind are unchangeable; yet it may be said with truth, for the purpose in hand, that the telephone, the radio, the automobile, have stirred people in new ways, aroused in them pleasures quite new. At the same time the production of these new things has been accompanied, nay has been made possible, by changes in the processes of production which have involved more capital, more plant, instruments more expensive, and so have opened the way for ever-increasing investment.

It has sometimes been said pessimistically that all the inventions and machinery of civilization have not improved one whit the material welfare of the mass of mankind. Yet he who will observe what are the commodities now produced for the masses and compare them with the slender list of things available even for the richest but a century ago must see how mistaken is the statement. It is more nearly true that the toil of most men has become no less; what they get for their toil is more. There has been a vast gain in the abundance and variety of the goods which yield satisfactions. And, to repeat, the process by which this gain has been secured without running into universal overproduction has been that of accumulation, invention, improvement, on the lines not only of better and larger plant and equipment but of greater diversification in the articles produced.

§ 5. Turn now to the matter of consumer's purchasing power in its connection both with economic theory at large and with monetary theory.

For economic theory the main thing is simple and clear. Consumer's purchasing power rests on their producing power or, to put it better, it is but another side of the same thing. One of the old commonplaces of economic literature—easy to understand and easy to forget—is that where the division of labor and production for exchange are all-pervading, each and every thing produced is demand and at the same time is supply. Looked at from this point of view—that trade is at bottom merely barter—supply cannot outrun demand. There can be no universal overproduction, no lack of balance between what men produce and what men can pay for. This is simple and obvious; it helps to understand the meaning of production and exchange. But it carries us little way toward understanding the difficulties which arise when the machinery of production gets out of balance and the monetary mechanism gets out of order.

We come closer to the real problems when we consider the relation between the demand (i.e. the purchasing power) of particular groups of laborers and the product which that group or class turns out. The purchasing power of the workmen is what they get as wages; and what they get as wages depends on what they produce. But what they produce is, for the purpose of the present reasoning, not merely a physical matter. It depends on marginal productivity in terms of value, i.e. of purchasing power. This holds for the great groups which we label as non-competing and not less for the other groups, still large, of men in the several industries, such as miners, carpenters, bricklayers, masons and iron workers, textile workers and so on. It holds for the profits of business managers, the earnings and salaries in the professions, the return to capital in the way of interest. All this has been the theme of the prolonged discussion of distribution in the preceding chapters, and in applying it the reader will bear in mind what has been said in the way of qualification and explanation. Most of all it must be borne in mind that the general proposition bears on the underlying and slowly changing forces that bring about the extraordinarily varied incomes of different sizes and kinds in modern societies. It depicts not an unchanging situation, yet one in which changes come slowly. The governing forces in distribution are in the end the marginal productivities or efficiencies of the several factors. What workmen get as wages depends on what they produce; on that depends their income for spending, their purchasing power as consumers.

This carries us nearer to the realities, yet by no means reaches the goal. While the analysis seems to hold in the long run, things happen in the short run which do not fit.

Suppose there is overproduction in a considerable range of large industries. More is turned out, if the concerns work at normal capacity, than can be sold at a profit. Plants shut down or work at half capacity. Less men are employed. Both the men and the owners—partners or stockholders—are less able to buy. All this happens frequently and on a large scale. Consumer's purchasing power declines. And this decline is not offset for the time being, nor indeed for a good long time, by an increase of purchasing power elsewhere. Other industries, not directly affected, have been turning out goods for the people in the industries now depressed and declining. These people are no longer good customers. It might be alleged that, not being directly affected, they might go on selling among themselves as much as before. But so far as they produced for the people who have been hit, they too cannot sell as much as before. The situation is like that following an earthquake or a calamitous flood. The industrial structure is shattered at one of its working parts and the other parts cannot go on at the same pace and in the same way. Production has come to be out of gear with the former play of demand. The greater the range over which it is awry, the farther do the effects reach.

A readjustment is to be expected as time goes on. It may be said that it is sure to come in the end. But in our days of large plant and great stocks of materials and goods in process the time may well be long. It would be going too far to say that during the period of unsettlement each and every industry is producing at a loss or even that each is depressed and shortening sail. But there is enough of this to explain the feeling that all around there is overproduction beyond the volume of purchasing power.

§ 6. We have now reached the monetary questions. In times of depression purchasing power in terms of money lessens. The visible and measurable volume of money shrinks. In a country like the United States, the deposits above all shrink; and their rapidity of circulation, also measurable tho not so easily, also shrinks. Money is hoarded and especially bank money. Much of it sticks in banks, some of it in purses and safe deposit boxes. This stickiness, hoarding, this decline in velocity of circulation, has two consequences. One is that people are slow in spending as consumers; the other, that they are slow in spending as investors.

Spending by consumers becomes hesitant and slow because of the general feeling of uncertainty. It is largely a matter of psychology and, as with all psychological moods, tends to be overdone. People become scared as business depression sets in and goes on, and spend less than they might—wear their old clothes, keep their old pots and pans, refrain from dispensable comforts and luxuries. After a while they begin to catch up and it is in accord with psychological trends that at some unexpected turn they should do so with a rush. The doings of producers, especially in the range of the industries which turn out the familiar goods, are inevitably affected by these hesitancies and irregularities in spending.

The other aspect, that of spending by investors, rests on essentially the same element—industrial and financial uncertainty. It too has largely a psychological background. But the uncertainty here is not so much about the *amount* of income one can spend without worrying as about the *way* in which one can spend an available income by investing part of it. A repeated experience of depressions is that in their course people do not stop saving. They pile up their accumulating income in savings banks and commercial banks. If they do invest it is likely to be in the purchase of seasoned securities. The rate of return on gilt-edge securities of all kinds goes down and their selling price goes up. Banks find that the lodged deposits awaiting investment accumulate. Reserves increase and "short-term money" is especially plentiful.

"While the poor cannot spend, the rich will not." This is supposed in many quarters to be the gist of the problems of depression. It is a widespread opinion that the troubles are the effects once for all of wide inequalities in distribution and that the remedy is to be sought in this direction. Get the money out of the hands of the rich, put it into the hands of the poor, and all will be well. During the great depression that followed the crash of 1929 the one great cause of depression was commonly thought to be the lack of "mass purchasing power." The main cure hence was sought in public works, relief distributions, higher money wages, spending in any way that would put money into the hands of the masses.

Now it would be going altogether too far to say that steps of this kind are either unwarranted as remedies, or quite futile even tho not in the nature of remedies. Merely as charity, as relief for distress and suffering, they stand on a ground of their own. In this aspect the debatable questions that arise are on the best means of administering relief. And as regards futility also—the more strictly economic question—they are not to be set aside once for all. The phrase "priming the pump" was often used and the analogy may fit. The economic machine might thus be set going, in the expectation that an initial impulse would lead to a steady and sustained movement. Just how much in fact was achieved by this sort of procedure in the decade of the thirties—how much in general can be thus achieved—it is impossible to establish with any certainty. In the main it would seem safe to say that the operations served chiefly as a palliative and were of no considerable effect as stimulants toward permanent cure. They may have started the pump but it did not keep going.

Looking at the long run and the problem of remedies, I cannot believe that the increase of mass purchasing power—that is, a permanent redistribution of income on a large scale—is a procedure which reaches the underlying causes of industrial cycles. A lessening of inequality in wealth and income may be regarded as a main goal of social policy, but it is not a promising remedy for the cyclical fluctuations. If the program were fully carried out—if the distribution of wealth were radically and permanently altered, if the incomes now low were greatly raised and those now high were much cut down—there would obviously be a change in the direction of the productive forces. More labor and capital would be turned to providing goods and services for the poor, less for those of the rich. Assume this to be done, and disregard too the pains of transition to the new stage. When it is all carried out to the full and the new stage completely achieved, there will be a different assortment of real income, adjusted to the new play of demand—more goods of the kind the masses demand, less of the kind demanded by the rich. But this situation would not necessarily or probably be exempt from change or disorder. Only if there were rigidly controlled stabilization, no novelties and no changes of taste and fashion—then indeed it would be much easier to deal with cycles.[1]

The increase of mass purchasing power may be of effect as a stimulant. It is likely to be of less effect if repeated. If one primes the pump again and again, there will be no underlying water left. If one redirects the whole economic current as a cure for social ills the significance of the wide-reaching change in distribution lies not in the realm of cycles and depressions. It lies rather in that of an entire remodelling of the whole social structure. The problems become those of socialism, not those of a betterment of the system of private property.

The same sort of doubt and criticism must be faced, I cannot but believe, as regards measures of quite different sorts which have been urged for the mitigation and prevention of business cycles. Such are changes in banking legislation and administration, resorted to so largely in the United States in the thirties—modifications of the laws on currency in the direction of more plentiful money and higher prices, such as the great devaluation of 1933; open-market operations and the like by the Federal Reserve system; huge loans by the federal government. The immediate effects of these measures on industrial revival are uncertain; the ultimate effects lie mainly in a different field from that of the business cycle.

When it comes to cures or preventions—anything analogous to the defensive serums which medical science has devised—unfortunately we are not less in doubt. The processes of investment may be made more healthy by legislation on corporate organization and management and on the way in which the banking system is hinged on the processes of investment. The establishment of the Securities and Exchange Commission for the regulation of security issues and of transactions in them, and the strengthening of the Federal Trade Commission were steps in the right direction. Something may be done thru the diffusion of knowledge on

[1] Compare what is said below in the chapters on Socialism, Chapters 67, 68.

the fundamentals of economics—on capital, investment, money and banking, the mere history of the business cycle. Imperfect as economics may be, more enlightenment will come if its results are understood than if they are ignored. To resort once more to the medical simile: a trained physician knows more and can be trusted more than an ignorant quack; which is not inconsistent with admitting that the physician still has much to learn and occasionally may learn something from the reckless activities and quasi-experiments of the quacks.

A better understanding of this whole range of subjects is perhaps reached by continuing our analogies and especially those having a medical or physiological slant. The economist, like the physician, can distinguish between procedures of various kinds—between palliatives and stimuli, remedies and cures, regimen and prevention. Mere relief for the unemployed is a palliative. So is legislation for compulsory reserves, which is the essence of insurance against unemployment.[1] Large public works are also palliatives; they may act as stimulants too. Both of these—reserves and public works—are helpful, yet neither can be continued indefinitely.

§ 7. One thing seems to be certain. Recovery does come. There is revival, readjustment, buoyancy once more. But then the same round or one very similar is likely to be repeated. The old and familiar industries again expand. Even those whose ways are obsolete and superseded by new ones—like the surface traction systems for passengers in cities—look up for a while and go on as before, regardless of their being topheavy and unprepared to face a new storm. Those among the familiar industries which have prospects for better endurance once again expand, like the cotton, wool, silk industries, threatened by the growth of the synthetic textiles, yet so far as one can now judge not in danger of being completely superseded. Much the same is the case with the railways. The newer industries, the automobile for example, not only ex-

[1] The statement may need qualification; it is possible that legislation of this sort may be devised in such way as to bring pressure on employers toward continuity and regularity of operation. It is not clear whether this can be effected to any great extent. So far as it can, there is something in the nature of a remedy, more than a palliative.

pand but are likely to expand too fast. That they should push forward is healthy growth, part of the "order of nature." It is in the variety of goods and the added spice to life brought by them that we find the "natural" and profitable development of productive power. But as the business and investing world at large gets to know about them capital is attracted that way, expansion proceeds apace, the possibilities of the future are exaggerated, the new industries become familiar, and they also are carried farther than is in accord with the demand. Eventually, satiety is approached here too. The industrial structure again becomes ill adjusted and unable to stand firm when an ill turn comes. Parts of it collapse, other parts get awry, and the old tale of crisis and depression has to be told once more.

The regularity of this recurrence is more surprising than the mere fact of repetition. Tho the regularity is not complete, in the rough it is not to be mistaken. It has been explained on various grounds. Sometimes the explanation runs in psychological terms: the alternations of optimism and pessimism, the psychology of the crowd. Again, something is ascribed to the fact that every decade or two there arises a new generation of business men who have forgotten or never learned the lessons of the previous crisis and go ahead as if nothing of the kind had ever happened. It is like the attitude of youth toward war; the horrors and miseries of the past are forgotten or not realized, and pugnacity, adventure, glory spur to another round. When all is said, the regularity of the modern business cycle is not easily explained. Not only the familiar cycle of 10–11 years is surprising but the regularity of an intermediate cycle of something like 40 months and (tho this may be mere speculation) that of even longer waves stretching 40 odd years from one to another. Our understanding of this side of the matter is still imperfect. The suggestion made by Jevons in 1870 that the regularly recurring spots on the sun might explain the 10-year business cycle was long thought quite fanciful, but possibilities of this kind have received more respectful attention as the evidence of astronomical and meteorological regularities is more thoroly scanned and then compared with economic fluctuations.

§ 8. What remains clear is that while the recurrence of the industrial crises may be in some degree connected with physical phenomena beyond our control, they are connected even more with features in our economic system about which something might be done. They are among the pains of growth, a phase of the uneven march of progress. Their ill consequences can be palliated; that is comparatively easy. They could be prevented entirely if we were content with a quite stationary state, in which the economic mechanism would go round and round in the same unchanging ways from year to year, decade to decade, generation to generation. No such situation is likely to appear either under the institution of private property or under that of socialism. But changes and readaptations can be made less headlong and misdirection can be checked. Some control of investment operations at the hands of great public banking institutions is nowadays deemed the most promising device: a check on rashness in times of boom, promotion of sober and well-planned investment in times of depression. The last named—promising investment—is most effective toward promoting revival if directed to ventures of a novel or growing kind which fit into the community's developing demands. But it remains to be seen how far a policy of this kind by the great banks can be carried out with such judgment as to bring industrial changes in the desired direction. However well this powerful instrument—great central banks—be handled, it is improbable that false steps in industry will be completely prevented or the right steps unfailingly taken. Mishaps in industry will continue and with them very likely the ups and downs of a rhythmic kind. The effects may be mitigated better than in times past and distress allayed better. Yet the same phenomena are likely to persist, less in volume but not essentially different in character. They are part of what we must pay for continuing industrial progress.

CHAPTER 44

RENT, AGRICULTURE, LAND TENURE

§ 1. The theory of surplus produce or "rent." "Rent" and "rental." Rent does not enter into the price-determining expenses of production. Rent is not the specific product of land.—§ 2. The existence of rent is dependent upon diminishing returns from land. Advantages of situation as affecting rent.—§ 3. Qualifications of the principle of diminishing returns: a possible stage of increasing returns; specific plots alone to be considered; the proposition refers to physical quantity of produce, not to value; a given stage of agricultural skill assumed.—§ 4. Are there original and indestructible powers of the soil? Predatory cultivation; intensive and extensive agriculture. Inherent differences tend to be lessened, but do not disappear.—§ 5. The extensive and intensive margins for land compared with the discrete and conceptual margins for capital.—§ 6. Land and capital compared.—§ 7. Land tenure. Cultivation by owners, each with moderate holdings, of great social advantage.—§ 8. Should the community appropriate or retain for itself agricultural rent?

§ 1. To understand the reasoning of the present chapter the reader should turn back to Book I, Chapter 13. There value under the conditions of differing cost and diminishing returns was analyzed. Equilibrium of supply and demand is found under these conditions when marginal cost and marginal vendibility are equal. Stated in simpler terms, the long-run cost of the most expensive portion of the supply regulates the long-run value of the whole supply.

It follows that those who produce at lower cost secure more than ordinary gains. Referring once more to the diagram (Vol. I, p. 166) it will be seen that the marginal producer at *B*, who sells at the price *BP′*, secures the ordinary gains on capital and the ordinary remuneration for labor—whether his own capital and labor or labor and capital which he hires at interest and for wages. If he did not secure such gains he would sooner or later withdraw from the industry. The producer at *A* has smaller expenses of production, measured by the distance *AA′*, and it would be perfectly possible for him to continue operations at the price *AA′*. The producer at *O*, who has the greatest advantage of all, could continue operations if the price were as low as *SO*. Both sell, none the less, at the ruling price $BP' = PO$—the price which must be paid in order to make it worth while for the producer at *B* to keep on and which must be paid in order to bring about equilibrium. The difference between the larger sum *BP′* and the smaller sums *AA′* and *SO* measures an extra gain for the more advantageous intramarginal producers. The total gain to all these fortunate persons is indicated by the area, of approximately triangular shape, *PP′S*.

This additional amount, secured by those producers who have advantages over the marginal producer, is commonly called "rent" by writers on economics because it usually arises in connection with land. It has been proposed to call it "producer's surplus." In ordinary parlance rent signifies a sum paid by one person to another for the loan or lease of any durable thing, such as a tract of land, a house, a piano. Its use by English-speaking economists to signify producer's surplus, with special reference to land, has gone on for several generations and on the whole has served to affix to the word "rent" this technical sense. It is true that "producer's surplus" is more apt, and that the technical meaning of rent has the disadvantage of conflicting with everyday usage and so of leading to misunderstanding among those not familiar with the terminology of the books on economics. On the other hand "rent" has the advantage of brevity and the sanction of long-continued usage by the best-known writers. It will be used in this book in the technical sense. Where there is danger of misunderstanding it will be spoken of as "economic rent." I shall try to use "rental" for the popular sense just indicated—the gross payment for the use of a durable thing—and hope that in any case the context will indicate the meaning.

Rent forms no part of the expenses of production; that is, it forms no part of those expenses of production which affect price. It is a differential gain, an excess over and above the total expenses of the more fortunate producers. Price is determined by the cost of the marginal increment. Rent is not one of the factors bearing on price but is the result of price. It arises because of the comparatively high price which must be paid to bring out the total supply.

It is true that rent commonly seems to enter into the expenses of some producers. Suppose that a producer at the point *O*, possessed of a source of enduring advantage—say a fertile or advantageously situated plot of land, does not wish to carry on operations himself but lets his land to someone else. That other person will be able to pay him for the use of the land an amount measured by *SP*, or the total rent. Not only will he be able to do so, but he will be compelled to do so by competition. On that land the amount *SO* suffices to meet all the expenses of production, including remuneration to labor and adequate return to capital. If the owner offers it for use by tenants they will bid against each other for the land up to the point where they will retain for themselves the usual return for labor and capital; that is, they will bid a rent up to the amount *SP*. Thereafter the tenant, having contracted to pay *SP* as rent, will say that his expenses of production are no less high than those of the marginal producer at *B*. Tho he pays less out for labor and the like he pays rent, which the marginal producer has not to pay. From his point of view, rent is as much an expense as wages and his total expenses are no less than those of any other producer. But all payments of rent, tho they are called expenses by such tenants, clearly stand in a different relation to the price from the expenses at the margin of production. They are the consequence of lessened expenses within the margin, not the cause of price at the margin. They equalize the position of different persons no one of whom is so fortunate as to own an advantageous source of supply. For the person who does own such an advantageous source they form an extra gain, which is secured equally whether he exploits his advantage on his own account or receives a payment from another who bids for the privilege of using it.

The typical case of rent, and the one which serves most readily to illustrate the principle, is that of agricultural land. Suppose that the producers at *O*, *A*, and *B* have farms of different fertility. The same application of labor and capital yields at *O* 25 bushels of wheat to the acre, at *A* 20 bushels, and at *B* 15 bushels to the acre. The price must be such as to make wheat raising at *B* worth while; otherwise the total supply will not be forthcoming. The supply which can be raised at *O* and *A* is limited and an additional supply must be got at *B* before an equilibrium of supply and demand is reached. The price is high enough to bring normal returns to the producer at *B* for 15 bushels to the acre. The receipts from 15 bushels also suffice to cover the expenses (including usual return to capital) for the producer at *A*. The extra 5 bushels got from his land thus constitute an extra gain for him. Similarly the extra 10 bushels at *O* yield an extra gain for the producer at *O*. And if the owners of *A* or *O* chose to let their lands, instead of cultivating for themselves, they could secure rents of 5 and 10 bushels to the acre or the equivalent in money price. It is immaterial whether they secure the advantage from the better site in the one form or the other.

Rent is sometimes said to be the specific product of land. In the same way, as we have seen, interest is often said to be the product of capital and wages the product of labor; and thus three elements in distribution—wages, interest, rent—are set against three factors in production—labor, capital, land. But this phraseology is to be used with caution. The reasons for questioning it with regard to capital have been already stated.[1] Labor applied in some ways (thru the use of tools) yields more than labor applied in other ways; in this sense only is there a productivity of capital. The same care in the use of the term should be observed in the case of land. Labor on some land yields more than labor applied on other land; in this sense only is there a productivity of land. If land were unlimited in supply and all were of uniform quality the natural forces inherent in it would still be directed and utilized by labor. But there would be no differential return on any plot of land, no emergence of rent, no notion of a separate productivity of land leading to rent. Rent arises because of the limitation of the better sources of supply, because of differences in the amounts brought forth by equal quantities of labor.

§ 2. Such is the fundamental principle of rent. But it requires

[1] See Chapter 38.

many qualifications. These concern the kinds and causes of difference in productiveness and need separate consideration. The case of agricultural land, which has been used most often to illustrate the principle, will engage our attention for the rest of the present chapter.

Unless there were a tendency to diminishing returns from any one plot of land there would be no such thing as rent. If the better sources of supply could be pushed indefinitely without lessening of yield—if more and more labor and capital could be applied to a given plot of land and could always bring an increase of product proportionate to the additional outlay—then those better sources of supply alone would be resorted to. The less good lands would be left untouched and all agricultural produce would be got from the best lands. The fact that this is not the case—that good lands, mediocre lands and poor lands are cultivated side by side—proves that at some stage there appears a tendency to diminishing returns from any one plot of land.

When additional labor and capital are applied to cultivation it may be a matter of indifference whether they be applied to poorer land or to the better land under poorer conditions. In the preceding section three grades of land were assumed, having yields, for the same application of labor and capital, of 25, 20, and 15 bushels to the acre. But it might also be supposed that the three applications of labor and capital were all made on the same land, yielding successively diminishing returns in the ratio of 25, 20, 15. In either case the marginal product is 15. In either case the 15 bushels constituting the last installment will not be brought to market unless the price is such as to make their production worth while; hence, in either case, the other installments bring a surplus or rent. And thruout the *margin of cultivation* is that stage in production where only the normal returns to labor and capital are secured. The margin is said to be extensive when plots of poorer land are resorted to; it is said to be intensive when more capital and labor are applied under less favorable conditions to the same land. Difference in yield would appear and therefore a differential return, even tho all land were originally of the same quality. In fact there is never such a thing as equality in the natural endowments of land. Some land is better than other; hence there is both an extensive and an intensive margin of cultivation.

Differences in situation have the same effect as differences in fertility. An apt illustration of the effects of situation (first elaborated by the German economist Thünen) is got by supposing all land to be of the same quality and to be situated on all sides of a central city to which its produce is brought for sale. Imagine concentric circles to be drawn about such a central point. Evidently the land in the nearer rings has an advantage over that in the more distant rings. All the produce is sold in the central market at the same price; but that from the more distant land has to bear a higher cost of transportation and its cultivator must be reimbursed for this. The owner of the nearer land has an advantage which causes rent to arise.

The advantage of situation is obviously less the lower the cost of transportation. The cheapening of carriage in modern times has greatly diminished the importance of situation rent. This is strikingly the case for all agricultural produce—grain for example —which is easily transportable. Refrigerating apparatus and fast freight facilities have made it possible to bring meat, milk, fruit, vegetables, from very distant sources of supply; yet the nearer lands still have some advantage from the situation. If the rates of transportation should be the same for all distances the advantage would disappear. The railways which bring the milk to some of the large cities of the United States adopted at one time the practice of a "postage stamp rate"—that is, an even charge on all shipments, distance being disregarded. So far as they carried out this method, advantages in situation and consequently economic rent resulting from situation were done away with for milk farms. As it happened public authority was appealed to by the owners of the nearer lands to prevent this practice, it being alleged that it was unreasonable and unjust to fix rates of transportation without regard to distance. The Interstate Commerce Commission sustained this contention and forbade the postage stamp rate; tho it would seem to have been to the advantage of milk consumers and not in violation of any sacred or inalienable rights of the nearer producers.

§ 3. We proceed now to some qualifications and explanations of the principle of diminishing returns.

In some stages of agriculture it may not appear at all. There are circumstances under which additional applications of labor and capital may yield for a time not less in proportion but more. This is most likely to occur where a people advanced in civilization suddenly takes under cultivation virgin land, as has been the case during the last century in the United States and in other new countries. In the first or pioneer stage, cultivation for such a people often proceeds under difficulties. A second stage is reached when more labor, more elaborate clearing and draining, more expensive agricultural implements, are put on the land; and then only is the largest return per unit of labor and capital attained. The question may be asked, how it happens—if this be the case—that additional lands are taken under cultivation at all before the stage of maximum productivity is reached on those previously resorted to. The answer is that the pioneer farmer looks not only to present yield but to the coming years when, as owner of the soil, he will possess much land in good condition. It is the lodestone of complete ownership that attracts men to the breaking up of the wilderness. But the stage of increasing returns which the process of settlement thus involves is but a temporary one—temporary, that is, in the industrial life of a community. Before many years still another stage, and one enduring indefinitely, is reached: the time comes when the land, tilled in the more careful way of the post-pioneer stage, begins to cease responding to more intensive use. Diminishing returns show themselves and agriculture reaches what we may consider its normal condition.

Next it is to be observed that the tendency to diminishing returns holds good only of a specific plot or specific plots of land. It does not necessarily follow that modern communities in general have to face difficult conditions. There may be additional plots of available land, no less good than those already used. The opening up of new regions was the first stage in a series of discoveries and improvements which had far-reaching consequences. It has greatly affected the older countries of Europe as well as the new countries themselves and has given rise to the knotty problems already considered[1] about the advantages of the trade between them. In the broad sweep of history these are but temporary deviations from the permanent course of things; but for recent generations they have been of great consequence.

Further, the proposition that returns tend to diminish is to be understood as referring to physical quantity of produce, not to value. It means that less bushels of wheat or of corn are got, less pecks of potatoes or peas, not that the cultivator gets a less money return. Indeed it is part of the proposition that he get an undiminished money yield. The price of wheat or potatoes rises in accord with the additional expenses needed for producing the last increment. Unless the price did so rise the farmer would not grow the additional produce. It is not the farmer who has to face unpleasant possibilities; it is the consumer, the population at large. Only so far as the farmer himself is a consumer of agricultural produce is he involved in the unwelcome consequences which follow from the tendency to diminishing returns.

Failure to understand this distinction between quantity and value has led to some curiously erroneous speculation on social problems. The tendency to diminishing returns has always been eyed askance by the constructors of utopias. It is an obstacle in the way of unlimited increase of production and so in the way of unlimited increase in population. Hence a tendency to pooh-pooh it and to look about for evidence purporting to discredit it. The fact that the cultivator earns no less under high cultivation is supposed to supply such evidence, it being ignored that not the earnings of the cultivator are in question but the physical quantities produced by him. A striking illustration of this sort of fallacious reasoning is in a passage in which the unshrinking optimist Kropotkin[2] points to the high earnings of market gardeners who raise produce for city markets on small plots of land. Consider how much in money value is produced on a tiny piece! Can it be said there is any evidence of diminishing returns or indeed any practical limit to what can be produced from land? Quite true,

[1] See Chapter 37.

[2] See Kropotkin, *Fields, Factories, and Workshops,* pp. 73–87. The passage is quoted with approval by so distinguished a thinker as Bertrand Russell, *Proposed Roads to Freedom,* pp. 50, 90–92.

there is no limit to the soaring of the value of the produce. The market gardener who raises early peas or green-house tomatoes may get a yield of thousands of dollars per acre. But he does not feed himself or feed his customers. He supplies an expensive luxury. The bulk of the quantity of produce used by him and his customers must come from other and perhaps distant land. For the community as a whole the tendency to diminishing returns on each several plot of land must be accepted as an obstacle to the indefinite advance of production and population and as a limit which must be soberly faced in all schemes of social reconstruction.

Finally, the tendency to diminishing returns must be understood with reference to a given stage in the agricultural arts. New and better ways of using the land may be discovered and may make possible an increase of product in proportion to the increase of labor applied; nay, may make possible a gain more than in proportion to the additional labor. Thus during many centuries, from the dawn of the Middle Ages until within a hundred years (more or less), it was customary in European countries that a part of the land—usually a third—should lie fallow each year, serving during that time only as a lean pasture for common use. The land actually under cultivation at any one time was only two thirds of the total, and any particular plot after being in use for two years was idle and recuperating for a third. About the middle of the eighteenth century root crops, especially clover, were found to offset in large part the exhaustion of the soil which results from continuous grain growing; and a systematic rotation of crops came into use which enabled all the land to be kept under cultivation all the time and yet (with judicious use of fertilizers) to maintain its productive power. More labor was thus applied to each plot of land than had been applied before and yet was applied under more favorable conditions. About the agricultural changes during the period from the middle of the eighteenth century to the middle of the twentieth, more will be said in the next section. They are an important phase of the greatest agricultural transformation ever seen. It is enough at this point to remark that the lands of the temperate zones were utilized in steadily improving ways and ways that yielded more and more without a rise in the marginal cost.

It seems paradoxical to say that there is a real tendency to diminishing returns and also that in fact there have been increasing returns. Yet both statements are true. Tho in backward countries like British India and China, and even in some parts of Europe, the soil still is used in the ways that we regard as primitive—ways that prevailed five hundred years ago—agricultural labor in the United States and in most parts of Europe is applied with much more intelligence and with better effect than five hundred years ago or one hundred years ago. None the less there remains a tendency to diminishing returns. Improvements in the way of rotation, fertilizers, deeper plowing, systematic drainage, stave off for a while the decline in return. So long as the amount which it is attempted to get out of any one plot remains moderate the stage of pressure is not reached. But this moderate limit passed, any attempt to get an increase of product encounters serious and before long impassable obstacles.

So far as permanent differences in the yield from the different sites are concerned it matters much whether agricultural improvements are equally applicable to all land or are applicable only to some land. If, for example, they were applicable only to the poorer grades of land (or those deemed poorer in the earlier stages of the agricultural arts) ; if by some processes of drainage, clearing, and leveling, available only for some soils once disadvantageous, these could be made as fertile as those previously more fertile—then rent, so far as due to the superiority of some lands over others, would disappear and would emerge only as all land came to be more intensively used. But if the improvements in agriculture were equally applicable to all lands the differences between them would remain. Good lands and bad would alike yield more but there would still be an extra yield on the good lands; hence, so far as both were cultivated side by side, there would be inequality of return for the same labor, that is, rent. And this in general has been the effect of agricultural improvements. They do not obliterate the inherent differences. The only sort of improvement which has markedly unequal effects is the cheapening of transportation, which brings the more distant lands virtually nearer and greatly reduces advantage of situation.

§ 4. Ricardo, with whose name the theory of rent is most associated, remarked that rent "is paid . . . for the use of the original and indestructible powers of the soil." But it is urged that the soil has no indestructible powers. If continually cropped it loses its powers. "Worn-out land" is a familiar phenomenon. The soil contains certain chemical constituents which are taken from it by growing plants and whose continued loss means the eventual destruction of fertility. The chief of them is nitrogen. This is restored (tho by uncertain and irregular steps) thru the spontaneous action of nature if the land be not cropped. Potassium and phosphorus are also essential for agriculture and also are likely to be exhausted by long-continued and unvarying cultivation. Hence the ancient practice of allowing land to lie fallow or allowing it to "rest." But it is restored more promptly and effectively by fertilizers and by the rotation of crops, and especially by the root crops. On all these chemical processes the science of modern times has thrown a flood of light, explaining the practices which had been empirically worked out in former times and pointing the way to new and better practices. Certain it is that improvident cultivation wastes the powers of the soil and that there is need of restoring to it what continuous cropping removes.

When new land is first taken in cultivation the necessity of restoration is not felt. The store of elements of fertility is then large. It may maintain itself, notwithstanding continuous drain, for years and even for a generation. If there be plenty of new land another parcel can be taken under cultivation when signs of exhaustion appear on that first used and so on, as long as new land is available. This is what the Germans call *"Raub-bau"*—predatory cultivation. Thus on the sugar lands of Cuba the crop is grown continuously year after year, the juice being extracted from the cane and the stalks and leaves burned as fuel. There is no fertilizing, and not even those elements which are contained in the stalks and leaves are restored to the land. But after a series of years even the richest sugar land begins to show a declining yield. Then, however, the planter turns to fresh plots and the same process begins over again. It will continue until no more fresh land is available; for predatory cultivation, so long as the land holds out, is the most profitable.

Such has commonly been the first stage of agriculture in the United States, especially on the fertile lands of the northern Mississippi Valley and the West. The usual crop has been wheat, because of the universal demand for that staple and its easy transportation. In this pioneer stage wheat is grown year after year, with no manuring or little of it and often with burning of the straw. Where the soil is rich in humus such use of it can be maintained for ten or fifteen years and sometimes for an even longer period. Yet in time the signs of approaching exhaustion appear. The land no longer yields as before; it must have a "rest" or be "nursed"; and the farmer must either turn to plots of virgin soil or cultivate the old with conservation of its capabilities. In the United States this transition has often been accompanied with a change in ownership. The pioneer sells his worn-out land—not yet in reality much worn out but simply in need of careful husbandry—to a newcomer, not infrequently a German or Scandinavian who is habituated to more complex ways of cultivation, while the pioneer himself moves farther west, again takes up virgin soil, and repeats the old round.

Predatory cultivation is one phase of extensive cultivation; it stands in contrast with the intensive cultivation of England, France, Germany, and most parts of Europe. Extensive cultivation means that labor and capital are spread comparatively thin. The yield per acre is commonly small. Thus the average yield of wheat per acre in the United States is between 12 and 15 bushels. In England the average is 25 bushels and more. But the yield per unit of labor and capital is smaller in England, for much more labor is applied to each acre. A farm of one hundred and sixty acres in the typical agricultural regions of the United States—say in the North Central states—is tilled by the owner and his family, with possibly one hired laborer. A farm of the same size in Great Britain is tilled by the capitalist farmer employing a dozen farm laborers.

Extensive cultivation, however, is not necessarily predatory cultivation. Labor and capital may be spread thin on the soil yet nevertheless may be applied with care and with due conservation of the elements of fertility. In the United States the first stage of pioneer or predatory cultivation—lasting perhaps for ten or even twenty years—is gradually succeeded by more careful but still extensive tillage. Most of the land in the upper Mississippi Valley was in its second stage by the close of the nineteenth century. It was to be expected that as population thickened and the resort to the new land became more and more difficult a gradual transition should take place toward the stage of high farming or intensive cultivation. More elaborate rotation of crops, more continuous use of each tract, deeper plowing, more frequent harrowing, systematic drainage, more abundant and more carefully selected fertilizers, came to be used, as they had already been in the advanced countries of Europe. This sort of change is the result of the tendency to diminishing returns and is a sign that the conditions of pressure on the land have been reached. High farming is essential to maintain the productivity of the land if large returns are sought from it; but it means that those large returns are got with some difficulty and that the limit to the possibilities of increase is beginning to be approached.

In any case, as the land of a country is used more and more its efficacy as an agent for production depends in greater and greater degree on what man has done for it. Those lands which were originally best have been denuded somewhat of their natural stores. Those which were originally less good have been brought nearer the average by continued careful cultivation. All have been leveled, drained, fenced, freed from large stones and provided with roads. The differences between plots are thus less great the longer they have been in use, and in old countries there is a tendency to bring all land to something like the same state.

From this it might be inferred that inherent differences in land cease to be of importance. But the conclusion by no means follows. It is true that all land needs careful use and depends on man's action for the maintenance of its fertility; but all does not respond to man's action with the same ease or to the same degree. Land with a deep layer of humus contains very rich stores of latent plant food, not easily transferred to the plant yet capable of being utilized almost indefinitely if only there be restorative cultivation. The physical constitution of land—in what proportions it contains sand, clay, humus—has an important influence on its possibilities for tillage. Tho a sandy waste or barren hillside may be brought to a state of high yield by continued care and remaking, it cannot be brought to that state or maintained there with as little labor as land having better natural endowment. Climate again—sunshine, temperature, and precipitation—is an important cause of enduring differences. New England can never be made as fertile as Illinois and Kentucky. The land in the Canadian Northwest, for example, is well adapted for wheat growing, and promises for a long series of years to give profitable opportunities for pioneer cultivation. But when, after perhaps a generation, the inevitable stage of restorative cultivation is reached, its possibilities will be found less than that of the land in the milder regions. Land that is frostbound thru the larger part of the year is not a flexible instrument and will not readily respond to more intensive cultivation. In the semi-arid regions of the western states—those stretches in Nebraska, Kansas, Texas which lie intermediate between the well-watered Mississippi Valley and the arid plains of Wyoming, Colorado and New Mexico—it was at one time said that "dry farming," in the way of deeper plowing, careful harrowing and rolling, specially selected seeds, would remove climatic obstacles long thought insuperable. Expectations ran high in this regard during the unusual and deceptive years of the war of 1914–18, when agricultural prices and profits shot up like rockets, sinking as quickly when the war ended. Just how far into the western plains cultivation may extend under normal conditions cannot be predicted; but it is certain that more labor will need to be applied in those regions for each bushel of product than in the Mississippi Valley, where nature provides ample moisture.

Tho inherent differences in fertility thus persist, it is true that on all land which has long been in use there is difficulty in determining how much the yield is affected by its "original and indestructible powers," how much by qualities supplied thru man's action. Economic rent is extremely difficult to mark off. Beyond question it is present on some sites: thus on bottom lands in our western valleys, where the layer of humus is extraordinarily deep, or (by virtue of situation) on convenient sites for market gardens close to great cities. We may be certain that on other lands there is little or none of it—on the rocky pastures of New England or on the highlands of Scotland. But on any particular plot which has been long under cultivation it is almost impossible to say how greatly labor is aided by the improvements which man has made, how much by inherent properties.

When once permanent improvements have been embodied in the land their effect is precisely the same as if nature had made the land good. Subsoil draining, for example, which has been applied on a great scale in Ohio, Indiana, Illinois and other states where the pioneer stage has been passed, means an irrevocable investment. When the drains are in, it is as if nature, not man, had provided the best means of admitting moisture and of discharging the harmful excess. So it is when great operations for drainage are undertaken—as on the Bedford Level in England or the tracts on the Mississippi River along the boundary between Missouri and Arkansas. Extensive areas, high in the elements of fertility, have thus been freed from excessive moisture. Once these improvements are made the return on the land depends on the principles of rent rather than on those of interest. It depends once for all on the productive quality of the land as it stands after the improvement.[1]

§ 5. The distinction between the extensive and the intensive margin of cultivation for land is essentially similar to that explained in Chapter 41 between the discrete and the conceptual margin of productivity for capital and labor. The poorest land is the discrete margin; one can point one's finger to it. The conceptual point of view—that of the non-discrete margin—is applicable when more and more labor and capital are applied on one and the same plot, and this margin cannot be readily visualized. What happens is that, as more is expended in cultivating a single plot, the addition to the output comes at a diminishing rate. The differences are present: less and less addition to the output as more

[1] Compare below, Chapter 47.

and more is put in. But where and how the differences are to be discerned is not a simple matter. This is because we find, in the case of land as in that of instruments made by man, not a repetition or mere duplication of the same operations but new kinds of operation. In the case of industrial capital there is the making not of additional implements of the same kind but of more complex looms, locomotives, power plants, highways, what not. In the case of land there is deeper plowing, elaborate drainage, a new rotation of crops, more fertilizers and new kinds of fertilizers. Between the two cases there is the further resemblance that the process of elaboration is not spontaneous or automatic but is linked with the general advance of science and with the experiments and examples of industrial leaders. What has been said of the complexity of the factors that underlie the far-reaching changes in capital equipment which are of the transforming kind rather than of the repetitive applies no less to the changes involved in the intensive cultivation of the soil. On the other hand, with the growing complexity of intensive cultivation the conceptual margin, troublesome tho it be to make it tangible and clear, becomes more important.

§ 6. It is the advance of agricultural chemistry and the use of chemical fertilizers, the understanding of the characteristics of the various kinds of soil and the best ways of using them, which bear most markedly on the conceptual margin. As a consequence of improvements of this character the margin has been pushed back in modern times to a surprising extent. Nowhere has it been carried so fai as in Germany since the time of Liebig—the middle of the nineteenth century. The process, accentuated in the twentieth century, brought Germany, for a while dependent on imported food for its growing population, to the point where all could be supported from a soil and under a climate by no means of unusual goodness. The population can be supported, that is, in the sense of being provided with the food indispensable for subsistence; but the land cannot be made to provide a varied and attractive diet in the way of meats, dairy products, vegetables, fruits. Such an abundance of provision the United States has been able to secure from land by pushing back the extensive margin within its boundaries, and Great Britain thru a highly developed international trade with regions still thinly settled. These two countries have made use more than others of both kinds of improvement, the extensive and the intensive. In all the western countries, Great Britain not least, the intensive improvements have gone on apace. They have their limits but the limits have proved more elastic than was dreamed of a century ago.

Between the intensive and the extensive improvements there is a difference analogous to that between land and capital, between natural resources and instruments made by man. Capital in the sense of instruments made by man can be multiplied indefinitely. If there be more people and greater demand for complex and effective tools more of them will be forthcoming. It is otherwise with land. As time goes on more intensive cultivation can be applied to each plot. If there be a continuing increase of population, and so of demand for agricultural products, all land will come to be intensively cultivated. But there is a limit to the available land, and on each several plot there is a limit to the amount which the most painstaking and scientific cultivation can extract from each plot and from all the plots. There may be intervals during which it will seem that there is no limit at all or one so distant as to be negligible. But in any larger survey of man and his surroundings, and of what he can make of his surroundings, the limitation cannot be swept away or ignored.

And yet the great burst of discovery and invention which set in during the eighteenth century, extraordinary in speed and volume after the middle of the nineteenth, had precisely the anomalous effect just noted: the limit to man's use of the land was pushed ahead so fast that it seemed virtually non-existent. This appeared to be the case for both of the ways by which land was made to yield larger supplies—the extensive and the intensive. The revolution in transportation suddenly pushed the extensive (the discrete) margin far forward by making it possible to bring to Europe grain and the other transportable agricultural products in quantities which for the time being were unbounded. In the United States, Argentina, Canada, Siberia, great areas of new land were opened. Railroads and ships could be built indefinitely, and it seemed as if new land also could be opened indefinitely. It was much the same with the vegetables and dairy supplies of the cities. The surrounding areas from which these things could be brought to the urban centers were enlarged more and more until they too seemed to have no limit. The advances in intensive cultivation were less sudden and dramatic than the extensive and indeed were of less quantitative effect. They were promoted too by protective duties on the continent of Europe, which served in part to check and in part to supplement the supplies that poured in from the distant new lands. These differences between the two phases are of minor importance for the present argument. Both changes were of a kind and of an efficacy not before dreamed of.

It was natural that changes so revolutionary should lead men to act and think as if a new era had set in, not only new but so radically different that all speculation resting on previous experience might be set aside. Why bother about diminishing returns when there were no signs of pressure in any visible future? If indeed the changes had been of the intensive kind alone that possibility could not have been so easily dismissed. Here pressure, tho it might be postponed, was felt earlier and more unmistakably. But with the combination of the two kinds of improvement it was easy to think that the future would be like the immediate present for as long a time as it was worth while to envisage. Rarely was it hinted—least of all emphasized—that this whole course of economic history was unusual, could not run on indefinitely, was likely to be checked sooner or later by the obstacle which man had faced thru the long ages—the limit to what can be got out of the soil and the limit to the total available area. We are still, in the fourth decade of the twentieth century, in the thick of the revolution and are barely beginning to see it in perspective and to understand how exceptional it is and how uncertain is its continuance. As a possible end looms in sight there are speculations and prophecies of still further revolutions: chemical and physical discoveries which will bring synthetic food without limit and dreams of unimaginable power out of the atom which will make it possible to people the whole earth's surface as thickly as the metropolitan areas of London and New York are now peopled. These are but dreams, not to be considered as pointing to any economic law newly discovered, any inherent tendency to increasing returns. The only tendency which we can now recognize as abiding is that toward diminishing returns from land; diminishing, that is, in the only accurate and pertinent sense, that of a pressure which sooner or later (and not indefinitely late) shows itself as man tries to get more and more output from any single plot or area of land.

§ 7. The leasing of land and the payment of a rental does not necessarily imply the existence of economic rent. What a tenant pays may be no more than the ordinary return, in the way of interest, on improvements made by the owner. But commonly the actual payment, the rental, contains something of economic rent as well as of return on capital. Tenancy raises some questions of its own.

Almost always tenancy is an obstacle to the best use of the land; for the tenant is concerned only with getting out of it what he can during his term and is tempted to employ predatory methods. In its barest form, where the landlord does nothing and the land is simply let to the tenant from year to year, it results not only in bad tillage but in demoralized tillers. Such was the outcome of cottier holdings in Ireland, maintained there for centuries in the dealings between alien landlords and an oppressed and ignorant tenantry. The situation is better where there is fixed tenure in the form of long leases, with provisions for compensation to tenants for improvements made by them and not exhausted on the expiration of the lease. Even under this arrangement the landlord must have a care for the way in which the soil is used and usually makes stipulations regarding the rotation of crops and the maintenance of improvements. Yet these very stipulations, if detailed, hamper the tenant unduly. In England a practice of short leases (usually from year to year) has been carried on without much ill effect because landlord and tenant have been virtually partners. The English farmer is a person of some means who leases a considerable tract of land and is prepared to cultivate it systematically for an extended period, relying on renewal of his lease at equitable terms so long as his husbandry is good. The landlord himself makes permanent improvements and is thus an investor in the land. The actual payment made to the landlord represents economic rent only in part. Traditions of friendliness and fair-minded dealing between the two have made this arrangement a workable one, and indeed the agricultural arts in England have reached a high degree of advancement under them. In Scotland long leases, sometimes for twenty-one years, are common and under them refined forms of intensive cultivation have been developed.

None the less, the most effective use of the land is likely to be made by the owner. Such at all events is the case where land is readily transferable and so can be bid for and secured by those who know how best to make use of it. This facility is lacking in many European countries, especially England and France, where, moreover, the obstacles which the state of the law presents are increased by the social prestige which often attaches to large landed estates and makes the owners reluctant to sell. In the United States none of these obstacles exists. Here, at least in the northern part of the country, the characteristic form is that of tillage by the owners. Farms are constantly passing from one hand to another according as varying possibilities of cultivation are perceived by different persons—a condition which promotes the most productive utilization of the soil. In the North Central states, the great agricultural region of the country, about one half of the farms are worked by their owners. True, since the opening of the twentieth century there has been an increase of tenancy in this region and in the North generally. The statistical information on this increase is not complete enough to make certain what it signifies. It may be merely a phase of the reaction from the extraordinary boom which began in the war period of 1914–18, then started up again for some years of the decade following, and collapsed after the crisis of 1929. It may be a concomitant of the far-reaching changes in the industrial and social conditions of the United States which set in during the succeeding decade. And it may prove to be not a persisting movement but merely a temporary slowing down of a process which has long played a large part—the efforts of younger men to swing themselves gradually by way of tenancies into a position of ownership as well as management. The future is as obscure and unpredictable in this direction as in so many others. All that can be said is that no fundamental change has yet come in the agricultural conditions of the North and that none is unmistakably in sight; the conditions of landholding here are not of an ominous kind.[1] The same is true of many parts of Germany, especially southern and western Germany.

A not uncommon form of tenure in the southern part of Europe —notably in Italy—is metayer tenure. The land is let for a share of the crop, often one half of the crop but more or less according to the fertility of the soil and the extent of the landlord's other contribution. The landlord himself provides part of the capital used. Metayer tenure has the advantage, as compared with hired labor, of stimulating the cultivator to get from the land as much as possible, but evidently with the drawback which comes from the fact that the landlord also shares in the output. In the southern part of the United States there is a widespread practice of share tenancy both among whites and negroes. The owners of the land here contribute a very large part (sometimes all) of the advances needed by the tenants, not only seed, implements, animals, but for the negroes even the food. This arrangement was doubtless inevitable under the conditions in which the southern states found themselves at the close of the Civil War. But share cropping, as it is called, continues to be common for white tenants also in the South, these being tenants who usually hire negroes as day laborers. The continuance of the system is promoted by the unusual character of agriculture in that region. There is one dominant crop, cotton, and the yield of that can be measured with sufficient accuracy, both as to quantity and value, when the season closes. The agreed share of the gross yield which is to go to landlord and tenant respectively can be ascertained without the intricacies and the bickerings which arise when there are varied crops, maturing and sold at different times. The same circumstance, it may be added, goes far to explain the prevalence of the system where the tenants are negroes.

[1] On the many complications of this subject, see the article by J. D. Black on "Farm Tenancy in the United States," *Quarterly Journal of Economics,* May, 1937.

Yet under any conditions share-cropping is not comparable in social advantage with complete ownership by those who work on the soil. It is inferior also to leases at a fixed money rent, if the leases are so adjusted as to bring security of tenure and encouragement to improvement. Tenancy even at its best is not good. A wide diffusion of the ownership of land and a predominance of cultivation by owners are the most wholesome agricultural conditions; and it is much to be wished that these conditions, which in the main still prevail over the northern part of the United States, should be maintained and extended.

§ 8. The considerations which have been adduced in preceding sections—the need of conserving the fertility of the land, the growing importance of human action as cultivation becomes more intensive, the difficulty of distinguishing between nature's endowment and man's improvements—have an important bearing on some social problems.

It has been proposed to confiscate economic rent for the benefit of the community. Rent is a surplus over and above what is necessary to induce investment; it is an "unearned increment," tending to rise as growing population leads to greater demands on the soil. Why should the individual landowner keep it? Under the so-called "single tax" it is proposed that all land be taxed to the full amount of its economic rent—the tax being called single because it is expected that so much revenue would be secured for the public as to enable all other levies to be dispensed with. Substantially the same result would be attained if the community were to take possession of the land once for all, never part with the title, and let the land to tenants for the amount of its rent—allowing the tenant to keep for himself enough to pay for all his improvements and for interest on them but requiring payment of the excess.

A fundamental obstacle in the way of this program of action is, as regards agricultural land, the difficulty of measuring the investment made in the soil and the normal return on it. Rent, as has been remarked, does not arise spontaneously. It is not earmarked as a separate return. Its emergence is inextricably intermixed with the complex processes of tilling the soil and of maintaining its fertility. For the effective use of the land there must be elaborate application of labor, much experimenting, plans of cultivation that run over a long period; not least, constant individual watchfulness and care. No stimulus to the best use of land is comparable to that which comes from secure possession, from the certainty that he who makes it yield abundantly will reap the results of his industry. And no kind of secure possession is so effective to this end as untrammeled ownership. It is true that by private ownership the community loses something which, if carved out with meticulous care, might be appropriated without discouraging good management. But the difficulties in the way of such carving are so serious and the advantages of good management so vital that the balance of social gain is against any scheme of appropriation by taxation or otherwise.

There is something attractive in the proposal that the community should never part with its title to the land but should merely lease it—lease it for long terms, in such manner as to give tenants free scope for improvements and no inducement to impoverish the soil, and yet to bring back to the community in the end the gradually increasing increment of economic rent. If a country had started from the outset on this plan, and if its government were rigidly honest, highly intelligent, and excellently administered, this mode of managing its patrimony would be preferable to private ownership. But no country has started on this plan or if it has done so (the historians are uncertain as to the extent to which the Germanic races began with a system of true communal ownership) long centuries of private ownership have followed. The spur of ownership was historically indispensable for the advance of the agricultural arts. It is conceivable that where a civilized community, equipped with the accumulated experience of centuries, takes possession of new land—as in the United States, Canada, Australia—it might retain in public ownership the fee of the land, parting only with long leaseholds. But it is precisely the fee which the pioneer generations covet. The thought of the conservation of the interests of the coming generations rarely presents itself to them or, if it does, they think of their own immediate descendants only, not of the distant population of a century beyond. Hence all communities, whether they have moved slowly thru a long historical development or have begun at once on a plane of advanced civilization, have rested their industrial organization on private ownership of land. Land has been bought and sold for centuries on the supposition that the property rights which have existed from time immemorial will be maintained indefinitely into the future. To destroy all these acquired rights is not indeed unthinkable but it would involve a reconstruction of the whole framework of society. It presents the problem of socialism, not of the appropriation of the unearned increment.

A different proposal is that to appropriate not the whole of the unearned increment but the future accretions. Let vested rights —the private ownership of land and the enjoyment of existing rents—remain undisturbed. But take for society at large the increase of rents that will arise hereafter. There can be no objections in principle to this proposal. The sole question is whether it will on the whole bring gain to the community. To carve out economic rent proper and to leave undisturbed those gains which are necessary to secure the effective use of the land calls for high intelligence as well as scrupulous honesty among the public officials. A dull or corrupt administration of so delicate a function would probably lead before long to the summary abandonment of the whole scheme. It is to be borne in mind, moreover, that where the ownership of land is much diffused a wide dispersion of economic rent takes place and those extreme inequalities are avoided which are the most objectionable results of the régime of private property. All things considered—administrative difficulties and the imperfections of government, as well as strictly economic factors—the balance of gain in a social system based on private property is probably in favor of the untrammeled right of private ownership in agricultural land and of such legislative regulations only as facilitate its free transfer and its easy acquisition by those who will use it best.

CHAPTER 45

URBAN SITE RENT

§ 1. How rent arises on sites for retail trading, wholesale trading, manufactures, dwellings.—§ 2. The principle of diminishing returns on urban sites; its operation less steep than for agricultural land.—§ 3. Site rent depends upon shrewdness in utilization. The activity of real estate speculators.—§ 4. When capital is sunk irrevocably in the land there is difficulty in separating rent from return on capital. How far ground rent is identical with economic rent.—§ 5. "Quasi-rent."—§ 6. How far the activity of real estate dealers and speculators is productive.—§ 7. Urban rent is sometimes deliberately created; is it then economic rent?—§ 8. City planning and the like by public authority: wherein similar to creation of rent thru private investment, wherein not.

§ 1. Urban rent resembles in essentials the rent of agricultural land. Like that it results from the differential advantages of certain plots. The application of capital and labor on some sites yields greater returns than on others. So long as the possibilities of production on the better sites are limited their owners are not subject to unrestricted competition and can retain an extra return for themselves; and this irrespective of whether they utilize the sites themselves or let them to others.

The cause and the extent of the differential advantage of urban land can best be elucidated by a consideration of the various ways in which the land is used. Most characteristic, and simplest in its manifestations, is the case of sites used for retail trading. Wherever throngs of people habitually pass, retail operations can be conducted with most advantage. Enter a great shop in the heart of a city and observe what goes on. The selling clerks are continuously busy; the turnover of capital is large and quick; the building and all its appliances are in constant effective use. Contrast the scene with the village shop, where the shopkeeper lolls about during the greater part of the day waiting for a customer or (if he be energetic) attending during a large part of his time to other things also. For each unit of labor and capital applied the product is vastly greater on the city site. By "product," in the case of the shop, we mean the contribution to the community's income of utilities or satisfactions—the completion of what is the last stage in the process of getting commodities into consumer's hands. In everyday speech the same thing is expressed by saying that in the one place much business can be done and in the other very little.

The precise reasons why some sites are better than others for retail trading are sometimes simple, sometimes obscure. Most simple are accessibility and familiarity. The places where urban transportation lines converge are the most valuable for retail trade. From such centers the retail streets commonly radiate, those being most advantageous along which the largest number of persons move to and fro in their daily tasks. Anything which causes many persons to betake themselves to a given point—a railway station, a post office, a theater—gives the neighboring sites an advantage for retail trading. Less simple are the effects of tradition, or of proximity to the dwellings of the well-to-do, or of the initiative of a few skillful dealers, by which for shops of the more expensive kind one street or region rather than another may come into vogue and its profitableness may for that reason become greater. Display has a great part in attracting customers (it is a cardinal maxim of the retailer that his windows must show his goods); hence on a busy street the southern side, where goods can be put into show windows with most effect and with least danger of spoiling, often has an advantage over the northern and commands a higher rent.

The prices of the commodities sold on the expensive sites are not usually higher. Here, as in the case of agricultural land, rent is not a cause of high price. It is the result of the facilities for selling many things at the usual prices. The so-called department store sells its wares at prices at least as low as those of the suburban or village shop. To this statement there seems, indeed, to be an exception in the case of those shops which make their appeal to the rich and to persons who ape the ways of the rich. Here a given article is not infrequently sold at a price higher than that charged for identically the same thing on less pretentious premises within a stone's throw. Here high prices and high rents go together; and the dealers, if asked, would certainly explain the connection between the two by saying that, having to pay high rents, they must charge higher prices. But in reality the causal connection runs the other way; it is because they can get high prices that they bid high for the premises and pay the high rents. In shops of this character there is usually a stock of well-selected and attractively arranged articles of good quality; there is quiet; not least, there is a flattering of the purchaser's vanity by obsequious demeanor and by a suggestion of superior company. The satisfaction of the snobbish love of distinction is one of the utilities here purveyed and is one for which most people are willing to pay handsomely. What has been said already on advertising, prestige, trade-marks, the pretense or reality (or something between) of superior quality, bears on this aspect of site rent and site value. On streets having a reputation for fashionable goods and a fashionable clientele the rents and the selling prices of land are raised by the same causes which raise the price of the goods themselves. The landlord gets his share of the spoil. But the landowner's share is more abiding than that of the tenants, since the site is used over and over again—perhaps not indefinitely, but thru decades and generations—for the sale of a long succession of things novel and deemed proper and handsome.[1]

Sites for wholesale trading command their rentals largely because of their proximity to other sites where the same or similar businesses are carried on. This advantage may seem a trifling one, especially in these days of the telephone. Yet where trading is done on a great scale a few hundred dollars more or less paid for rent, or even a few thousand, do not signify much in the general account, and the facilitation of larger dealings leads to the ready payment of a high premium for the convenient sites. Here every sort of negotiator can run in promptly; banks, brokers, shipping agents, insurance companies, are close by. Wholesale dealers in the same trade commonly are near each other; in a great city there is the metal district, the dry goods district, the boot and shoe district, the shipping district, and so on. All cluster about the

[1] This phase of urban rent has been analyzed admirably by Professor Edward Chamberlin, in his book on *Monopolistic Competition*, Appendix D.

financial center, which in turn gets its advantage from being in close touch with any and every kind of business. The most various sorts of persons need to be where they can easily get at their customers and where their customers can easily get at them; such as lawyers, brokers, schemers and middlemen of all kinds, the managers and representatives of distant manufacturing establishments. All bid for premises near the heart of business. Hence the office building, developed to perfection in American cities. The largest urban rents seem to be secured, at least in American cities, on sites used for offices, for financial enterprises, and for the great retail shops. They sometimes reach an extraordinary range. An acre of land in the financial center of New York City had (about 1930) a capital value of roughly $30,000,000, representing a net rent of over $1,000,000 a year.

Manufacturing sites sometimes command their price because of intrinsic advantages. They may be near water power, or a deep-water harbor, or cheap fuel and materials. Facilities for transportation by railway tell no less than water facilities. In the United States, so long as competition among railways was active and railway rates were lower, if one line could be played off against another, a spot at which several lines met had advantages in much the same way as if nature had made the site good. When once a city has developed, it continues to attract manufacturing establishments for reasons that are often not apparent on the surface. Why should a premium be paid by a manufacturer for urban premises when sites apparently no less good can be had at much lower rentals in the country? Here too the telephone would seem to remove the drawbacks entailed by remoteness. And yet the keen calculations of shrewd business men, constantly weighing the advantage of proximity against a higher rental charge, cause the gravitation of many manufactures to the urban centers and the suburbs close to them. Easy access to customers, to supplies, to subsidiary industries, even to competitors, is one factor. Probably most important is the plentifulness and flexibility of the labor supply, to which reference has been made [1] and which is of

[1] See Chapter 14.

particular moment where work is subject to rapid fluctuations.

The precise point at which a city's business operations will concentrate and at which urban rents will be highest is often determined by no natural or inherent causes. The site of a great city itself is indeed usually the consequence of natural advantages, such as a superb harbor, as in the case of New York City and San Francisco, or the confluence of rivers in the neighborhood of great coal supplies, as Pittsburgh, or access to inland water routes, as Chicago. But within the city there is usually no reason why one small area should be preferred to others as superior for business. It is the gregariousness of industry that gives business sites their value, just as the gregariousness of men has the same effect on sites for dwellings. Some one center will be resorted to by all and will be prized by all; but the causes which fixed the center at Threadneedle Street or Wall Street are usually historical and complex and sometimes whimsical.

The value of sites for dwellings is explained by the same principle, with similar complexities and similar apparent anomalies. Sometimes dwelling sites have intrinsic advantages—broad and sunny streets, frontage on parks and open spaces, convenience of access. But the advantage often rests on other and less obvious causes. Nearness to one's kind is alone sufficient to explain the demand for some spots. Crowded, noisy, and unhealthful city streets attract the working classes more than quiet lanes in the country; something always is going on. At the other end of the social scale, among the well-to-do and most of all among the very rich, snobbish differences tell enormously. Certain streets are resorted to by those who have social distinction. Thither flock all who yearn for such distinction—a great and growing multitude—and sites believed to be proper for the select are paid for at rentals limited only by their incomes. The very cracks and crannies of fashionable districts, narrow side streets and dark back rooms, when touched by this potent charm command high rentals, notwithstanding intrinsic unattractiveness.

§ 2. Something closely analogous to the tendency to diminishing returns shows itself on urban sites.

Buildings can be pushed higher almost without limit. In these modern days of steel frame construction, ten, twenty, thirty, sixty stories are practicable. But sooner or later the stage is reached where the gain from additions to the structure begins to diminish, and where it becomes a question whether it is not better to resort to building on another site than to push construction further on the same site. Where the land is used for manufacturing or mercantile operations that stage seems to be reached, in American cities, with the sixth or eighth floor. One rarely sees a building of greater height used for these purposes. The poorer light and air on the lower floors, the cost of lifting goods and materials (even with smooth-running elevators), the difficulties of supervision, begin to tell, and tell the more as more stories are added. Where buildings are used for office purposes in the business centers of great cities they are often pushed much higher, at least in the United States. The advantage of being at the very heart of things is so great that a multitude of persons, engaged in all sorts of occupations, are willing to pay liberally for this facility, and a city in itself is established in the towering office building. But even here there is eventually a limit, tho one which the progress of invention is steadily pushing higher. It must be borne in mind, in any case, that all the sites cannot be used in this way, for then the buildings would cut off too much of each other's light and air. Hence adjoining sites must be controlled and limited; in other words, taking the combined sites, the possibility of intensive use is much more limited than it appears to be when a single plot is considered by itself. Situations on a corner or those which face a public square or other open space (like Trinity churchyard on Broadway in New York City) offer the possibility of investing an enormous capital on a given area.

Much the same is true where dwellings are put on urban land. Here also buildings can be made taller, thus securing very intensive use of sites advantageously situated in large cities. Dwellings for the very poor as well as for the very rich can be pushed high: tenements for those who must be near their work (or think they must be) and near their comrades, and great mansions or apartments for those whom fashion attracts to "choice" sites. But eventually, even with steel frame construction and with elevators and telephones, a limit is reached where it begins to be less profitable to add more and more stories. The tendency to diminishing returns, under the increasing application of more and more labor and capital to the utilization of the same site, finally asserts itself.

This tendency does not act so steeply on urban land as on rural land. On a plot used for agriculture diminishing returns are encountered at a comparatively early stage. It is true that for certain purposes—as for market gardening or vineyards—very intensive use can be made of a few agricultural sites; precisely as highly intensive use is made of a few urban sites. But in almost all cases diminishing returns are reached comparatively early on agricultural land and the obstacles which cause a lessening of product act steeply. On urban land, on the other hand, the obstacles appear more gradually and hence there is a larger choice between the more and the less intensive use of the sites. One will find side by side, on the same city street, very high buildings and comparatively low ones; indicating that, as regards the additional stories on the high buildings, there is neither any great gain (over and above return on the cost of construction and management) nor any sharp tendency to a lessening of return as the building is pushed higher. It would seem that very large amounts of capital can be invested on some urban sites, especially on business premises, with a prolonged stage at which returns are nearly constant.

§ 3. On urban land as on agricultural land there is no separate product of the land. Nothing is automatically yielded by the site; nothing is earmarked as "rent." What happens is that labor and capital applied on some sites yield unusually large returns. Those sites being limited, the owners are able to keep for themselves the excess of return over and above what is usually got.

The yield on the advantageous sites depends in no small degree on the skill with which they are used. Their full possibilities are not seen by all persons. The bidding for them comes most actively from those who have the shrewdness to see what can be done on them and the courage to put their calculations to the test of actual trial. Mistakes are frequently made and losses incurred by those who lease or buy city land on high terms, while at other times success and unusual profit follow from its ingenious utilization.

For example, the office building which is so striking a feature of American cities is the result of a process of gradual evolution. Successive sets of persons have devised more and more elaborate utilization of central sites—new methods of construction, higher buildings, more convenient service. Each improvement entailed a certain risk; each, if fortunate, promptly had a host of imitators. A successful venture brought a differential gain first to the promoters and investors who entered on the venture, later to the owners of similar sites. Very commonly, in American cities, the innovator who has in mind a new use of the land (say thru a more elaborate building) will buy it outright from the previous owner at a price based on the traditional ways of using it. Then, if he succeeds in his venture, he finds the return on his total investment handsome and his site worth in the market more than it was before. Sometimes he leases the land for a long term and then enjoys the gain during the period of his lease. Sometimes the owner himself is shrewd enough and energetic enough to use his site in such a way as to get the maximum yield. In whatever way the more effective and profitable utilization comes about, it soon has plenty of imitators, the new method becoming the common one for sites of the same sort. Then it is succeeded in due time, especially if the city continues to grow, by other still more ingenious methods. But success does not invariably follow. Mistakes and miscalculations occur, as in every kind of investment. Often enough it happens that a projector pays high for a site and erects an elaborate building, perhaps one adapted to special uses, in the expectation of meeting a brisk demand for the quarters provided in it, but finds that he has overestimated the growth of business in the city or the demand for the particular accommodation which he offers.

In every large city there are so-called "real estate men" (in a later lingo "realtors"; a tawdry neologism but a convenient one) who make it a business to manage investments in urban realty, partly for themselves, partly for others. Among them a process of selection causes the less shrewd to drop out, the more shrewd to come to the fore. Usually there are among them some who are gifted with a sort of instinct for discerning the possibilities and adaptations of the various grades of city land, and they commonly make large sums, sometimes fortunes, either from the purchase and sale of sites or as managing agents for the owners. They set the pace so to speak, and are followed by the rank and file. There are always others, equally venturesome but less shrewd or less fortunate, whose experiments do not succeed and who lose money for themselves and their backers. The spur of individual profit and the stimulus of competition are no less necessary here than in other parts of the industrial world for the most effective employment of the factors of production. And here also the difficult problem is that of ascertaining whether rewards are so adjusted that enough shall be earned by projectors and managers to induce the full exercise of their economic talents, and not more than enough.

§ 4. The investment of capital on urban sites is usually more irrevocable than on rural sites. It is true that there are some agricultural improvements, such as operations for irrigation or permanent drainage, which last indefinitely. But most work done on farms exhausts its effects in a short time—usually in a few years—and the choice recurrently presents itself whether any particular application of labor and capital shall be repeated or shall be discontinued. The investment of capital on urban land, on the contrary, is usually such that the improvements last a very long time and hence that a change is made with difficulty.

Thus in many seaports tide flats or shallow stretches have been filled and deep-water sites secured. For such an investment there is no wear and tear and hence no possibility of shifting the capital in the manner in which it may be shifted when invested in machinery—by letting it wear out and replacing with something else. The changed land surface is there once for all. So it is whenever land has been leveled or filled. The case is similar, tho not so extreme, with buildings. It is true that buildings do not last forever; but they may last for generations, even for centuries. Commonly they have to be kept in repair, in order that they may be used at all. So long as they yield anything over and above the expense of repairs it is worth while to maintain them, even tho the return be but slight on what has been invested. It will be profitable to tear down an old or ill-adapted building and replace it with a new building only when the new one promises to yield not merely enough to pay a satisfactory return on its own cost but in addition enough to compensate for the loss of the net revenue which still was coming in from the old one. Consequently the antiquated structure, even tho it does not utilize the site in the best way or to the full extent, remains undisturbed for a long time, yielding such a return as its conveniences may make possible. Where a city is growing rapidly the demand for new structures will cause the stage to be reached at a comparatively early date when it will pay to raze an obsolete building and substitute something new and up to date. Where a city grows slowly, still more where its population is stationary, such a building, especially if thoroly put together and in little need of repairs, may remain in use indefinitely long.

In other words, when once an urban site has been adapted to use by an investment of capital—and the common and typical mode of investment is that of erecting a building on it—the return on it is irrespective of the extent of the investment. The parcel of "improved" realty—land and building as one complex—earns an amount determined solely by its serviceability for business or dwelling uses. It is only in the very long run that a difference becomes apparent between rent and interest—between that return which goes to the owner of the site as such and that which goes to the owner of the capital put on it. As time goes on buildings do wear out, old ones are torn down, and new ones are substituted in their place in order to put the land to its most profitable use. Landowners then secure the full differential gain which their site is capable of affording. But the slowness with which capital invested on land can be shifted may prevent for a long time the attainment of this maximum.

It may seem that the difference between rent and interest is clear in the case of land leased for a ground rent. In Great Britain urban sites are commonly leased for a long term (usually ninety-nine years) and built on by the lessee. Leases on ground rent are not unknown in American cities and are becoming more frequent; tho the common custom here is still for the landowner to put up the building himself. When ground rent is paid by a lessee to the landowner the amount received by the latter is almost always economic rent pure and simple. In Great Britain, where the owner of the urban site customarily does nothing whatever to improve it, his income seems to be clearly of this nature.

But it by no means necessarily follows that the whole economic rent of the site goes to him. The long-term lessee may pocket, for many years, part of the rent of the site.[1] The increase of population, or its greater concentration in a particular city, may cause the site to become more advantageous than it was expected to be when the lease was made. The buildings which the lessee erects on it may bring a return much more than sufficient to pay interest and depreciation; there is a surplus which accrues to him thru his lucky bargain. It is possible, of course, that the reverse may happen. The site may become not more advantageous than was expected but less so; and the landlord will then receive under his bargain (if the lessee remains solvent) more than his site proves to be worth. During the last hundred years, when population in all the civilized countries has not only grown but has crowded more and more persons into the cities, the more common experience has been that ninety-nine-year lessees have pocketed part of the site rent. When long leases of this sort reach the end of their term there is sometimes a wonderful accretion for the heirs or successors of the lessor of a century before. An ancestor of the Duke of Bedford in the eighteenth century leased large tracts for ground rents on what was then the edge of London. Ninety-nine years later, when the land was in the heart of the great metropolis, his descendants reaped a huge harvest of urban site rent. Such windfalls bring into sharp relief the meaning of "unearned increment," and they suggest also questions as to the possible limita-

[1] In the city of New York leases of sites are often made for twenty-one years at a stipulated rental, with privilege of renewal for a second and perhaps third term of twenty years, the rentals for the additional terms to be fixed by arbitration or on the basis of a fixed percentage (five per cent, say) on the appraised selling value of the land. Such an arrangement makes it more certain that the landowner will secure the full site rent, no less and no more.

tion of private ownership in urban land to which we shall presently give attention.

§ 5. The term "quasi-rent" was invented by Marshall to designate the sort of situation described in the preceding paragraphs. The return on any structure built on the land is like rent—is a quasi-rent—so long as that structure endures. And it may endure for a long time. A house or a trading establishment, a manufacturing plant, cannot be moved or swept away. Possibly, to be sure, it can be remodelled. The ingenuity of realtors in the rapidly growing and changing American cities has led to surprising remodellings of buildings that had become obsolete. But the main structure, however changed to suit new surroundings, is fixed for long periods. The rental secured is that on the "property" as it stands; it is based on the utilities yielded; to use the well-worn phrase, it is not a cause of the prices charged for the things produced on the site but a result. There is only a conceptual demarcation between interest on the structure and rent on the site.

That conceptual demarcation is not impossible. There is commonly a traditional, more or less settled kind of use for any one location or region of urban land and there is a going value, a capitalized rent, for the site. This it is which assessors in the United States try to measure when they arrive at a separate value for land and buildings for purposes of taxation; and this it is which buyers and sellers, owners and managers, have in mind when figuring on rentals and adaptations. If the rental on the property as a whole is less than the site rent thus gauged the building will be removed and replaced by one suitable to the site, i.e. one which brings in a return on the capital invested and in addition the site rent as commonly estimated. But if the rental, while something above the rent, is still less than normal interest plus that rent the structure may remain as it stands for an indefinite time, earning (i.e. yielding) the quasi-rent. All this works itself out by processes of trial and error, by higgling and bargaining. Properties which have become difficult to handle are bought by the speculative-minded as they see new possibilities. If the city continues to grow, site rent as a whole continues to rise. Even individual plots have their ups and downs. The site rent is not a separate return but is part of the quasi-rent of the "improved" property. Least of all is it to be demarcated with precision, affected as it is by the uses to which the land is put, by changing fashions, by the devices of the owners and managers for making the most out of it. Yet this it is which in the long run is a site rent, distinguishable from the return which goes to the owner upon what is spent in erecting buildings.

§ 6. Reference has been made to "real estate men" and "realtors," and to the higgling and bargaining by which the prices of city sites are fixed. Speculation in urban land is a familiar phenomenon in modern communities. Especially where the law of real property makes easy the transfer of title, sites are bought "for a rise" and are passed from hand to hand at prices which go up and down according to the calculations of sellers and buyers. In cities that grow rapidly, or are expected to grow rapidly, the speculation is sometimes furious. The bidders for promising sites overreach themselves and in the end some among them incur heavy losses; while others, more shrewd or fortunate, pocket gains from the accruing rise in the value of the land or from the mistakes of their fellow speculators.

No small amount of energy and skill is thus given to figurings and calculations, bargainings and perhaps intrigues, whose outcome seems to be merely that one person rather than another gets the gain from growing site value. From the social point of view this appears to be a waste of energy. True, it is not quite like ordinary gambling, where one person gains precisely what the other loses. Unless real estate speculation be overdone, one person gains only that which another fails to gain.

This in the main is true, yet it is subject to qualification. Speculation in city land does contribute something to the community's welfare in so far as it promotes the most effective use of the land. It stimulates those who are engaged in it to ferret out all the possibilities. It tends to bring the land into hands which will utilize it to the utmost. The successful speculator is commonly a projector who hits on new and more effective uses of the sites or a person who fraternizes with such projectors and weighs their schemes with judgment.

Here as in almost all of the working of the system of private property the question is one of the balance of advantage and disadvantage. Much the same question presented itself in the discussion of speculation in commodities, such as grain and cotton.[1] Speculation, whether in goods or land, has its advantages for the community; but more persons engage in it, and more labor is given to it, than is necessary to secure that advantage. There is no small diversion of time and energy to what must be termed unproductive operations. How far these can be restricted without sapping the inducements to improvement is part of the fundamental problem of modern society—that of promoting both progress and wider distribution of the results of progress.

§ 7. Urban land values and urban rent are sometimes *created.* As has been said, the precise point at which a city shall arise is not determined solely by natural causes; still less do such causes determine the precise spot within a city which shall have large site value. Projectors sometimes try to direct the forces that bring urban rent into existence. A large industrial enterprise or set of enterprises may be established in a small village, or on a spot where there had not been even a village, in the expectation that about it a city will grow with its accruing land values; the owners (or managers) buying up the land in advance and expecting to profit by its sale or lease. Thus the Pullman Company established the town of Pullman, near Chicago. The Steel Corporation deliberately created Gary. A great railway company, by placing its repair shops and workshops at one spot or another, may influence markedly the growth of a city. And within a city the same sort of intentional direction of the urban currents may be attempted. Two or three great firms or banking houses may transfer their operations to a new street and carry business after them. Similarly with sites for dwellings: persons of wealth and social repute may move to a new district and give it the prestige of fashion. By purchasing in advance the sites they propose to bring into favor they may secure for themselves the newly arising land values.

All such operations, however, whether they create or merely

[1] See above, Chapter 11.

divert urban values, are attended with risks even greater than those of ordinary investment on the land. Where, for example, a new city is sought to be created, streets must be made and water mains, sewers and other conveniences put in. The whole depends for its profit on the fulfillment of the expected growth. A set of projectors tried to create a manufacturing town named Depew near the city of Buffalo and spent much money in preparatory operations. But they found it difficult to get either industries or people to betake themselves to Depew and the final outcome was failure and loss. So it may be with attempts to turn urban currents toward new streets or outlying districts. The favor of the crowd—whether it be a set of business men or of the idle rich—is proverbially fickle. Here again, shrewdness and personality tell. Some individuals will undertake such ventures and overcome obstacles with success, while others will fail. The higher site values which may be attained in places so developed will not represent economic rent pure and simple; they will be to a greater or less degree compensation for risk and earnings of managing activity.

There are cases, on the other hand, in which the risk is small, even negligible. When a government establishes a great workshop or a large educational institution it is well-nigh certain that population will be directed to the favored spot and that some influence on site values will appear. When an important railway fixes on a given town as its "division point"—that is, a center for administration and operation—or places its manufacturing and repair shops there, the result is hardly less certain. It may chance that the managers and directors of the railway, who know in advance what is to happen, will then make money by clandestine purchase of sites—a semi-corrupt abuse of positions of trust which unfortunately too often appeared in connection with railway management in the United States.

§ 8. It remains true in general, then, that the risk in rent-creating ventures is great, the outcome dependent on business judgment and management. That not everyone can achieve success is shown by the fact that this is not the usual course in urban development but an unusual one. If there were here a royal road to fortune we may be sure that the successful operations would be many, and new sites created and developed in abundance. Obviously it is not so. "Residential" suburbs and sections, good manufacturing and trading sites, ordinarily grow up without deliberate planning. They begin tentatively and then grow apace—or falter. They are affected, to an extent and in ways difficult to foresee, by urban transportation, technological improvements, even the mere whims of fashion and of business. That Wall Street or the several sections of Fifth Avenue, Leadenhall Street or Mayfair should develop as they have was beyond the vision of the keenest observer a half century ago.

Public authority, it is true, has so strong a hand and so wide a range that it can undertake developments of this kind with some assurance. It is part of the general temper of the twentieth century that the haphazard growth of cities is no longer accepted as a matter of course, and that the power of the state is exerted to bring a lay-out more convenient, more healthy, less ugly. City planning, tho by no means a new thing in the world, entered on a new phase with the extraordinary growth of modern cities. There is no longer an unquestioning acceptance of the results of unbridled private activity. The change of attitude is but one of the many in which it is hard to draw the line between that which is best to leave to private initiative and that which the public can manage and direct to advantage. Certain it is that the operations of the private owners and managers of land, while they have achieved marvellous results in the utilization of particular plots, have shown little power to direct the long-run course of urban growth even for private gain and no pretense of any far-sighted planning for the general good.

In all this an important distinction must be borne in mind. There are two ways in which land has been cleared and smoothed, made accessible, converted from a crude instrument into one ready for use. Sometimes it has been done by the very men who plan to utilize or sell the improved instrument for their own gain. Sometimes it has been done by public action looking not to anyone's individual gain but to the good of all.

The growth of transportation facilities serves as an illustration. Streets, roads, motor highways, canals, railways, bridges are instruments for making land available. Man's action may be said to "create" these lands quite as much as when he adds to the area of cultivable land by draining the Zuider Zee. But streets, roads, and railways are ordinarily made not by the owners of the adjoining land and at their expense but by the state or by investors. There is an obvious difference between the farmer who improves his own acres and the state or town that makes the highway or the railway that carries the produce of his land a hundred or a thousand miles. Where indeed it is highly probable that land will be specifically increased in value, special taxes are often levied —"betterment assessments"—by which the state tries to recoup itself. But there has been no such attempt in the immense majority of cases where public or private operations have proved to add to the value of land; because the extent of the gain, great tho it may ultimately be, is virtually impossible of measurement at the time when the improvement is started.

CHAPTER 46

RENT (*Concluded*)

§ 1. The rent of mines, how influenced by risk.—§ 2. Diminishing returns in mines.—§ 3. Are mining royalties rent?—§ 4. The selling price of a site is a capitalization of its rent.—§ 5. The problem of appropriating rent for the public is presented most sharply by urban sites. The possibility of leases on long term by the state; the historical development of unqualified private ownership and of vested rights.—§ 6. The future increase of rent a proper object of taxation, but presents many difficulties. Modes of levying such taxes.

§ 1. MINES present a case in some respects similar to that of urban and agricultural sites, in some respects different. There are obvious differences between individual mines. Some are richer than others or more advantageously situated and these yield a differential return to their owners. If we assume free competition and mobile investment we may reason that, as the demand for a given mineral (say coal) increases, more and more mines will be put in operation—the most productive first, then those less so; that the coal will normally sell for enough to repay all expenses of production on the margin, that is, at the poorest mine in use; and that all better mines will yield a surplus income which is strictly rent.

But with mines the conditions of mobile investment hold good only to a limited degree. Mobility of investment presupposes not only ease of transfer for capital but also a generally diffused knowledge of the prospects of profit. Neither of these conditions obtains in mining, which calls for an irrevocable and usually very large investment and at the same time involves a high degree of risk and uncertainty.

There is some risk in all use of land. The risk probably is least in the long run (that is, over a series of years long enough to equalize the irregularities of the seasons) in the case of agricultural land; for the possibilities of such land are readily discerned by the capable farmer. It is greater in the case of urban sites, where there is the chance of ill-adapted buildings, of shifting population, of the caprices of business movements. It is greatest in the case of mines, varying again for different sorts of mines. Even tho prospecting is sometimes facilitated or encouraged by a preliminary geological and physiographic survey (such as, for example, that which ascertains the carboniferous area of a region) and even tho it may thus be known that abundant mineral underlies a given area, none the less expensive trial is needed to ascertain how much there is, of what quality, of what ease of procurement. When once a coal mine has been opened and put into operation it is usually possible to judge how long the supplies will last and what will be the expense of getting them to market; but even this is in some part a matter of guesswork. The case is similar with iron ore. Here also drilling and prospecting will often show how large, how good, how accessible, is the ore body; but this preliminary knowledge is got only by scouring a wide territory. A multitude of failures in "prospecting" is relieved by occasional success. Where minerals occur in pockets the chances both of failure and success are greatest and the miner's operations are akin to gambling. Such was the case with the so-called bonanza mines of the precious metals in Nevada. Some discoveries of these extraordinarily rich pockets of gold and silver brought fortunes to their owners. On the other hand there were unnumbered failures, tempted by deceptive surface indications. Copper mining long was notoriously uncertain and speculative and seems to remain so. In all these cases, even when the first excavations are promising, there is a stage of doubt, while the capital is being invested in shafts, machinery, concentrating and smelting works. Venturesomeness, judgment, persistence, and efficient management are essential to ultimate success.

Where there are many losses there must be corresponding gains. The traveler thru such states as Colorado, Nevada, Montana, Idaho, Arizona, California, sees the sides of the hills and mountains scarred by innumerable openings, each with its telltale pile of rock. The immense majority of these ventures were failures. Were it not for the chance of some great prizes all this necessary work of exploration would not have been undertaken. Under such conditions a high return on the lucky ventures does not constitute a true surplus. Nor is it easy to say whether on the whole the gains in successful mining ventures suffice to offset the losses in the unsuccessful. Prizes often have an undue effect on the imagination. The unfailing attractiveness of a lottery (in which it is obvious that the speculators as a body must lose) proves that where there is a chance of great gain from a lucky stake, men will often pay for the chance more than its actuarial value. There is ground for supposing that in mining for the precious metals in former times the total outlays were not recompensed by the total net earnings. At least a possibility of the same sort exists as regards mining operations in general.

It is probable that in many mining ventures the risk is less now than it was in former days; while on the other hand the need of large initial investment is greater. With the advance of geological and mineralogical knowledge it has become much more possible to infer from the surface outcrop or from experimental borings the quality and quantity of what is underneath. The improvements in treating ores have made available low-grade ores of gold, silver, copper, lead, such as occur not in pockets but in continuous veins or great beds. This is the case, for example, in the gold mines of South Africa, from which so enormous a supply of gold has been secured during recent years. Here mining operations, when once the body of ore has been found, are in no great degree speculative; and the yield on the better sources of supply has more the nature of a true surplus or rent. The same is the case with much mining of iron ore and coal in modern times, where the mineral body can be surveyed and appraised in advance with some measure of certainty. None the less—especially in view of the heavy investment in diggings and machinery required by modern mining methods—risk is greater than in most industrial operations above ground.

§ 2. There is, in a sense, a tendency to diminishing returns in mines. Yet in this regard also the general reasoning which underlies the principle of rent must be qualified.

In any one mine there is often—probably in a majority of cases—a tendency to lessening yield with increasing depth. Pumping to keep it free of water becomes more costly and minerals must be hoisted farther to bring them to the surface. So it is with the tin mines of Cornwall, which after centuries of working have now been extended beyond the shore line far under the bottom of the sea. It is the case, also, with the anthracite mines of Pennsylvania and the copper mines of Michigan. And in the end, too, every mine reaches its absolute limit. A mine is not, like agricultural land or an urban site, a permanent instrument enabling the investment of capital to be continued without limitation of time. Its store is fixed, even tho sometimes very large, and when that store is exhausted there is not diminution of return but complete cessation.

Against these tendencies to diminishing return and to ultimate exhaustion in any given mine must be set the possibility, even the probability, of the discovery of new mines. The total land area available for agriculture (even tho there are sometimes unexpected openings) is known with sufficient accuracy. But what is contained in the bowels of the earth must always be more or less uncertain. The nineteenth century was marked by the finding of wonderful mineral resources. In Great Britain there was the discovery of the great Scotch iron ore deposits at the opening of the nineteenth century, and of the Cleveland deposits (on the northeast coast) in the middle. In the twentieth century great coal deposits were unexpectedly discovered in southeastern England. In the United States, after the coal deposits of the Pittsburgh region came those of Ohio, Indiana, and Illinois. Not less important and surprising were the great copper deposits of Michigan, Montana, and Arizona, discovered successively after the Civil War, and the iron ore deposits of the Lake Superior region of later exploitation. The gold mines of South Africa have been found within the same recent period. It is known that there are other untapped resources: great iron and coal deposits in China, coal regions in Alaska, copper ore in mid-Africa; and there may be still others not yet dreamed of. Notwithstanding the limitations of each single deposit in the earth's crust, mankind for long years to come may look forward to an increase rather than to a diminution of its available mineral resources.

§ 3. The owner of a mine when he leases it to another for working usually gets a royalty—a fixed payment of so much per ton. Royalties naturally vary with the quality of the minerals and the ease of their extraction. They are a rough-and-ready way of carving out the economic rent. They are not necessarily in the nature of rent; for where a mine has been found by "prospecting," with all the risk of possible failure, the payment may stand for no real surplus. But where royalties are paid in well-explored countries, on minerals whose quality and value are reasonably well known, they are simply rent. Such seems to be the case with the royalties on English coal mines.

It is argued by some distinguished economists[1] that a royalty is in any case different from rent; or rather that there is on every mine some sort of payment to the owner, some revenue for him, and that even the poorest mine will yield a return in the nature of a royalty. The better mines yield in addition a true rent, disguised as a further or ampler royalty payment. The ground for this distinction is that a mine contains a fixed store, and that the owner will not consent to its partial exhaustion unless he receives some recompense. But I am skeptical of the validity of the reasoning. The mere fact that a store is physically limited does not enable its owner to secure a price. Sand and clay are thus limited; but the available quantity is so abundant that a clay pit or sand deposit is worth nothing unless it has an advantage of situation. It may be doubted whether any payment at all, royalty or whatever it be called, can be secured by the owner of the very poorest mine, assuming he has done nothing to develop it. Deposits of this sort are at the margin of utilization, and at the margin there is no surplus of any sort. Probably no mine in its entirety is on the margin; just as no farm in its entirety is on the margin. Good bits are mixed with bits less good, and the actual payment is adjusted by a higgling process, in which account is taken of the whole of the natural opportunities as well as the total expense and risk of development. Here as in every part of the economic field the concrete phenomena show only an approximate correspondence

[1] This is Professor Marshall's view, *Principles of Economics,* Book V, Chapter X, § 6 (6th edition). It seems also to have been Ricardo's view, *Political Economy* Chapter III. On the whole subject, see Professor L. Einaudi, *La Rendita Mineraria*

with the sharply stated theorems that serve to indicate their general trend. Rent proper plays the same part in mines as in other natural agents.

§ 4. The selling value of a natural agent—be it agricultural land, an urban site, a developed mine—is a capitalization, at the current rate of interest, of the fixed income which accrues to its owner. It varies, therefore, inversely to the rate of interest. Suppose a building on a given site is to cost $100,000 and promises a net income or commercial rental of $15,000 a year; then if the rate of interest be 5 per cent the investor will readily pay $200,000 for the site. On his total outlay of $300,000 he will get $15,000 or 5 per cent. If the rate of interest should fall to 2½ per cent the same site would sell for $400,000. The differential advantage of the site would remain as before—worth $10,000 a year; and the buyer would get 2½ per cent on his investment by purchasing the site for $400,000. On the $100,000 invested in the building he would be compelled by competition to accept the current interest rate of 2½ per cent and the total rental would be $12,500, not $15,000. The decline in the rate of interest would lessen the return on the building (considered alone) but would double the value of the land. The lower the rate of interest on freely offered capital, the higher the sum which will be paid for any piece of property which yields a fixed return.

The same principle applies to what are known as guaranteed securities—the shares of corporations, such as railroad corporations, which have been leased on fixed terms. Thus one railway may be leased (virtually bought up) by another, with stipulation to pay an annual sum equal to 10 per cent on its shares. If the current rate of interest is 5 per cent each share of the leased railway (par value being assumed to be $100) will sell for $200. If the rate of interest is 4 per cent each share will sell for $250; if 2½ per cent, for $400.

The selling price of land is affected, of course, not only by the process of capitalizing its present rent but by the expectations of the owners and of the investing and speculating public concerning the future. In a growing city an advantageous site will command a price more than in proportion to its present rent because it is expected that the rent will increase still further as the years go on. Conversely, a doubt as to the future of the site will cause it to sell at a price lower than its present rent would determine.

§ 5. The same problems of public policy arise for urban land and mines as for agricultural land. There is here an unearned increment, arising with the increase and thickening of population and ascribable in slight degree if at all to the labor or care of the fortunate possessors. There is a differential return over and above what is necessary, on the most liberal estimate, to induce the adaptation of the site to its most effective uses. Why should not the community appropriate this return?

This question is presented more sharply in the case of urban land than in that of agricultural land. In the first place, it is usually possible to ascertain with more accuracy just what is the site rent and the site value of urban land. We have seen that for any specific plot of agricultural land which has long been in use there is great difficulty in determining how much of its productivity is due to natural advantages, how much to man's action. That difficulty is less for urban plots. It is usually possible to state at least a minimum sum which represents the differential advantage of the site pure and simple. Something must be allowed, it is true, not only for pure interest but for the risk and labor involved in building and management. But after the most liberal allowance for all such items a surplus remains. In other words, it is possible to set aside some part of the gross return which is clearly rent for the site.

In the second place, urban rent is usually concentrated in fewer hands and gives rise to wider inequalities of wealth and income. Urban rent may or may not be in the aggregate greater in amount than agricultural rent. In countries like Germany and France agricultural rent is probably at least as great. In England, where much the larger part of the population is gathered in cities and where the importation of foreign produce has checked the growth of agricultural rent, urban rent is no doubt much larger in the aggregate. It probably is so in the United States also; for the abundance of farming land and the efficiency of the means of transportation have limited agricultural rent, while the increase of city population has vastly enhanced urban rents.

And urban land is usually in fewer hands. True, the agricultural land of Great Britain is concentrated in comparatively few hands. In Austria, Hungary, Spain also there are (or were) vast estates in the possession of a small number of titled proprietors. In France, however, in southern and western Germany, and in the United States, the ownership of agricultural land is widely diffused; and its economic rent is dispersed among millions of proprietors. Urban rent, on the other hand, flows into the hands of a much smaller number of persons and among these a few receive great amounts. The Duke of Westminster and the Duke of Bedford are types of British peers who have been enormously enriched by the ownership of urban sites and the falling-in of long-term leases. John Jacob Astor in the early years of the nineteenth century became the owner of sites in New York whose value in the course of the century became almost fabulous; his descendants not only enjoy this yield but have enlarged the family holdings until their income has exceeded that of dukes and princes. The same sort of thing has happened in almost every American city. Certain "old families"—usually founded by an ancestor of the successful business man type—have become rich from the growth of the community. It is true that tenacious holding of the land by successive generations of the same family is much less common in the United States than in Great Britain. The ease of transferring the title to land and the habit of speculation have caused a dispersion of urban rent in our own country and a parceling of the increment among a succession of purchasers. None the less, in the United States as in other countries, urban rent has been among the causes of conspicuous inequalities in wealth.

Hence the proposal to appropriate for the public the whole or a part of rent is urged more insistently for urban sites than for agricultural land. It seems to me impossible to deny that if a reservation of rent for the community had been made from the start, with due care and discrimination, the community would have been better off. The effective utilization of the land would not have been retarded, while a lessening of the general tax burdens and a check to inequality would have been secured. Careful and discriminating management would indeed have been essential.

The quinquennial or decennial carving out of economic rent would have raised delicate questions as to how much allowance should be made for the return necessary to enlist shrewdness and enterprise. A mechanical administration of such a system, still more a grasping one (and public administration is too apt to show one or both of these characteristics), might bring more harm to the community in checking the utilization of land than good in capturing the unearned increment.

The leasing of land on long terms by the state, which was suggested among the possibilities for agricultural land, would have been no less possible for urban land. So far as the promotion of investment goes, a lease for 99 years is as good as a title in fee simple. No doubt if land were held on some such terms from the state, the holder during a large part of the 99 years might secure a handsome slice of the accruing site value. But at least when the end came the community would reap its gain. Much shorter leases—for 50 or even 25 years—could conceivably be drawn, with provisions for compensation to the improving tenant such as would allow sufficiently free play for the investment of capital. Land leases for such terms are not uncommon in the city of New York (e.g. on the Astor properties) and are not found incompatible with the most intensive utilization of the sites.

In the case of mines it is difficult to see how any other method than that of long leases on some sort of royalty basis could secure the two desired ends—the effective utilization of the resources and the conservation of the public's fundamental equity. The uncertainties of mining are such that any recurrent carving out of economic rent is quite impracticable. The only feasible policy would be that of allowing private enterprise to take its risks and reap its rewards over a long period. No doubt the possessor or tenant during his term would be tempted to work the mine to the utmost and perhaps exhaust it; a difficulty possibly to be met by requiring the payment of a progressive royalty as a large output was reached. Here, as elsewhere, occasional great gains to lucky or shrewd investors must be accepted with equanimity; a policy too grasping overreaches itself.

All this, however, is little more than idle speculation, at least so far as the past is concerned. No community has reserved to itself, by lease or by periodic levy, the right to the unearned increment. Historically it could not be otherwise. We face a situation similar to that of interest on capital. Private property in land was an indispensable instrument for the growth of civilization. Surveying the history of European industry and the growth of European cities we cannot see how advancing arts, free enterprise, accumulating capital, could have been secured without the instrument, comparatively crude as it may seem, of unqualified title to land. The new countries of modern times—the United States, Canada, Australia, Argentine, and the like—might conceivably have started with a more far-sighted system of land tenure. In fact they have not done so. The force of tradition and habit, the rapacious desire of the pioneers for the unrestricted title, ignorance and indifference about the underlying economic principles, have led them to follow the ways of old countries and to accept the established principles of the unqualified law of real property.

Hence the problem of vested rights in urban land and in mines stands as stubbornly in the way of the ardent reformer as it does for agricultural land. The purchase and transfer of urban sites have gone on from time immemorial in the same way. To the present owners the capitalized value represents an investment or an inheritance. Land at its existing value cannot be treated on different principles from those applied to other kinds of property. The whole institution of property may indeed be overhauled; all private ownership and investment, all inheritance, may be restricted, conceivably abolished; but unless the system of private property be remade the existing rights to land, as they have been allowed to develop thru the centuries, must be respected.

§ 6. The question is different as regards a rise in rent that is still to come. There is no vested right in the indefinite future. The proposal that the future increment shall be reserved for the community was made fifty years ago, chiefly with reference to agricultural land, by John Stuart Mill and other reformers. But the advantages of unrestricted property in agricultural land, especially where wide distribution of ownership prevails, and the difficulties in the way of carving out economic rent with any accuracy

—these considerations have led to the rejection of Mill's proposal, as regards agricultural land, by most economists of the later generation. On the other hand, with the rapid growth of modern cities and the unmistakable swelling of site rents, a reservation for the community's benefit with respect to urban land has met with steadily increasing recognition.

Many persons of conservative bent object to such proposals on grounds of principle. They urge that this would be only a beginning. Eventually not merely the increase newly accruing would be appropriated but existing values as well. Objections of this kind, however, are urged against every proposal for reform and, if allowed, would prevent any disturbance whatever of the *status quo*. The day is gone by when they are felt to be insuperable. The dogma of an unrestricted right of property and the belief in the expediency of the exercise of that right without a jot or tittle of abatement have been shaken beyond repair. The rights of property must prove themselves on examination in each particular case, and must submit to modification where a balance of gain for the public can be reasonably expected.

Less easy to answer are the objections on the score of practicability—whether a legislative scheme can be devised in such way as to meet the complexities of the situation. How proceed? The problem is by no means a simple one. The accruing increase of rent is the thing which it is desired to divert to public use. But what emerges most openly is capitalized value. The easiest way of adapting the machinery of taxation to the phenomenon familiar to all the world is to tax in proportion to the higher selling price of land. To tax the increase in selling price may indeed seem to accomplish the same end as to tax the growing rent; since the price is but a capitalization of the rent. Yet there are difficulties and complications.

From whom shall such taxes be collected? Usually the proposal is for collection from the seller. This being the case, the buyer pays the full value of the site and the seller is mulcted by the tax gatherer for part (conceivably the whole) of the increase in value. But this process tends to prevent the seller from parting with the site; he will hold it and secure the site rent for himself rather than sell subject to a tax. There will be a certainty of securing the accretion only if the land is periodically valued or if its transfer by inheritance is made the occasion of levying a special tax. Periodic valuation is not impracticable; but it is extremely complex and expensive. Indeed so expensive is it that this alone is a forbidding obstacle; the cost of ascertaining the increment may easily be greater than the revenue secured. Only if a valuation of sites is undertaken in any case for other tax purposes (the ordinary taxes on real property), and if continuing records are thus available, is there likelihood that a substantial net revenue will be secured. It would carry us too far afield to enter on a discussion of the administrative and political questions that must arise: the control of valuations, the rights of revision and appeal, the friction between local and central authorities. No doubt difficulties of this type are often exaggerated. They are made much of by those who at heart oppose all change and turn to any and every pretext for justifying their opposition. On the other hand, ardent reformers often fail to face squarely the problems involved in the legislative formulation of their proposals. No final judgment can be rendered on any scheme until it is seen what it is like in the form of a carefully drafted bill or statute.

There is still another objection to taxes on seller's increment. They are, so to speak, a sale by the public of its birthright. The buyer pays the full capitalized value and pays the increment (*via* the seller) to the tax gatherer. In effect he buys a rent charge in perpetuity. The state parts with its principal; in consideration of a sum paid in at once it parts forever with its right to appropriate the accrued increase of site rent. This is unthrifty, in the same sense in which it would be unthrifty for an individual to spend his principal rather than his income. And obviously the process contributes to the perpetuation of the leisure class. The buyer and his descendants buy the right to collect for the unlimited future the site rent whose capital value has been paid over to the public.

It would seem in principle much preferable to levy all such taxes, whether their intent be to capture a large slice of increasing rent or a small one, with reference to the economic rent itself. This is doubtless not in accord with existing practices in the purchase and sale of real property; and in the United States it is also quite out of accord with the tradition of levying all local taxes on the capital value of property, not on the income. Hence it is a method difficult of adoption, particularly so because tax changes of every sort encounter more vehement opposition than almost any other kind of economic readjustment. Yet the periodic assessment of site rent is in itself not more difficult than the periodic assessment of site value. The increase of site rent, or whatever part of it is to be secured, could be subjected to an annual charge, with revaluation every five years or every decade. Selling value would adjust itself to the diminished share left the owner, modified (as now) by changes in interest rates but not affected (or less affected) by prospects of rise in the rent. The chief difficulty inherent in this method would appear for vacant land—urban sites whose potential rents are high but which for the time being are withheld from use by their owners. They may have high capital value but in their existing undeveloped state no rent at all has accrued. To leave them untaxed would contribute to keeping them undeveloped. Our existing American system of taxing vacant land on its capital value does indeed operate to hasten its utilization. Yet to tax it in full on an estimated potential increase of rent would be a troublesome matter, in view of the fact that all such land cannot possibly be brought into use at once and all of it cannot be made to yield a rent at once. Some sort of compromise would seem to be called for—a partial tax, perhaps at half rate, on such potential increases: enough to bring pressure on the owner to utilize the site.

A partial tax, indeed, is all that can probably be levied with enduring public advantage on any increase of site value, regardless whether the site be vacant or built on. This limitation of the application of the principle results from the aleatory element which attaches to urban sites. There is some analogy to mines. If every profitable mine were to be taxed for its full "rent" (in the sense of the excess over ordinary return on the capital invested in that particular mine) and if, on the other hand, every unprofitable mine were left to its own fate mining ventures would not be made. The public's way of playing the game would be heads we win, tails you lose. The case would be similar if all growth of urban site rent were taxed in full but all decline were left uncompensated. True, the analogy between mines and city sites is not complete; for the element of chance in the former arises because of the uncertainty of the physical condition underground, in the latter because of the fickleness of urban demand for the surface. But there is the essential resemblance that the investment of capital must be made, whether on the land or under the land, and that in both cases it involves risk. Rent does not accrue spontaneously or automatically. The full utilization of a city site, like the development of a mine, calls for enterprise and judgment and for the irrevocable sinking of large sums; and it entails the possibility of loss and failure.

Such reasoning must not be pushed to the conclusion that there should be no attempt at all to tax future increment. The problem is one of degree. Risk there is in urban building ventures; but not risk so great and so all-pervasive as to make the outcome solely a matter of chance. The constant buying and selling of sites, the bargains in leases on ground rent, the higgling of the market, give a significant indication of what is expected by the real estate fraternity and of what return may fairly be expected in the way of growing site yield. Some substantial part of the reckonable future of sites can be taken for the public without deadening the spirit of enterprise or hampering the full utilization of the land; always provided that the legislative problems be solved and that the administration be honest and efficient.

Last but not least, a most troublesome difficulty has to be faced, that of making allowance for a general movement of prices. If all prices double, money rents of land may be expected to double also; more slowly, it is probable, than the prices of most commodities but in the end with substantially the same rate of advance. The special causes affecting each particular plot meanwhile will still be in operation, causing its site rent to rise or perhaps to fall—to diverge more or less from the general trend of prices and of rents. How disentangle the increment which economic theory and social policy would wish to set aside? These cannot but be knotty problems even when prices rest on the gold standard. The gold standard ordinarily prevents rapid and abrupt changes; it may assure stability for five or ten year periods; but it by no means prevents fluctuation over the longer period which must be considered in schemes of increment taxation. The difficulties become almost insoluble after such a monetary revolution as ensued with the war of 1914–18. Indeed, there is no scheme of economic or social improvement whose complexities are not increased to an intolerable degree by such fatal disruption of monetary standards. All taxes, all rent, all payments, all modifications and equalizations of income, must be framed in terms of money; but what did money terms mean in 1920 compared with those of the years before the cataclysm? And who can say what they would mean a generation later? [1]

[1] In 1911 Germany enacted an increment tax (on increases in urban site value) which at its maximum reached 45 per cent—30 per cent for the imperial treasury, with a possible 15 per cent in addition for local bodies. Great Britain in 1909 enacted a similar tax of 20 per cent. Based as they necessarily were on the pecuniary values at the time of enactment, they were rendered hopelessly out of accord with their professed aims and principles by the subsequent price revolution. The British tax was repealed in 1920; the repeal was defended, however, not on the ground that monetary standards had changed but because of the complexity and expense of land valuation under any conditions. The German tax later became merged in a general tax on all increases of values.

On the general subject of the taxation of sites, compare what is said below, Chapter 71, on the taxation of land and buildings.

CHAPTER 47

THE NATURE AND DEFINITION OF CAPITAL

§ 1. The importance of the distinction between interest and rent little stressed, sometimes denied, in recent economic literature.—§ 2. Grounds for maintaining that all returns from property of any kind are homogeneous.—§ 3. A different conception of "rent" and "interest," the two being regarded as different ways of stating the same sort of income. "Artificial" and "natural" capital. How measure the amount of capital?—§ 4. The important questions are on the effectiveness of competition, the existence of a normal rate of interest, the justification of interest.—§ 5. Quasi-rent once more.

§ 1. WHAT has been said in the preceding chapters on the various forms of rent has an old-fashioned ring. It rests on the supposition that in the last analysis there remains a difference, and an important one, between the incomes from natural agents and those from instruments made by man. The trend of modern economic discussion has come to be not exactly to deny or cast aside the difference but to slur it over. Other ways of looking at the income from property, of whatever kind, have come into vogue. There is the socialist attitude which (as has been already said) regards all property income as equally unjustified; all alike is to be wiped out. Different in degree rather than in kind is the attitude of those who would maintain the essentials of private property but are much disposed to prune its excrescences. For these the distinctive marks of abnormal and unnecessary growth in property and in property income are quantitative rather than qualitative; it is more important to prune wealth and income than to look whence it came. So far as ownership of land is widely diffused it does not matter much just how it comes to yield a revenue to the owner; the main desideratum is that there shall be a large number of owners. In the case of agricultural land wide diffusion of ownership is the thing desirable, for this improves and also strengthens the system of private property. And it promotes efficient cultivation, which can be both promoted further and made to work better by legislative measures. This sort of justification is less applicable to urban sites because of the great incomes that are likely to flow into single hands. It is not so much on any grounds of strict economic principle—such as better use of resources—that the state may here intervene as on the larger ground of mitigating unequality, which has come to underlie governmental activity in so many directions.

None the less, a classification of the property incomes—interest, rent, quasi-rent, royalties—is desirable, not only for an understanding of the working of the system of property but for weighing its good and its bad effects. Hence the present chapter.

§ 2. There are several tenable grounds for regarding all these incomes as homogeneous. In the first place no returns are earmarked as monopoly gains or as rent, and none are distinguishable at sight from simple interest. When it is said that land "yields" economic rent, the phrase is used elliptically; so, also, when it is said that a patent or an industrial monopoly "yields" a monopoly return. What happens in the case of land is that the output is large in proportion to the labor or outlay in preparing and tilling it; and, in the case of monopoly, that the receipts are large in proportion to the expenses of constructing a plant and operating it. In either case there is an exceptional return, a surplus yield. But this is distinguishable from interest only on the assumption that there is a well-defined *non*-exceptional return—one normal for capital subject to unfettered competition. In any concrete case there is always a difficulty in setting apart with precision that return which would be received under competitive conditions from the surplus which would disappear if competition were free.

Further: the divergences from the "normal" return, or simple interest, are many and various. They shade into each other by gradations. All sorts of industries present a differential element; not only the urban site in the heart of a metropolis and the valuable patent monopoly but the factory established at a "strategical" point and that which has a quasi-monopoly of prestige and trademark. There are plenty of industries and plants where for very long periods much more than simple interest is secured. There are others where much less is secured. The older writers often described the industrial situation as presenting a few cases of monopoly and some other cases of easily distinguished "rent," and then a great stretch of industries having normal revenues. But this does not accurately represent the extraordinary variety and irregularity of the world as it is.

Again, in view of the diversities in the rates of return it is reasonable to say that monopoly returns are not separable from economic rent. True, the essential element of monopoly, as we have defined it, is control of the supply; and so far as a monopolist has this he is in a different position from the person who has merely a differential advantage in producing part of the supply. But complete monopoly control is very rare; some sort of competitive or inferior substitute is commonly to be reckoned with. Monopoly gains then may be said to be only a variety of the species "rent." And in any case monopoly gains rest on the fact that the thing monopolized has high serviceability or utility; it yields more in the way of eventual satisfactions than other things, and hence may be said to yield a differential return, very much as a good water power or a fertile field yields a differential return. What its owner gets is thus analogous to the "rent" derived from a natural agent.

§ 3. Considerations of this kind have led to a method of approaching the problem of property income different from that followed in the preceding chapters. It is said, and with undoubted truth, that all concrete instruments of production have a derived value. They get their value from the utilities which in the end they bring about or aid in bringing about. The income-yielding power of a cotton mill results from the price of the cotton goods, which in turn rests on the utility of the goods to consumers. The income-yielding power of a railway rests on the usefulness of rapid transportation; that of a house lot on the agreeableness of the dwelling and the site; that of business premises on their convenience for making or distributing commodities. Some of these instruments are more effective in supplying utilities than others, and in proportion as they are more effective are more valuable. But all belong to the same class: they are immature utilities, so to speak, and are valuable in proportion to the satisfactions that in the end will ripen.

It is a further development of this train of thought, and a further proposed change in phraseology, to say that every instrument yields a "rent"—a rent not in the older sense but in quite a new sense. That "rent" is its yield or its income; in the sense in which the possessor of a settled income is designated (on the continent of Europe) a "rentier." It is the net income yield of the instrument, resulting from the utilities which the instrument provides or aids to provide. Whether it be a huge steamship made by much labor or a lucrative city lot, the income of the owner depends on what this concrete thing yields in the way of addition to the ultimate income of the community. The one as well as the other is based on serviceability. The owner's income, it is said, may be regarded as "rent" or as "interest," according to the point of view. Regarded as an absolute sum, it is the rent of the instrument; regarded as a percentage of the property or capital embodied in the ship or the lot, it is interest. Capital being regarded as homogeneous and as including all the various kinds of instruments, all return from it is homogeneous. The return is regarded in a different light but is not different in essentials because we dub it interest or rent.

Pursuing this train of thought further we might say [1] that capital is of two kinds—artificial and natural. Natural capital is that which has been classed under the general head of "land" or "natural agents"; artificial capital includes all instruments made by man. Natural capital may be highly useful and highly valuable, as in the case of a rich mine or a deep harbor site. In that case it may be said to contain or embody a great deal of capital. A power plant or a factory in which a monopolized article is produced may be said also to contain or embody an exceptional amount of capital. The valuation is high; the capitalization indicates the existence of a large volume of capital.

Evidently still another question is involved: how *measure* the amount of capital? The reasoning just stated would measure it in terms of value. And this too is the ordinary business method of measurement. A mine, a railway, a parcel of real estate, a factory, each is valued on the basis of its net income; it is capitalized. The distinctions sought to be drawn by economists between interest,

[1] With Professor A. S. Johnson, *Introduction to Economics,* p. 107.

rent, and monopoly gains find little response in the world of affairs. There all property is valued in terms of its income; all that brings in an income is alike capital and all is measured or capitalized on the basis of its income. Those economists who dissent from the older view follow the business community's way of defining and measuring capital. In that older view, on the other hand, the definition of capital as instruments made by man led to its measurement in a very different way—namely, in terms of cost, of expense, of labor. As will appear later, these are not precisely equivalent terms; [1] but for the purpose of the present discussion, discrepancies between labor involved and expense incurred may be neglected. In the main, capital under the older view was measured in terms of labor involved. Capital meant previous labor or embodied labor; and capital was greater or less not according to its value but according to the amount of labor involved and the length of time over which that labor was spread. The difference between the older and the newer views is similar to that between a "commercial" and a "physical" valuation of a railway.

Pushed to its last consequences, the measurement of capital in terms of value leads to some results that take one aback. A public debt, say in the form of a French "rente" (that is, a mere promise to pay an annual sum), is capitalized in terms of selling value; and it becomes "capital." A burden on the taxpayers is thus included under the term "capital," tho that term in general indicates the useful apparatus of the community. A naked patent right or a "franchise," not yet attached to a concrete instrument, becomes capital. A perpetual pension, such as the English Parliament used to grant to royal favorites or military heroes, becomes capital; it too can be measured in terms of value and capitalized. Nay, a human being, in so far as he is an instrument for production—and he may be conceivably regarded as such, just as a slave is an asset—becomes capital; and then return to labor, as well as income from property, may be regarded as "interest" or "rent." [2]

[1] See below, Chapter 53.

[2] This extreme application of the reasoning is made by Professor I. Fisher, *Elementary Principles of Economics,* Chapter XXIV, § 1, and by Professor F. A. Fetter, *Economic Principles,* Chapter XVI, § 1. Compare also J. B. Clark, *Distribution of Wealth,* Chapter XXII.

A word more about the attitude of the socialist on these matters. To the socialist the difference is simply between tweedledum and tweedledee. All these incomes are unnecessary and unjustified. All result from a bad social system and should be abolished. And true it is that all are alike in that they make possible the leisure class. This last is the phenomenon in existing society which, when once privilege is no longer regarded as part of the order of nature, most calls for explanation. Why should a considerable number of able-bodied persons live in idleness and plenty? That the aged and infirm, the children and even the women (at least the married women) should not be engaged in the ordinary productive occupations seems proper enough; but why should healthy adult men and women not labor to contribute to the general welfare of society? In the feudal system the privileged classes were at least called on to render military service. In our own society they are called on for no service at all. Is this inevitable? Is it just? Are not these questions the same for all of the leisure class and for all of their incomes? Do they not all own "capital" and all alike secure a capitalist income?

§ 4. Two important questions underlie these matters of definition and phraseology. One is the question of taxonomy, of cold classification: are there sufficient differences between the various sorts of income from property to make different names reasonable for the incomes and serviceable in explaining them? The other is a question of large social import: are there grounds for applying a different public policy to the various sorts of income? Both questions, as it happens, turn in the end on the same point: is there effectiveness of competition as to capital (artificial capital), and is there a normal competitive return usually secured from investment *and* needful in order to induce investment?

It is clear that there is not effectiveness of competition or equalization of return as to "natural capital"—land and natural agents. The better among these agents yield more than those less good. So far as there is similar ineffectiveness of competition and similar inequality in return among the instruments made by man, their yield presents no phenomena essentially different from those of natural agents. But if there be effective competition over a large range of the various forms of artificial capital, no one among those in the competitive class will permanently bring to its owner an exceptional or differential return; then there is interest, and interest only, on capital in the narrower sense; and then there is a substantial difference between "interest" and "economic rent."

On this matter of the actual efficacy of competition we must speak with reserve. In some directions it is clear that the older notion of full competition between all forms of artificial capital must be given up. There are industries in which large-scale operations and increasing returns lead to monopoly—such as many of the so-called public service industries—and in which the return is thus analogous to economic rent in the older sense. There are the trusts and quasi-monopolies in which similar variation from a supposed normal return is found. Even in industries outside the pale of monopoly or combination there are extraordinary variations in the returns got by the owners of factories, warehouses, ships; so far there seems ground for rejecting the whole supposition of equalization in yield from artificial capital, and so for rejecting all distinction between rent and interest.

Yet, in the long run, for probably the greater quantity of "artificial capital" the matter takes a different aspect. Tho the competitive régime has broken down over a considerable range of industries it has not yet ceased to be the prevailing régime. True, there are great variations in the returns secured by the owners of almost any form of concrete capital; but these are mainly explicable, as will presently appear,[1] from differences in the business capacities of the owners. Setting aside the differences arising from this cause; setting aside also those resulting from the irregularities of demand; having regard to the irregularities of supply because of slowness with which new plant can be made and the even greater slowness with which old plant wears out; looking at the long-run results—we find after all a tendency to equalization over a large part, probably the larger part, of the industrial field. If a particular kind of artificial capital proves exceptionally profitable more of that kind will be made and the return on it will be lowered. In this probability lies the essential ground for distinction between

[1] See below, Chapter 49.

capital and land, interest and rent, competitive gains and monopoly gains. If the return on every specific kind of concrete instrument were a mere matter of accident quite unaffected by any competitive or equalizing influence—then all alike would be mere "rent" yielders and would have a value resting once for all on the utilities provided thru them. The conditions of demand alone would govern. It is certain, however, that the conditions of supply affect at the least a very large portion of the concrete instruments. Only a part are limited natural agents or are shielded from competition by a monopoly position. So far we can speak of a normal return or interest, in the one case, and of rent and monopoly gains in the other cases.

§ 5. We return thus to the point of view taken when the phrase quasi-rent was introduced.[1] If a plant has once been made, a building once constructed, the income from it has no immediate or direct relation to its cost. The income is the result solely of what the structure will yield as it is. The capital sum for which it stands is merely the capitalization of that income at the going rate. And if the plant or building lasts forever; nay, if it lasts for generations —for a period which may be short in recorded history but is long in economic history—that tells the whole story. If, on the other hand, the structure is not durable; if it wears out in the span of a few years or a generation—it will not be rebuilt unless there is reasonable expectation of securing the going rate of return. It may be maintained and repaired for a yeriod of years, even tho it yield less than that rate, since it is better to get some net income than to get none at all. But eventually the outfit will be scrapped. So long as it remains in use the return is like that from a piece of land or a water power; it is like their rent, and to be distinguished and dubbed a *quasi*-rent only when the element of time is introduced.

The same applies to a house or factory which is good beyond the average standard of the time. What this yields in the way of net receipts or income depends in the first instance on the usefulness of the structure. The income is the rent of the concrete physical thing as it stands. The reason for not speaking of it as a rent once for all but of using the term quasi-rent can only be that in time

[1] Chapter 45.

other structures equally good will be put up and the return will be cut down by competition to the going rate. We have seen how the utilization of urban sites and the incomes from urban buildings are affected by the plans, the imaginative powers, the venturesomeness of the owners (or their representatives and factotums). Time elapses before it is generally appreciated that a new kind of structure is profitable, and still more time before others imitate the leaders by erecting other structures of that kind. Meanwhile there is a quasi-rent which is larger than the going return; just as in the converse case there is one smaller. In this particular field of investment—urban buildings—there is indeed a difference between the new up-to-date structure and the old outmoded one; the time required for equalization thru increase of the new kind or scrapping of the old is *shorter* when the new "improvements" are profitable than when old ones cease to be so. New structures can be put up in a few years and high quasi-rents are cut down at a comparatively early stage. But if the quasi-rent drops, the abandonment of those already put up takes place slowly and the scant quasi-rent may persist for many years. And this stage of making the worst of a bad business lasts the longer the more durable was the original construction. One of the striking characteristics of boom periods in the United States has been that new dwellings, hotels, theaters are erected, more elaborate than before and better equipped, yielding for a few years a handsome quasi-rent; but soon to be duplicated by others and deprived of their short-lived differential advantage. When the period of depression ensues both the pioneers and their followers are likely to be hard hit. It is this sort of overproduction that has been among the characteristic features of the recurring depressions in the United States.

In general, then, net income from any durable instrument of production is at any given time a matter of "quasi-rent." As regards an individual piece, this kind of "rent" (rental) may happen to be the same as the ordinary or normal rate of return on capital; but it may be less, may be more. As regards investments in the aggregate there is probably ground for saying that the return on investment as a whole is in modern times less than "normal";

because the amounts of money funds or savings pressing for investment are enormous, the optimism of the investors persistent, intrusion into a new and promising field easier than withdrawal from an old and overworked one.

All these peculiarities of the problem indicate how the whole distinction between capital and land, between instruments made by man and instruments provided by nature, hinges on the element of time and of competition acting in the course of time. If a piece of equipment constructed by the application of labor and capital lasts forever the income is like a rent once for all. If it lasts say a century, like subsoil drains on farming land or buildings of extremely solid construction in a city, it is virtually the same. Where the thing endures for a generation with but moderate depreciation, like an ordinary dwelling, it is in most cases handled as if the future could be disregarded and the income is very like a rent. Few persons look ahead more than a generation. But if a mechanical instrument endures for a few years only, like a motor car, no one would regard the income from it as essentially like the rent of a parcel of real estate.

CHAPTER 48

BUSINESS PROFITS

§ 1. Business profits rest on the assumption of risks. The term "profits."—§ 2. Position of the business man as receiver of a residual income. Irregularity and wide range of this income; its relation to prices. Tho irregular, it is not in the main a matter of chance.—§ 3. The part played by inborn ability; that played by opportunity, environment, training.—§ 4. The qualities requisite for success: imagination, judgment, courage. Mechanical talent not so important as might be expected. Relation of the business man to inventors. Diversity of qualities among the successful.—§ 5. A process of natural selection among business men. Natural capacity tells more than in most occupations.—§ 6. Motives of business activity and money making. Social ambition the main impulse; other motives are also at work.—§ 7. What changes would occur if business ability were very plentiful and capacity for muscular labor very scarce.

§ 1. We return now to the main course of the argument, resuming the subject of distribution. Business profits present many of the problems exhibited by differences of wages, a phase of distribution to be considered shortly.[1] Yet they have many peculiarities and call for separate consideration. Various phrases have been used to designate this constituent in distribution: "wages of management," "net profits," "business earnings," the reward of the "entrepreneur" or "undertaker" or "enterpriser." In everyday usage "business profits" indicates the sort of income now to be considered and "business man" similarly indicates what kind of person secures it.

In common speech "profits" and "business profits" are usually stated in terms of a percentage on the capital employed. A man is said to make profits of ten per cent or twenty per cent on his capital. If part of the capital is borrowed and stipulated interest is paid to a creditor the amounts so paid are deducted from the gross profits. No such deduction is consciously made, however, for interest on that capital which is put in by the business man himself, not borrowed. Yet if interest be regarded as the mere return on capital, and business profits as earnings which are like wages, the

[1] In Chapter 52.

deduction should be made in the second case as well as in the first. The capital invested by a business man and managed by himself would secure the current rate of interest if lent to someone else and managed by someone else. Only that amount which is over and above interest on the owner's capital should be regarded as business profits.

The essential distinction between interest and business profits is recognized in everyday discussion quite as often as it is ignored. It would be admitted by all, as a matter of course, that there is a difference as regards the reasonableness or probability of a given rate of return. If the rate of interest is six per cent the rate of profits, it is agreed, ought to be higher; and it is expected that in fact it will be higher. The reasoning of the street and that of the economist would be more easily brought into accord if business profits were usually spoken of not as a percentage but as a lump sum, a total accruing each year or each six months, like the income of an architect or lawyer or physician. But various causes prevent this usage; not merely the tradition of older days, when the business man usually managed his own capital and borrowed comparatively little, but other more substantial causes, such as the all-pervasive conduct of business in the corporate form, and not least a real connection between amount of capital and the gross sum of business profits. Of these matters more will be said as we proceed. During the first stage in the analysis it is best to draw a clear line of distinction between the business profits of the manager and the interest on his capital.

Everyday speech not only often fails to distinguish between business profits and interest but confounds with profits such things as rent and monopoly gains. A patent worked by its owner is spoken of as yielding large profits. Royalties paid on a patent or a copyrighted book are often termed profits. Similar language is used regarding the gains accruing from a valuable urban site. The adoption by economists of the terms of everyday life leads to frequent misunderstandings and sometimes to real ambiguities; for it cannot but happen that the economist himself at times will use words in the vernacular sense. He will speak of high "profits," for example, when he has in mind merely good fat returns of one sort or another. In the present discussion, and in general thru this book, "business profits" will be used in the sense already indicated: namely, earnings over and above interest, over and above rent or monopoly gains.

The independent conduct of industry is the salient characteristic of the business man's work. He assumes the risks of the outcome of industrial operations; whereas the salaried person or wage earner has a definite amount promised him in advance for settled duties. In this respect it is immaterial whether the business man conducts operations on a large scale or on a small. The village cobbler and the owner of the large-scale shoe factory, the petty shopkeeper and the great merchant, the peasant proprietor and the estate farmer alike are business men and earn business profits. The physician or lawyer who is engaged in the independent practice of his profession is, from this point of view, in the same class; for his position evidently differs in a similar way from that of the physician or lawyer who is engaged at a fixed salary. But usually in connection with business management we think chiefly of those who conduct operations on a considerable scale, who manage substantial amounts of capital, who hire others to work for them and under them, who have to make plans of some complexity, whose own work is mainly or exclusively the direction of affairs. We think, too, of the more common "business" operations in trade and manufactures. We shall best approach the special problems of business profits by considering first these familiar and typical cases.

§ 2. The business man stands at the helm of industry and guides its operations. Into his hands first flow the proceeds and he distributes to others their share. He pays to the hired workmen their stipulated wages. Similarly, to those who lend him capital he pays stipulated interest. It is his weighing and guessing of the money-making possibilities of different sites that determines the rent of urban land, and he pays to landowners their rents. After making these various payments he retains in his own hand what is left. His income may therefore be described as residual.

This position as residual claimant explains one striking characteristic of business profits—the irregularity of the income. In one year the business man may earn nothing, may even lose. Another year he may gain great sums. The variations from year to year of the same individual's profits arise from the business man's assumption of industrial risks. Tho some hazards are so regular in their occurrence over a large number of cases that they can be insured against (fire and loss at sea), many must be borne once for all by the individual who first assumes them; such as those from fluctuations in demand, inventions and new processes, ups and downs in prices. The net income of the business man is inevitably fluctuating.

The business man more especially feels the effects of changes in prices. When prices rise he gains for a while; when they fall he loses for a while. This is true of changes in the price of particular commodities as regards the business men who have to deal with those commodities; it is true of changes in general prices for business men as a class. Hence many people get the impression that buying and selling and skillful manipulation of prices are of the essence of business. It has already been pointed out [1] in what way rising and falling prices affect the relations of business men with the laborers whom they employ. The business man being the buffer for the first effects of all changes in the value of money, there is a close dependence of business profits on prices. But this is a temporary relation; while it affects the fluctuations in his income, it does not determine in the long run its amount or indicate its source.

So great are the risks of business that many people, again, look upon it all as a game of chance. Some win, some lose—it is but a great lottery. And there are not a few individuals who actually enter on business operations in this spirit, with as little close calculation or careful management as a gambler uses. But it requires no refined observation to show that success is not entirely a matter of luck. True, there are gains in one year, losses in another. Sometimes it even happens that permanent success is won by chance. A turn in the market, a new commodity, a new mine, may yield a fortune—the business man's goal. One who has thus won a prize may have the good sense to stop and to withdraw with his winnings from the uncertain arena. But usually he tries again and still again.

[1] See Chapter 20.

Then over a series of years it appears that some individuals show a steady balance of gains, others lose in the end and disappear from active business. The elements of success are various—shrewdness in meeting risks as well as skill and ability in organization. But continued success is not due to chance. It is due to the possession by some individuals of qualities not possessed by others.

Again, these qualities are possessed in varying degree, or at least with very varying results, by different individuals. The great range of this income is even more striking than its irregularity for any one person. Some men seem to have a golden touch. Everything to which they turn their hand yields miraculously. They are the captains of industry, the "big men," admired, feared, and followed by the business community. Others, of slightly lower degree, prosper generously, tho not so miraculously—the select class of "solid business men." Thence by imperceptible gradations there is a descent in the business and social hierarchy until we reach the small tradesman, who is indeed a business man but whose income is modest and whose position is not very different from that of the mechanic or the clerk.

A wide range in the earnings of individuals doing the same sort of work is a peculiarity of all intellectual occupations. Tho some mechanics are more skillful and better paid than others the differences are not comparable to those between lawyers, physicians, artists, business men. This is because the differences in intellectual endowments between men are vastly greater than the differences in manual vigor and aptitude. Tho not every man can be made by training and practice a skilled mechanic, very great numbers can be brought to the highest possible expertness. It may be that many more men could be made by training into serviceable physicians and lawyers and business men than in fact are so made; but the number who can attain the highest possible pitch of skill in these occupations is very small indeed.

§ 3. The differences in the long-run earnings of various business men raise the same questions as were considered with reference to ordinary wages. Are they due to differences in inborn abilities? or are they the result of training and environment? Do the more prosperous business men spring from the general non-competing group of the well-to-do, with all the advantages of that class? or is their success irrespective of their start in life and due mainly to natural endowments?

Some familiar phenomena point to the explanation on the ground of inborn differences. Poor boys rise to fortune. In the United States the farming class has been a great nursery of fortune builders. On the other hand the sons of these very captains of industry frequently drop from the posts of leadership. Notwithstanding all the advantages of training, notwithstanding the inheritance of means and of favoring opportunities, they are apt to resign the active conduct of business to men who again have risen from the ranks. Cases of this sort, to be sure, are not always as significant of the non-inheritance of business ability as they seem to be. The failure of the rich man's sons to emulate his achievements may be due to lack of motive, not lack of capacity. The spur of need and of unsatisfied social ambition is lacking. None the less, there are cases in plenty where those to whom the management of an established business is bequeathed fail to maintain it even tho they try. Again and again old-established firms whose founders have died go to pieces under the management of the heirs.

But here, as with other occupations, there is danger in fastening attention on the conspicuous phenomena alone. Captains of industry are doubtless born. So are great poets, musicians, men of science, lawyers. Tho there may be occasional suppressed geniuses among the poorer classes, ability of the highest order usually works its way to the fore. Talent and good capacity, on the other hand, are much less rare and they need to be nurtured. A favorable start may bring success to one man of good ability; its absence may prevent another no less able from rising. Beneath the highest tier of the extraordinarily capable business men there is a great stratum of prosperous and well-to-do persons to whom the advantages of capital and connection have been of cardinal importance.

Capital and connection—these are the two factors which may make a business career, whose absence may mar it. Every business man must have the command of means, his own or borrowed. True, if he has the highest abilities, lack of means will not long embarrass him. His start may be slow but he will soon have savings of his own, will borrow easily, and before long will find associates who are not only willing but eager to intrust him with all the money he wishes. It is otherwise with the man nearer the average. If parents or friends supply him with the command of capital, he has a great advantage over the less favored of the same ability. So it is with connection—not merely acquaintance and relationship but all the varied influences of environment. He who is born in the well-to-do classes is surrounded from the outset by the business atmosphere. Traditions, advice, opportunities, come to him spontaneously. He finds a favoring ground for the development of whatever abilities he possesses.

Set training doubtless counts for less in the business career than in the other occupations of the well-to-do. Tho it is probable that in the future business training will be less haphazard than it has been in the past and will be in greater degree the object of methodical instruction, set teaching will never play the part which it plays in the professions. The career will be always comparatively easy of access. The obstacles to be surmounted will be chiefly those from lack of means and from all the vague but potent influences of environment.

§ 4. The business man of the first order must have imagination and judgment; he must have courage; and he must have administrative capacity.

Imagination and judgment—these are needed for the generalship of industry. The successful business man must be able to foresee possibilities, to estimate with sagacity the outcome in the future. Especially is this necessary in new ventures; and it is in new ventures that the qualities of generalship are most called for and the greatest profits are reaped. Countless schemes for money making are being constantly urged on the business community. Most are visionary. Among them the captain of industry will pick out those that really have possibilities, will reshape and develop them, and bring them eventually to success. Sometimes he errs; there could be no great successes unless there were occasional failures; but the right sort of man on balance has ventures that are profitable. Not infrequently those are supposed to have the requisite judgment who in fact do not possess it. Personality tells, but may be deceptive—a vigorous presence, incisive speech, kindling enthusiasm. Time and again an individual with such a personality secures a hold and a following, and is enabled to embark on large ventures. Yet finally he comes to grief unless in the end he proves to have the saving quality of judgment.

Executive ability is probably less rare than the combination of judgment with imagination and courage. But it is by no means common. It calls on the one hand for intelligence in organization, on the other hand for knowledge of men. The work must be planned and the right man assigned to each sort of work. The selection of efficient subordinates is of the first importance. A vigorous constitution—vigorous in its capacity to endure prolonged application and severe nervous strain—is almost a *sine qua non,* as it is with the military leader.

A business man almost always has to do with the physics and mechanics of industry. Every director of large enterprises must choose between competing mechanical devices, must watch the course of invention, must be in the fore with improvements. It might be supposed, therefore, that men of mechanical talent would become the leaders in industry. Yet this is by no means the common case. Most frequently the inventors, engineers, and mechanical experts are in the employ of the business man. Occasionally an individual appears who has in high degree both the business qualities and the inventor's qualities. Such were Stephenson, the English engineer, and Werner Siemens among Germans. Such also were some of the New England pioneers in the textile manufactures during the first half of the nineteenth century: Lowell, Batchelder, Bigelow and others. But the union of two diverse kinds of ability in one person is no more common here than in other walks of life. Usually the sort of judgment, insight, courage, persistence, which are needed for the development and wide use of improvements are not possessed by the inventor himself. Watt, the inventor of the steam engine (or at least its successful perfecter), needed the judgment and resource, as well as the capital, of his business partner Boulton. Ericsson was an inventive genius of the first order: his screw propeller revolutionized marine transportation and his *Monitor* influenced to hardly a less degree the development of modern warships. But he pinned his faith also on the caloric ship, regardless of the fact that the required bulk of the machinery made it commercially impossible. Edison was rightly called a wizard; but he failed conspicuously in some notable ventures, such as the utilization of magnetic iron ores and the construction of standardized cement houses.[1] It is by selection among numberless projects constantly pressed on his attention that the business man exercises one of his most characteristic functions.

Too much stress must not be laid on any enumeration of the business man's qualities. All sorts and conditions of men prove to have the qualities needed for pecuniary success—the cautious and the daring, the sober and the enthusiastic, the loquacious and the taciturn, those given to detail and those negligent of detail. The different aptitudes appear in every kind of combination. Some heads of large organizations keep every thread in their own hands, and not only plan the large outlines of their ventures but look to every detail. Others intrust almost all administration to subordinates and keep themselves free to think, plan, confer. There are those who keep strictly to "their business"—the particular branch of industry in which they have embarked; and again there are those who launch freely into new and varied enterprises. No one key opens the doors to success.

The differences are equally striking in qualities not directly connected with pecuniary success. Some business men are of intellectual bent, others are dullards in everything but business. Some deal generously with their employees, others constantly scheme to overreach them. Some are high-minded and public-spirited, others mean and selfish. Fifty years ago writers on economic and social questions were prone to celebrate the virtues of the class. In recent years "business" has come to be in bad odor; it is associated in many minds with grasping monopoly, mere manipulation of securities, tyranny over laborers. In truth, the business man at his best is an admirable figure in our modern world and at his worst

[1] The biographies of inventors, such as Church's *Life of Ericsson* and Dyer and Martin's *Life of Edison*, are full of passages on the vagaries of the tribe. I venture to refer the reader to what I have said in the first chapter of my own book on *Inventors and Money-makers*.

is a very ugly one. The variety among the men who prove to have the money-making capacity is a standing cause of wonder.

§ 5. Among all these different sorts of persons a process very like natural selection is at work. To predict who has in him the qualities for success is much harder than is prediction with regard to most occupations. The aptitudes and abilities which must be possessed by one who would succeed in law, in medicine, in engineering, in teaching, show themselves at a comparatively early age, and a friendly observer can often give good advice as to the choice of these professions. But the qualities that make for success in business management not infrequently develop late, or at least show themselves late and only under actual trial. Surprises are more common in this walk of life than in any other. A constant process of trial is going on. Those who have the requisites for success come to the fore, those who lack in some essential drop to the rear.

The drift of all this is that in the business career, as compared with most others, inborn capacity on the whole counts more, training and environment less. Environment and ease of start seem to be of consequence in what we may call the middle range of the occupation—the businesses of moderate scale, requiring a substantial capital and yielding respectable middle-class income but calling for no unusual degree of judgment or administrative ability. The growth of large-scale operations in every direction has made businesses of this sort relatively less important and numerous than they were half a century ago. No doubt they are still numerous and important; and as to them there may be something like a caste or non-competing group. They tend to remain in the hands of those who have the advantages of capital and connection. So far as they are concerned it may be true that there are plenty of persons in the so-called lower group of society and in the working classes who could take charge equally well. But in the upper range of the business world, in the large enterprises which dominate more and more the industry of modern times, native ability tells.

Native ability is recruited from all classes. There are conspicuous cases of men rising from the ranks. Yet most of those who come to the fore have probably begun with the associations and environment of property and of business. The commonest case is that of the young man born in the middle class and imbued with its traditions and ambitions, inheriting vigor and judgment, but not enervated by the inheritance of large means. As has already been remarked, the farming class in the United States, which belongs in its traditions and outlook rather to the possessing than to the non-possessing class, has been in this country a great nursery of business ability. Possibly there is a fund of such ability hidden and smothered among the hired workmen. But the ease with which capable men make their way, even from the poorest beginnings, speaks against the supposition. So simple is access to this career, so common is the rise of the very capable from the ranks, so constant and searching the process of natural selection in the business world, that we may regard it as probable that all who have marked natural gifts are enabled to exercise them. It is almost certain that such gifts have a preponderant influence in determining permanent business success.

§ 6. The aim of the business man is to "make money" and the chief motive which stirs him to making it is social ambition.

The successful business man is the backbone of the well-to-do and possessing classes of modern society. His ambition is to accumulate, not merely to earn a living. The lawyer, the physician, the teacher, is reasonably content if he succeeds in supporting and rearing a family according to the standards of his class and in making some moderate provisions for the future. The lawyers, being in close association with the business set, may be also infected with the fever of accumulation. But the business man cannot escape that infection. The aim of all in his class is to gain more than enough for support. To get together a competence or a fortune is the one test of "success." He must be able in his later days to live at leisure on his settled income, or at least transmit to his descendants the opportunity of leisure. We do not commonly think of the money maker as a person who saves; not infrequently he is a liberal spender. But he spends less than he makes. His one aim is to make a great deal more than he spends and to put it by. His accumulations, tho they may involve little conscious sacrifice, are none the less real savings and constitute probably the most important source of the community's supply of new capital. Tho no statistical or quantitative measurement is feasible, it is probable that the larger portion of the extraordinary growth of capital during the last two centuries has come from the competences and fortunes of the business class.

Every successful business man thus leaves behind him a trail of accretions to the well-to-do classes. His children start with advantages of education, environment, easy command of capital. Their occupations, their ambitions, their standards of living are on a new plane. If they inherit ability it finds scope for exercise at once. If they have only moderate capacity the best is made of this by training. Often the riches which they inherit prove a treacherous gift, preventing the use of good natural powers and encouraging sloth and dissipation. There was a tradition in older days that new-made wealth did not remain long in the same family. It was said to be but three generations from shirt sleeves to shirt sleeves. No such generalization would be tenable today. The machinery for safely investing and keeping accumulated property is highly developed and is at anyone's command. They who once possess can continue to hold, and persons who have been lifted among the soft-handed classes cling to their place with extraordinary tenacity. While there is a continuous movement upward—not great in volume but steady and considerable—there is no appreciable movement downward.

The most powerful spur to the business man's activity, to repeat, is social ambition. The deep-rooted impulse of emulation leads him to try and swing himself into the ranks of his "betters." The pride of commanding the services of others, the instinctive craving for external marks of distinction and superiority, have been gratified in modern times most commonly and most readily thru money making.

Other motives have played their part. A true taste for the refinements of an easier and ampler life, an appreciation of what is intrinsically and permanently beautiful, has sometimes been a motive to pecuniary gain; tho it is to be suspected that genuine feelings of this sort are less common among the business men themselves than among their descendants, and not too common among the latter. The love of power, which is closely allied to the instinct of emulation, is a strong spur to unceasing accumulation. Mere megalomania sometimes appears among the captains of industry—a desire to bring larger and larger domains under subjection. With all this goes the impulse to activity. Idleness soon palls. Many a business leader whose wealth far exceeds the ambition of his early days continues none the less to scheme and to work from lack of anything else to do. He has learned to play the engrossing game of money making; he can play no other that satisfies him for long; he continues to work and to make money in order to escape being bored.

The desire for wealth which possesses the business class is thus not a simple motive but one very complex. It is much to be wished that other and nobler motives could be substituted, and that the same courage, judgment, and strenuous work could be brought to bear for rewards of a different sort and with less unwelcome consequences in the inequalities of worldly possessions. Something of the sort is dreamed of as feasible by those who would completely overturn the régime of private property. Not high money gains but a ribbon, a laurel wreath, the spur of fame, should suffice to call out the best energies of the industrial leader. What may be these possibilities we shall have occasion to consider elsewhere.[1] Certain it is that in the past the monetary motives have mainly prevailed. In them and in their power over the mass of mankind is the psychological lever which explains the great upward economic movement of the last two centuries. It is probable that motives of the same sort will long continue to operate and will long continue to be indispensable for sustained material progress. The business man as we know him, with his virtues and his faults, his good and his evil effects on society, will long be a factor of the first importance in the distribution of current earnings and in the shaping of social stratification.

§ 7. By way of bringing into sharper relief some of the conclusions reached in this chapter and those preceding and following it let us make two extreme suppositions: first, that capable business men of the highest order are very plentiful; second, that stout, able-bodied, unskilled laborers are very scarce. In other words, let

[1] See Chapter 68.

us suppose that the conditions of supply for these two sorts of service are precisely the reverse of what they are at present.

If capable business men were very plentiful every species of enterprise would be conducted with the utmost judgment, vigor, and intelligence. The smallest retail shop would be managed with the same ability as the largest trading or manufacturing concern. At present the highest ability is turned to those great enterprises in which it tells most; precisely as central sites in cities are turned to those kinds of business for which their advantages tell most. With an indefinitely large supply of first-rate business ability this sort of human power would be directed not solely to the channels in which it was most effective but to others in which it was less effective. The gain, or addition to the output, resulting from its application under the least favorable circumstances—in other words from its marginal effectiveness—would determine the rate of remuneration for all persons having such capacity. We may assume, for simplicity's sake, all these to be of equally high capacity. In the next chapter the consequence of differences among them will be considered; for the present argument it is not material whether we assume complete equality or admit some differences of degree. The men of high efficiency would be immensely more plentiful than men of similar ability now are; and their gains would be very much less than now.

The effectiveness of the labor of society as a whole under such conditions would be very much greater than it now is. Every business, from the largest factory to the smallest shop, would be so managed as to secure the utmost return for every scrap of expenditure. All goods and services would be more plentiful. But the share going to the business men would be less. If we conceive the process to be carried to its farthest limit and good business men to be as plentiful as common unskilled laborers now are, their reward would be on very much the same level as that now current for common day wages.

Turn to the other supposition. Suppose the human race vastly deteriorated in its physique; the great majority of men incapable of holding the plow or lifting the pick. Then the few still able to perform sustained manual labor would receive high rewards. No kind of labor is so little to be dispensed with. As the huge warrior was the admired hero in the days of Achilles, so in a society where common labor was scarce the much-envied person would be the brawny workman. He would be highly paid because the marginal utility of his labor would be great; and he whose quality is scarce and is paid for at a high rate generally gets to the top of the social ladder. No doubt the muscular laborer would look down with contempt on the rest of mankind, dependent as they would be on him for the necessaries of existence; precisely as the capitalist business man now regards with contempt the day laborer, dependent on him for the opportunity to make a living. Social stratification would be turned topsy-turvy.

CHAPTER 49

BUSINESS PROFITS (*Continued*)

§ 1. Analogy between business profits and rent. A similar analogy in other occupations. How far the element of risk vitiates the analogy.—§ 2. The difference in business abilities explains differences in cost of production. The conception of the "representative firm" as settling normal expenses of production.—§ 3. One of the manifestations of business ability is in the selection of good natural resources. In the end an important difference between economic rent and differential business profits.—§ 4. The connection between the return on capital and business profits. Relations between owners and managers of capital at different times. Modern tendency towards a separation of functions and rewards.—§ 5. For considerable periods command of capital brings in a given enterprise the probability of larger profits; but not in the long run without business ability.—§ 6. For industry as a whole and capital as a whole there is a connection between interest and business profits. How they may diverge in the end. A view of business profits which distinguishes them sharply from labor incomes.—§ 7. Other views, which regard profits as secured primarily by the promotion of new ventures and markedly different from mere wages of management.—§ 8. Legitimate and illegitimate business profits. Their restriction within the legitimate limits depends on the removal of monopoly gains and the maintenance of a high plane of competition.—§ 9. Are business men spurred to better management by industrial depression? by demands from labor unions? by legislation?

§ 1. In the preceding chapter the earnings of business men have been treated chiefly in their bearing on the problems which are connected with differences in wages and with the social consequences of such differences. We may proceed now to the relations between profits, on the one hand, and rent, wages, and interest on the other; and to various ways of making money that are doubtfully to be classed under the head of business profits.

An analogy between business profits and rent has often been pointed out. High capacity in a business man is like high productiveness in a site. The effectiveness of the labor and capital managed by a capable man is greater than that of labor and capital managed by one less capable; just as labor applied on good soils yields more than labor applied on poor soils. If there were an indefinitely extensible supply of able business men no one of them could secure high earnings. In the same way good land would not yield a rent if there were an indefinite supply of it. This mode of treating business profits was developed most systematically and emphatically by Francis A. Walker, and it became a corner-stone of his theory of distribution.

The same analogy exists in the differences between the earnings of men of varying gifts in other occupations. The talented surgeon or physician earns more than his colleagues because he is more efficient, and so the lawyer, the engineer, the architect. In any group of men who compete with each other at the same sort of work the more efficient—that is, the more productive—earn more in proportion to their efficiency. So far as the differences are due to inborn gifts the results are in the nature of rent.

To this it has been objected that allowance should be made for the element of risk, and that when such allowance is fully made the analogy to rent is shorn of most of its significance. Tho there are successful lawyers, there are also briefless barristers. When there are blanks as well as prizes it may well happen that the prizes do not suffice to offset the blanks, and then the earnings on the occupation as a whole contain no surplus and there is no element of rent. This, it is said, is peculiarly the case with business profits. Success in business is highly uncertain. Prediction about any individual who enters it is extremely difficult, especially in the early stages of a career. It has been said that only one tenth of those who try to establish businesses of their own succeed in the end. The estimate is but guesswork and very likely exaggerated. But it points to a fact. In view of the risks and the obvious possibilities of failure, must there not be some prizes to maintain the resort to the occupation? When regard is had to business work as a whole and business profits as a whole, can the high reward of the fortunate few be regarded as a real surplus?

There is weight in the objection, but it is not conclusive. It is true that business ventures are uncertain as to their outcome, not only because it is of their essence to assume risks but because it is peculiarly difficult to say in advance whether new aspirants possess the qualities which fit them to meet and overcome the risks. On the other hand, the extent of the risks assumed is easily exaggerated. The very fact that no previous expensive training is essential lessens the sacrifices and disappointments of those who try and fail. True, they may lose some of the means which they owned or which have been intrusted to them; and this loss is sometimes large. Usually, however, the first steps in business are on a modest scale and experiment on a modest scale suffices to test whether there is the requisite capacity. If there is failure the aspirant falls back into the ranks of the hired class and becomes a clerk, bookkeeper, superintendent. His earning power is less than he had hoped but it is not reduced to zero.

There may seem to be a difference in this regard between the business calling and the professions that require set training. The expensive and elaborate preparation for a legal career may prove to have been thrown away. The would-be lawyer may not have it in him to attain success in the law. But the risk of this in most professions is not comparable to the risk of failure in active business. Ordinarily he who has a good training for a profession is reasonably sure of getting a living from its practice. He may not win one of the prizes but he is likely to secure a modest income, sufficient to make the investment in his education worth while. Such is the situation with physicians, engineers, architects, teachers. The risks are perhaps greater in the law, as the prizes are also greater. Great pecuniary success in the law depends not only on high intellectual qualities but on the business qualities also. Some professions there are, again, for which a long and elaborate preparation is required and in which the outcome is yet highly uncertain. Painting, the composition and performance of music, opera singing, are such. Considerable promise and the presence of a true vein of talent may end in nothing but virtual failure in these arts; for only a very high pitch of ability and achievement brings a valued success. Even here there is the humdrum routine of teaching to fall back on—sadly disappointing to the ambitious artist but usually sufficing to eke out a living. In any case the artistic callings are exceptional, resorted to by comparatively few and affected largely by other motives than those ordinarily leading men to their choice of a career. On the whole, in the so-called professions the risk of failure is not great. Investment in an education usually brings its return.

Thus for various reasons the element of risk does not play so vital a part, either in business or in the professions, as to neutralize the significance of individual differences in earnings. In business the initial stake is not so great; in the professions the winning of a fair return is not so uncertain. Some men are born more capable than others and the higher range of their earnings, due to unusual gifts, is analogous to rent. Since inborn differences play a relatively more important part in business profits than in other earnings of the well-to-do, the analogy to rent is closer.

But this sort of reasoning can throw light only on the *differences* of business profits, and especially on that upper range of incomes to which hitherto we have chiefly given attention. In the lower ranges of business earnings as well as professional earnings the forces at work are the same as those governing wages in general. Hence the rent theory of profits can throw no light on the fundamental questions. These are inextricably connected with the general problem of wages.

§ 2. The differences in the abilities of business men engaged in the same occupation constitute the main explanation of a phenomenon which has puzzled many observers—the variations in the expenses of production between competing establishments. In the discussion of value[1] we considered industries having constant returns and commodities whose value is determined by expenses of production uniform for all competitors. But it has been repeatedly pointed out that in fact no such uniformity exists. In no considerable industry of modern times are competitors on the same plane. Some produce more cheaply than others, having better plants, better organization, command of more efficient or cheaper labor or of cheaper materials, more "strategic" location.

If such differences were permanent and unalterable they would bring all industries into the class of diminishing returns and would make the principle of rent applicable universally. But they are not permanent or unalterable, except so far as good sites or

[1] See Chapter 12.

cheap raw materials are limited. Most of the circumstances which are commonly referred to as showing wherein different enterprises have varying expenses are due at bottom to the personal qualities of their business leaders. If some have better plants or more advantageous locations than others it is because they have been planned with greater skill and foresight. Especially under those conditions of rapid advance in the arts which characterize modern times, opportunities for improvements in the industrial outfit are first availed of with shrewdness and daring by the leaders of industry and then imitated by others of less, tho still of notable, capacity. When the great mass of those engaged in a given industry succeed in adopting the improvements of the leaders these devise still further improvements; and the differences in expenses of production are thus maintained indefinitely.

To fit this situation into our reasoning on value and expenses of production we may adopt Professor Marshall's notion of the "representative firm"—a firm not far in the lead, not equipped with the very latest and best plant and machinery, but well equipped, well led, and able to maintain itself permanently with substantial profits. Side by side with such representative firms are the exceptional leaders. Side by side with them are also the weak and the struggling—some under inept management and doomed to failure and others under good management but still in the early stages of scant capital and unestablished connection. Prices tend to adjust themselves to the expenses of production at the hands of the representative firm. When conditions are normal and settled in the industry, that firm earns "fair" profits—such business profits as business men of good ability secure in industry at large. Their superiors earn much more. Their inferiors earn less; perhaps go to the wall, perhaps rise slowly to better fortune.

If now an ill turn is encountered by such industry—if demand should suddenly fall off or heavy taxes should be imposed by the state—the first effect will be to cause the weak and struggling firms to disappear, the representative firms to lose money or at least to fail to make money, the leading firms to submit to lessened profits. The ultimate effect will be that some of the representative firms will withdraw, some perhaps will fail. Some of the leaders will transfer their energies into other directions. Indeed a keen eye for the prospects of an industry, a shrewd selection of those industries about to enter a period of prosperity and a quick abandonment of those threatened with reverses—these are among the qualifications of the money maker. The converse takes place if an industry has a good turn thru an unexpected increase of demand or a rapid cheapening of its raw materials. Then everyone engaged in it makes money, even the ill-equipped. The able and well-equipped, who happen to be in the best condition for taking advantage of the favorable situation, may roll up fortunes in short order. How soon and how easily the readjustment to more normal conditions will take place depends on the extent of the irrevocably invested plant, on the predictability of demand, and in some degree on the personal characteristics of the active leaders in the industry. As in all matters that depend on human impulses and human calculations no mechanical regularity in the phenomena is to be expected. It is only in the long run that able business men secure incomes in accord with their ability; it is only in the long run that they and their imitators transfer their energies from unprosperous to prosperous industries; it is only in the long run that the representative firms and their expenses of production prove to have a dominating effect on the range of prices.

§ 3. The differences between individual producers not only have an analogy to rent but have their effects on rent and on distribution. A capable business man who happens to own an advantageous site may be said to get two sorts of rent—that from the exceptional site and that from his exceptional ability.

We might expect these two sorts of gain to be quite disconnected. The able man, it would seem, could apply his ability at nature's margin as well as above the margin. In fact he usually applies it above the margin. One of the manifestations of ability is the prompt and full perception of the possibilities of the good sites. So it is with mining ventures. They usually get under the control, by purchase or by lease, of the capable managers, and are exploited to better advantage by these than they would be by the less capable. In agriculture the better farmers buy or rent the better lands and secure a combined rent of ability and of fertility (or situation) greater than could be secured by ability alone or fertility alone. This sort of correlation appears strikingly in the case of urban rent. The expensive business sites are almost invariably utilized by the upper tier of business men—the captains of industry and the solid merchants of the great cities. The more expensive the site the more likely is it to be in the hands of a man of exceptional gifts. There is a sort of pitting against each other of two kinds of rarities—the sites and the men. If business men of marked ability and (or) ambition are very numerous they bid against each other for the central sites and urban rent rises to a level by so much higher. If there are fewer of them they are able in a greater degree to retain in their own hands the gains which can be reaped on those sites.

One word more as to the resemblance between business profits and rent. All differences in wages which result from the non-competing groups, and which thus are not of the equalizing sort, may be said to be analogous to rent. The carpenter earns more than the day laborer because the supply of his services is limited and because the utility of his services is greater. There is thus in all real differences of wages an element similar to rent. But there is an important distinction between these cases and the rent of natural agents. In the one, human action and human motive alone are in operation; in the other, nature's limitations are the essential factor. The carpenter and the business man put forth their powers because of a reward, and are stimulated to put them forth the more as the reward becomes higher. The differences between good sites and bad sites are irrespective of such motives. And in its social aspects this distinction is all-important. It is not impracticable for society to appropriate in some way economic rent and monopoly gains. But the appropriation of the extra gains which human beings secure because of their possession of unusual faculties would affect the exercise of those faculties. It would be going too far to say that it would prevent their exercise. Other motives than those of pecuniary gain may be made more effective than now. But as men are, and as private property and competition now influence them, nearly all need the spur of material reward to bring into full exercise their abilities. The extra gain is a price which society must pay in order to secure the extra service.

§ 4. If business profits are in some respects analogous to rent they are in other respects closely related to interest.

We have tacitly assumed that so much of a business man's income is to be regarded as profits as is in excess of interest on the capital which he manages. If he happens to borrow his capital that is clearly true. He then pays interest to another and only his net earnings over and above interest go to him as business profits. Usually his capital is partly borrowed and partly his own (or that of relatives or friends, put at his disposal from other than cold-blooded pecuniary motives). On that part which is his own he must indeed remember that interest could be got at current rates without the risk and labor of actual management; and therefore he must reasonably reckon only the excess over such interest as his earnings of management or business profits. This way of regarding the situation is followed in an arrangement found in many firms which have silent or inactive partners. Out of the net earnings of a given period, say a year, interest is first allowed on the capital put in, whether by the active partners or by the others. The excess, after paying all interest, then constitutes the business profits proper. Out of this there is first allotted a fixed payment in the nature of salary to the active partners. The remainder is divided between active and inactive partners in proportion to capital provided by them, and constitutes a return for risk, general oversight, and judgment.

Such a sharp distinction between the constituent parts of gross profits is of course more likely to be made where there is a corresponding division of functions—where some provide the capital, others do the active work of management; where some share the risks, others do not. In the eighteenth century the common form of business organization, the private firm or partnership, was not such as to suggest the distinction. Then the investor, the person looking to a return in the way of interest only, had little to do with business; his investments were in land or in public funds. The business man borrowed occasionally from banks or professional money lenders but had no permanent associates divorced from the management. Hence the economists of those days regarded business profits as one homogeneous return secured by merchants and capitalist employers. Among the British economists this mode of treatment continued nearly to our own day. Adam Smith regarded gross profits as the return both to capital and to the managers of capital. He remarked that double interest was regarded as a fair, moderate, reasonable profit. High profits and high interest went together; hence he adduced the historical fluctuations in interest as indicative of the fluctuations in profits.

In modern times the growth of corporations has brought about a vast participation by investors in business enterprises, a division of function between business men and investors, and hence greater attention to the really different nature of their doings and earnings. Many corporations borrow on long time in the form of bonds, whose holders are supposed to be free from risks and to receive pure interest, while yet they are permanently associated with the enterprise. The holders of stock are something more than investors pure and simple. They are, in a way, silent partners; they may exercise judgment and cannot escape risk. The actual work of management is in the hands of salaried managers, who may also be stockholders, but may not be.

§ 5. For short periods, even for periods of considerable length, business profits and interest are often closely connected. Ready command of capital commonly brings to an individual enterprise not only returns in the way of interest proportionate to the amount of capital but a better chance for large profits.

For an individual the larger or smaller capital which is at his command and the consequent larger or smaller scale of operations have an important influence on his net earnings. At first sight these two between them seem to constitute the dominating factor. The business men who produce or sell smaller quantities get the same prices as those producing or selling greater quantities; the expenses per unit of the large-scale producer or merchant are usually less than those of his smaller rival; it seems to follow that his gains are larger merely because he has more capital. If the management of a great business called for no more ability than that of a small one, and if the command of abundant capital came solely by inheritance or favor, the consequence would follow. But the connection between the command of capital, the scale of production and volume of profits proves to be by no means automatic. Large-scale operations require more executive capacity than small ones, more insight and judgment, more courage. Command of capital comes in the end not by accident but according to ability. At the start and in ordinary times it is as easy, or at least seems as easy, to manage a large business as a small one. Hence the importance of capital and connection in the earlier stages of every business man's career. Hence too the more enduring influence of capital and connection in those businesses which never reach a very considerable scale or never get beyond the simpler conditions of management. But with almost all enterprises conditions change as time goes on, new methods or processes are devised by the keen-minded and venturesome, and adaptation to new competition must take place. Then only the able and enterprising continue to control large undertakings and large capital. The less capable fail to make the profits they expect. If, as not infrequently happens, they persist in trying to manage what overtops their capacity, bankruptcy ensues and their all is swept away.

True it is that the adjustment of the scale of operations and of consequent profits to individual capacity is much affected by custom, established reputation, good will. A firm which has been built up by an able founder runs on for a long time of its own momentum. This is particularly true of trading, both retail and wholesale, where connection and reputation count much in holding customers. It is often true of manufacturing, where trade-marks may play an important part. It is most of all true of banking, where reputation and good will are of the essence of profitable operation. Those who succeed to well-established enterprises may continue for years to reap large gains even tho they have no marked ability. But the dominant influence of inborn gifts shows itself in time. Old firms decay unless regenerated by fresh blood. New firms rise and a different generation of business men comes into control. Among these may be the capable sons of capable fathers, inheriting ability as well as capital and connection. But most of the new men are not the descendants of the old. They rise by force of character from small beginnings, and into their hands comes the control of large capital and the grasp of large business profits.

§ 6. The same close connection over limited periods, and the same divergence over longer periods, appear in the relations between interest as a whole and business profits as a whole. The factor that most directly and unremittingly acts on interest is the amount which business men can afford to pay and which competition compels them to pay. The process by which the return to capital is settled works out its results thru its influence on business profits. The advances to laborers are made by the active capitalists —the business men—and the ensuing increase in the output comes first into their hands; for they act as intermediaries between hired workmen and the investors. When gross profits (in Adam Smith's sense of the term) are high they are able and willing to pay higher interest or higher wages, or both; and conversely they are able to pay less when gross profits are low. Improvements in the arts which increase the marginal productivity of capital tend in the first instance to raise both business profits and interest.

As time goes on, however, the parallel movement is likely to be modified. The mode in which the gain shall be divided between the two depends on the conditions of supply for business capacity and for investors' savings. If savings, and so the command of capital, are abundantly put at the business man's disposal a larger share goes to his profits. If, on the other hand, a great number of capable business aspirants bid for the savings a larger share goes to interest. If both capital and business power are plentiful wages tend to rise; the incomes of the possessing classes as a whole tend to become less and the inequalities of wealth are by so much mitigated.

In modern times it is probable that business profits have succeeded in retaining a comparatively large share of the gains from the great advances in the arts. Savings and capital have responded very rapidly and amply to increased possibilities for investment. The rate of interest has remained, when long periods are considered, fairly stable, notwithstanding the enormous advances in accumulation and the enormous improvements in the utilization of capital since the Industrial Revolution set in. All the civilized countries have gone thru great bursts of progress during which the productiveness of labor has been rapidly increased and the opportunities have been favorable for large gross profits and high interest. Such was the experience of England during the first three quarters of the nineteenth century; of Germany during the last quarter of that century; of the United States during almost the whole of her history. Tho interest has gone up in all these countries during the accentuated periods of these movements, it has fallen again with each slackening. But business profits for those possessing the qualities of leadership have been large thruout, sometimes enormous.

§ 7. Some different views of business profits—views which bring into deserved prominence certain peculiarities—may now be mentioned. They distinguish business profits sharply from wages. In them what a business man gets is regarded as a composite income, even after cutting out such constituent elements as should properly be regarded as either interest or rent. Part of what he gets is still thought to be simply wages; but part is neither wages nor interest nor rent; it is different from any of these; and this peculiar element is alone regarded as "profits."

Among these views one lays special stress on the consequences of changes in the arts. Business profits are treated as accruing solely from such changes. If changes in the arts were to cease, if competition were to work out its results perfectly, if prices were to conform closely to expenses of production, the managers of industry would receive nothing but wages—wages determined in the same fashion as other payments for labor. But in a dynamic state—a state of unstable equilibrium, of transition, of advance—there is opportunity for business men to secure something more. By taking the lead in utilizing inventions or improving organization they make extra gains, which last as long as they succeed in holding the lead. Business profits, so considered, are ever vanishing, ever reappearing. They are the stimulus to improvement and the reward for improvement, tending to cease when once the improvement is fully applied.

Another view, in some respects similar, separates business profits from wages by considering as wages that amount which the individual would have been paid if hired by someone else. An independent business man's actual earnings are likely to exceed that sum; the excess is business profits. Here emphasis is put on the element of risk. Profits differ from wages in that they are the result of the assumption of risk and constitute the reward for that assumption.

The question here again is one largely of phraseology; but underlying it is the substantial question whether a satisfactory line of demarcation can be drawn, and "wages" in this sense really distinguished from "profits." Salaried posts of management have a very wide range—foremen, superintendents, general managers, presidents. A process of transfer is constantly taking place between the salaried ranks and the independent business managers. Both are affected by causes of the same sort. A capable man will make large gross profits for himself or will be paid a good salary if others hire him. It may even happen that he will really earn more if hired by others; he may have executive ability yet lack sagacity and judgment.

These questions and distinctions arise most sharply in connection with the great industrial corporations of modern times. Their application to this characteristic development of the modern era will be taken up in the next chapter.

§ 8. The tenor of the preceding discussion has been to justify business profits as the result in the main of efficiency and ability. The community on the whole gets an equivalent for the business man's earnings; indeed must allow some such earnings in order to secure the useful services rendered. But it is often maintained that such justifiable earnings form only a part of business incomes and that the total incomes much exceed the range of the worth-while returns. The contention beyond question has some truth; there are illegitimate as well as legitimate business profits. To put it in other words, a good deal of "business" is unproductive; it serves not to add to the well-being of the community but to get something away from other people. How much is of this character is not easy to say.

Sometimes the case is simple. Gambling speculation, such as that of the "bucket shop," is clearly unproductive. Corrupt contracts with government officials, such as can be sublet by the corrupter to another who actually does the work contracted for, are in the same class. The deliberate manufacture and mendacious puffing of a noxious (or even harmless) "patent medicine" is to be similarly regarded.

Commonly, however, in cases of this kind useful and harmful activity, illegitimate and legitimate profits go together. Take for example a subsidy obtained by corruption and not needed to promote the industry in question. The business man's labor in securing the subsidy serves to rob the public; but his labor in guiding the industry may be effectively directed and in its results serviceable. A consistent free trader would say that labor given to manipulating tariff legislation in favor of protected industries was the reverse of productive; but the persons in charge of the industries may manage them well. An employer may take advantage of the helplessness of women and children, of the ignorance and bargaining weakness of unorganized workmen of any sort, and may secure their labor at less than "fair" rates;[1] at the same time he may organize that labor with high efficiency.

There are numberless ways in which the predatory exercise of business power is mingled with activity that is useful. Such are fraud and adulteration in the making of goods; vociferous tooting of an article no better or worse than its rival but foisted on a gullible public at a high price by advertising; cheating of laborers thru "company stores" or in the letting of company tenements, thru fines nominally for poor work (weavers), thru overcharges (on miners) for materials and supplies. One of the most conspicuous and far-reaching forms of predatory business work is in the abuse of positions of trust by directors and managers, often closely associated with stock exchange speculation—a subject taken up with some fullness in the next chapter.

The restriction of business profits within "legitimate" bounds depends on two things: on the one hand, full and free competition;

[1] Compare Chapters 58 and 59.

on the other hand, the maintenance of competition on a high plane.

First, freedom of competition. Monopoly profits are not "illegitimate" in the sense in which those are which result from sharp practice and cheating; but they are "illegitimate" in being greater than necessary to induce the exercise of the full productive faculties. Setting aside such debatable cases as patents and copyrights, they mean that the public pays more than there is any need of paying. Shrewd understanding of the possibilities of monopoly and skillful management of monopoly industries have been great sources of business men's incomes and fortunes; and this without violation of law or of the proprieties of business life. The regulation of monopoly industries is among the most urgent of social problems and is essential for keeping business profits within the limits of the reasonable or legitimate.

The maintenance of a high plane of competition depends partly on law, partly on public opinion and the pervading moral spirit. The aim of the law is, or should be, to make men's relations with each other such as to promote the general good and to inhibit predatory doings. This is the basis of the main provisions of the law of private property—protection to property holders, punishment for physical violence and robbery, free contract, definition and prevention of fraud. As industrial conditions change and as men's consciousness of common interest enlarges, the legal relations are modified. Slavery, which was part of the established order of things not only in ancient times but till nearly our own day, is now forbidden in all countries that pretend to be civilized. Competition and bargaining between men and the exercise of force are not allowed to proceed on this basis or to this extreme. Characteristic of our own day is the regulation of the terms of dealings between employer and employed—laws for regulating the mode of paying wages, the hours of labor, minimum wages, as well as those regulating "company stores" and like possible sources of profit felt to be illegitimate. Pure food laws belong in the same class. So do the improvement of legislation regarding stock companies, the definition and enforcement of the liabilities of directors and managers, the prevention of swindling in promoting and floating corporations. The aim thruout is to compel all persons, and especially the leaders and managers of industry, to conduct their operations under such conditions as will direct their energies to productive and serviceable emulation only.

Public opinion is an important factor, both in leading to legislation and in adding to the effect of legislation. The more the anti-social effects of predatory activity are recognized and frowned upon the more will business energy turn to ways of true service. Opinion among business men themselves and in the whole social stratum of which they are a part has been infected by the worship of the millionaire. The more these classes have some intelligent insight as to what business men really do, and high standards as to what they should do, the better will be the working of the system of private property under the business man's guidance. Widespread teaching of economics, such as is carried on at present in our American universities and colleges and schools, ought to contribute much to this end.

At best there will always be a residuum of dubious business profits. So long as there is freedom of investment and of contract there will be foolish investors, hapless speculators, short-sighted bargainers. Shrewd and strong persons will take advantage of the ignorant and weak. There will always be operations in which it is difficult to draw the line between fraud and sharp bargaining. There will always be men to whom moral scruples mean little. Some things of this sort are the inevitable concomitants of the régime of private property, which even at its best can be justified only by a balance of good over ill.

§ 9. It remains to consider a qualification, to some extent a modification, of the preceding analysis. What has been said seems to imply that the stimulus of money making urges the business man on and that a damper on money making checks his activity and effectiveness. It has been contended, however, that this is by no means the whole case. It is alleged that often his efficiency is spurred by obstacles, not checked. Pressure by legislation, or demands from workmen for a larger share in the gains of a concern, depression in business—all lead him to search for better technological equipment and better management.

The view that pressure and low profits promote business efficiency has been expressed about all sorts of economic situations. Sometimes it is said that during the downward swing of the business cycle technological improvements are most likely to be introduced; whereas they are neglected or disregarded when business is booming. Sometimes legislation for promoting health in factories or preventing accidents is supposed to promote the installation of better machinery and the construction of better plants, and so to make business in the end more prosperous as well as more civilized. Taxes on business for beneficiary funds—provision for accident, old age, unemployment—bring a similar pressure and may have a similar result. Not least, demands by labor organizations for higher wages may lead the business manager to search for any and every possibility of cutting down waste and adding to effectiveness of operation; and great among the possibilities is the better, more tactful, more humane handling of the men.

There is truth in this, but there is much exaggeration. The modicum of truth and the danger of pushing the reasoning too far are shown best by considering what happens in a time of business depression. Often enough improvements in plant are then taken in hand. But what commonly happens in the plant is the introduction of improvements already known and tested, such as may be expected with confidence to be effective in short order; not far-reaching novel improvements which look long ahead. When times are bad, people may be pressed to catch up; most of all, apparently, in the early stages of a depression. But they do not then enter on large commitments of a kind whose outcome cannot be foreseen with certainty and which may involve a long stage of trial and error. These are the moves which bring the greatest progress in the arts and in the end the greatest pecuniary returns. They involve long-range planning, patience, and optimism; and commonly there is repeated need of putting in more and more money for preliminary and launching expenses than was expected. Their incubation goes on thru all the phases of the business cycle; they seem to be undertaken rather more in good times than in bad. They rest on the hope of gain, and would hardly be undertaken if at every stage and in every direction new large payments were called for of a kind not quickly conducive to success.

When it comes to the other class of improvements—those already tried, tested, and ready for introduction—it is more likely that pressure will stimulate progress. How far this process goes, how long it can be continued, is not easy to say. What can be done by successive moves may fail to be achieved when the moves are undertaken simultaneously. Large payments of many kinds and in all directions may be called for in close succession; yet the gains even from the best-known and best-tested improvements rarely come at once. They are least likely to come with promptness during the bottom period of a business cycle. At that stage heavier expenses are more likely to put a brake on progress than to speed it up.

A case that stands by itself is that of the effects of pressure by labor unions for higher wages. I think it is to be granted that where the conditions are favorable, this sort of pressure may conduce to industrial improvement. It will by no means necessarily do so. The favoring conditions are partly external, partly internal. They are external when the general economic situation is one of activity, hopefulness, ease in the credit and banking situation; and, not least, when an industry is in a stage of transition to new and better ways of production. Thus during the closing years of the nineteenth century and the opening years of the twentieth the clothing manufacture (the making of finished garments) in the United States was in process of getting free from a long-standing practice of subletting to the so-called sweatshops under which most of the work was done at the hands of subcontractors, usually operating on a small scale in poor quarters and with little capital, often unscrupulous. These small business men were being superseded by manufacturers having ample capital and good credit, operating in large workrooms and installing machinery of new types. The employers of the new type could accede to demands for higher wages, healthful conditions, honest treatment, and at the same time turn out their goods in the long run at prices no higher than before, even less. They would have pushed out the sweatshops in any case. Trade union pressure hastened the process. The change was representative of the better side of the evolution in modern large-scale operations.

Other conditions may be described as internal; most noticeably they are found in the relations between employers and employed even when no marked technological changes are impending. Pressure in these relations is most likely to be of permanent effect in stimulating improvement when it is smoothly exercised. If employers and employed have long been in friendly contact and have learned to respect each other, the organizations of the men will more readily consider new machines or new arrangements of work and coöperate in their introduction and operation. By this process, backed by firm organization, demands from unions can be of effect in pushing out the poorer employer and manager and raising the plane of effectiveness thruout an industry.

All this is not to say that labor unions bring such results usually or automatically. The progress of industry depends on à multitude of factors: the advance of natural science, the course of invention, internal and external improvements, a well-knit industrial structure, the human element in private industry as well as in public affairs. As regards labor unions, a course of events such as has just been described is unfortunately not common or representative. It may become of wider meaning if labor unions attain a fairly settled state, with intelligent and conscientious leaders; and if, on the other hand, not only good handling of machines, processes, marketing, but good handling of human beings becomes a distinctive mark of the leading and successful business man.

The working of the whole system of private property would bring a larger material output and would do more for the happiness of mankind if the internal situation were relieved of an immense amount of unnecessary friction and contention. It is possible that a firmer organization of the employed and a betterment of the ways and traditions of the business world would both contribute to that end. Something better than incessant contest and maneuvering may come to characterize the bargainings between masters and men. On these matters more will be said in later chapters.[1] Conceivably the power of a well-organized union will promote the elimination of the hard-boiled employer and the competition of the business world will promote the elimination of the short-sighted and ineffective business manager.

[1] See Chapters 59, 60.

CHAPTER 50

BUSINESS PROFITS AND CORPORATE MANAGEMENT

§ 1. The structure of a corporation. Investors, holding stocks and bonds; directors; executive officers.—§ 2. Risks assumed by the first investors; they receive profits as well as interest.—§ 3. The board of directors. Their activity and influence seems to become less as the size of the corporation enlarges. The executive officers, their relation to the directors and the stockholders.—§ 4. Are the earnings of the chief executives in an American corporation—"the management"—to be regarded as "wages" or as "profits"? The salaries of the other operating managers?—§ 5. The tantième system on the continent of Europe, resting on a distinction between wages and profits for the chief executives. After the war of 1914–18 a development of something similar in the United States under the name of bonus.—§ 6. The influence of a tantième system on efficiency of management. The earnings of executives of American corporations often contained an element of covert gain—graft more or less honest. Speculation by them and by directors; a part of the speculation widespread in the community.—§ 7. How classify these dubious incomes.—§ 8. The wider aspects. Effects on sustained inequalities of wealth and income; on legislation and political power, on labor relations.

§ 1. We take up now the relation of business profits to the corporate management of industry. Something has already been said about corporate organization and management, chiefly as regards the effects on the accumulation of capital and on the productivity of industry. The reader may gain by turning back to the earlier chapter on those topics. We now consider those aspects of the corporate problems which are connected with what has been said in the chapters immediately preceding on business profits.[1] And it is the great corporations that will be discussed—those with many millions of capital and numerous shareholders, listed on the stock exchanges and their shares freely bought and sold. The close corporations and family corporations are usually of moderate size, and in any case present no special problems of the kind here considered. It is Big Business in the corporate form that needs further attention.

[1] By the term profits in this chapter I shall mean business profits, or the earnings of "enterprisers" or "entrepreneurs."

Something is to be said at the outset on the structure and organization of a great corporation. Universally there are three distinct sets of persons: first a large body of investors—stockholders and often bondholders; second, a board of directors elected by the stockholders; third, an executive officer, or set of executives, the active managing persons, selected and appointed by the directors. These are the main groups. Within them there may be further segregation. The stockholders may be divided into preferred holders and common holders, and (in the extraordinary United States experiments and complications of the twentieth century) may be still further divided into sundry classes with different powers and rights. The bondholders too may be subdivided, both as to priority of claim to the earnings and as to their legal rights. The directors may have an executive committee to which great powers are delegated and which often is the real board; the other directors, not on this committee, being supervisory or even merely honorific and ornamental. The chief executive officers may themselves be members of the board; such is commonly the case in England and the United States. Indeed the chief executive in England is entitled "the managing director." In Germany the active managing head (entitled Direktor) is not ordinarily a member of the board.

The subject can be considered under three heads. How far must there be modifications of the previous analysis as regards (1) the functions performed and the work done; (2) the qualities and abilities needed; (3) the nature of the earnings secured? These several elements obviously are interrelated. In the case of the private firm they appear conjoined in the individual business man. So they are also, on the whole, in the close or family corporation. But in the case of the great corporation there is a division. Here there has gradually emerged a new kind of situation, highly complicated, and presenting problems for which the analysis of the two preceding chapters, while helpful and indeed essential, can be applied only with important distinctions and qualifications.

§ 2. Turn now to the first of the three aspects just enumerated. The characteristic function of the business man is the assumption of risk. The reader will remember what has been said already about the "reward" for risk: that it is not merely a matter of compensation for chance and uncertainty but one of a return, when it arises on a large scale, which means the possession of faculties out of the common.

In a corporation the initial risk is obviously assumed by those who provide the capital, and among these most unmistakably by the stockholders. They are the venturers in the undertaking. In the early stages the bondholders, tho their legal status is quite different, are venturers also. There is some difference between the two in the degree of risk assumed; that of the stockholders is the greater. Quite as important as legal position is the element of time: risk is greater or less according as an enterprise is in its earlier or later stages. In the earlier stages the uncertainty is great, the risk inevitable for all concerned. As time goes on it may appear that the whole venture was ill-judged; everything put in is gone, bankruptcy puts an end to it all. If there is success and a large concern gradually develops, the position of the security holders of all kinds becomes different. They may then have "securities" that are really secure and the element of risk may be at the minimum. The bondholders more especially are then fully confident of getting the interest to which they are by contract entitled. The original takers of the bonds (subscribers) may have been tempted by the promise of an interest rate higher than the then going "pure" rate. If the higher rate comes to be regularly earned part of the return is regarded as a "profit," which can be realized, if desired, in a lump sum by selling the bonds (perhaps now "prime") at a premium. The same may be the outcome with the shares of stock. Dividends may be earned and paid regularly, and the stock may go to a premium; here too the holders may sell or may hold. Both bondholders and stockholders thus receive a mixed return; to be analyzed as in part interest and in part profits which compensate for the risk incurred.

It was a recognition of this mixed situation which led to the practice, long common in the United States, of offering to those who first embarked in a corporate venture a block of varied securities. For (say) \$10,000 paid in the subscriber would receive \$10,000 in bonds and also \$10,000 in stock; or \$10,000 in preferred stock and $10,000 in common stock. What might come to be earned on the first block (bonds or preferred stock) represented interest; plus a fillip ("profit") for the risk incurred. Anything earned eventually on the common stock was profit pure and simple—mere return for risk and judgment. This sort of procedure was sometimes spoken of as "watering" stock or as "getting something for nothing"; the stock had cost nothing and yet was expected or at least hoped to get a return.

Usually the group of persons who took the initiative in starting the venture and contributing the funds were closely associated: an inventor or prospector, a promoter, a banking firm and its customers, the friends of these. As time went on and the concern came to be a going one the groups became less closely tied together. The securities became known, perhaps listed on the Exchange; holders sold their shares; other owners came in; speculation might set in and a new and different set of economic and social problems arose.

§ 3. Next: the qualities, doings, functions, interrelations of the persons engaged in a corporate venture. It is simple as regards those who provide the capital and take the initial risk—the original stockholders and bondholders. Some spirit of adventure they must have, and some modicum of judgment, but nothing marked in either way. When it comes to the next group in the corporate set-up, the board of directors, the requirements are somewhat the same in kind but there is a considerable difference in degree. At the outset the members of the board usually hold on the average more stock than the other stockholders and so take larger risks. The difference is still greater as regards management and judgment. The directors are supposed not only to be in constant touch with the course of affairs but also, what is more important, to use their judgment on questions of policy and more or less on details of management. This sort of service is called for more especially and more largely in the early stages; then the directors commonly do direct. In the later stages, when a concern has grown to be large, going, settled, the situation tends to change. One might expect the activities and powers of the directors to enlarge as the corporation enlarges. Yet in fact it is commonly otherwise. This has been the tendency at least in the United States. The board of directors of a long-established corporation came to be larger in numbers but to have less actual importance. A larger proportion of them, perhaps a majority, are chosen merely because of their name or their general business repute. Most of the functions are performed by an executive committee of the board, an inner group. What the board did during the early stages in the way of judgment on larger matters of policy, still more what it did in the way of supervision of current management, comes to be settled in the main by that inner group, the others merely giving formal approval.

As regards the executive officers, there has been commonly an even more conspicuous development of the same kind. The leading executive became not merely a salaried manager but a leader and even a commander, one whose judgment was not only respected but commonly followed, the person mainly responsible for success or failure. He was not merely a salaried person engaged to give his whole time to the work; he was more—the titled president of the corporation and a member of its board of directors. If he had satellites, leaders like himself tho under him, these also might be members of the board. All these personages were likely to be members of the board's executive committee, and very active members. Herein also the corporation, as it grew larger and larger, evinced an increased concentration of power. As its total capital investment and the total number of stockholders became larger the number of persons who really guided and managed it became smaller.[1]

It thus appears that while the security owners—especially the stockholders—in form seem to be the "business men" of a huge corporation of the modern kind, they have in fact but a minor part in those doings which we associate most with business management and business profits. The stockholders take one great initial risk; it is by them that the first capital is staked. More or less the bond-

[1] It is not easy to make out how far this may have been the case in earlier days. Quite possibly a *de facto* dominance by one man or a small group existed long before it became overt and familiar. It would seem that it developed earlier and more completely in the United States—perhaps in Germany too—than in Great Britain. The persistence of the term Managing Director in the British Joint Stock Companies, even in the larger ones, apparently is not a mere conservatism of phrase but a sign of some retention of the original relation.

holders do something of the same sort. But when the first commitments have been made the security holders fall into the background of the business picture. True they continue to incur risks, the stockholders most obviously so; and this even in the corporations that seem most stable and secure. But such judgment as they exercise, and such risk as they assume or refuse to assume, hardly affect at all the conduct of the concern's affairs. The individual stockholder has an influence only indirectly and obscurely thru his sale or purchase of shares. If he sells he leaves it to the buyers to exercise their judgment and assume the risks. If he is optimistic and judges the management to be good he buys, adds to his holdings and assumes additional risk. But he does not, indeed cannot, take part in the current management, in the judgment, the decisions which are called for as operations go on year in and year out, and as they change with the passage of years. The continuing functions of the business man—the entrepreneur—are performed by a small knot of executives, among whom one is apt to be *the* leader.

§ 4. We turn now to the third part of the problem: the nature of the incomes secured. This may seem to be no more than a matter of classification, such as sometimes bulks large in economic discussion and may or may not lead to anything that signifies. In this case there is some bearing on large questions of social development and social policy. The question of classification is whether business profits are to be regarded as a form of wages or as a return essentially different from wages; and the larger question, as regards the great corporations, is whether these incomes, taken as a whole, have the same relation to the distribution of wealth and income as wages and salaries of the familiar kind, or a different relation.

The various persons who do the work of direction in a large concern—something other than routine manual or clerical labor—are of many grades. The better paid among them, such as presidents, general managers, heads of departments, get "salaries." Those less highly paid, such as foremen, perhaps the superintendents, get "wages." "Salary" is simply euphemistic; the two terms indicate only a series of grades. Yet there are broad lines of division in the hierarchy of industry which separate groups from groups; and among the men of the highest-paid group there is again a broad line of division which is important for our present problem. It is based on the distinction which Marshall drew between "engineering" and "superintending." Engineering is the planning of an enterprise; superintending is the execution of the plans. The two call for different qualities. For superintending there is need of capacity of a standardized sort, well known, not hard to recognize, earning a return in the market which is generally accepted as "just and fair." Engineering requires capacity of a more elusive sort, not so readily detected, not so easily found or appraised. The men of the first group pretty clearly get "wages." Is the same to be said of those in the second?

This situation exists and this question arises in the great American corporations of modern times. There is the president, the commander-in-chief. Commonly there is a small group of higher executives, often dubbed vice-presidents, in charge of important fields, such as Finances, Sales, Operation. These constitute what has come to be called the "management"; made up variously for different corporations but a small group for any one however large the concern may be. These are the engineers. The dominating personality is usually the president; the others take a part with him in exercising judgment and in settling policies. All have fixed salaries, large but not uniform or standardized. Distinct from them is a second group: they are in Marshall's class of superintendents but may often have the title of "manager." Their work is primarily that of carrying out policies which have been settled. Their salaries may be "good," even high, but are tolerably well standardized. They do indeed need qualities out of the common—energy and steadiness, intelligence, knowledge of details of the job, judgment of men, physical capacity to endure occasional heavy and nerve-straining work. Their advice may be sought and welcomed. But they are not in general men of outstanding personality, with qualities of imagination, initiation, inventiveness.

All this points to a distinction. The salaries of the men of the second group, the operating managers, are wages pure and simple. The salaries of the first group are not so easy to analyze and classify

They are more in the nature of business profits. The recipients have responsibility and assume risk. True, their salaries may be fixed in amount and may seem to be independent of the outcome of the enterprise as a whole. Therein they are on the face of things in the same position as the men of the operating group. Yet there is a difference. The operating heads of departments and their superintendents are responsible primarily for the settled routine. The leaders have a responsibility for the final profit or loss. The fact that salaries are fixed once for all, while consonant with the realities of the situation for the first group, is not so for the second. These latter must "make good." Of course allowance is always made for the inevitable ups and downs of business, for lean years amid good years. But over a period the president and the others must "show results" or be superseded. True, a process of supersession is a trying one for the directors, the larger stockholders and the interested bankers by whom it is carried out. It is entangled with personal associations, friendships, unwillingness on all hands to face a failure. But in the end the men who do not possess the needed qualities go, the helm is taken by others having them or supposed to have them. The captain of industry remains permanently in command only if he proves to be the man for success.

The head of a great corporation, even when he receives a salary only, is thus in a sort of *de facto* profit-sharing situation. This was recognized on the continent of Europe earlier and more explicitly than in the English-speaking countries; a curious divergence in development, which seems to be explicable only on the ground of tenacious business tradition and conservatism in the English-speaking group.

§ 5. We proceed now to the well-defined practice on the Continent and that newly developing in the United States.

On the Continent the executives of large corporations usually receive not fixed salaries but sums which vary with the earnings of the business which they manage. The Direktor (that is, the executive head, the "engineer") of a German stock company receives a fixed salary, and in addition a stated percentage ("tantième") of the net earnings. The tantième is universal. The most common figure is five per cent, and the most common basis of computation is that of the net earnings after meeting all operating expenses (including interest on borrowed capital) and also payment of a fixed moderate dividend, equivalent to interest, on capital. If the concern is a very large one, not only the chief executives but others also in positions of great responsibility have a tantième; that is, to compare with corresponding American positions, not the president only but the vice-presidents also. Sometimes the leading officials divide the tantième; which indeed might amount, for a great concern, to an inordinate sum if received by one only.[1]

The fixed salary of the executive (or executives, if more than one) is moderate. It is supposed to be such as to enable a man to live respectably according to the standard of the social stratum to which he presumably belongs. It is a sort of guaranteed minimum for the particular kind of work. Over and above comes the conditional tantième. This may amount to double the salary, even more. If the concern is highly profitable the executive not merely earns a living but "makes money."

All this is regulated by a written agreement for a term of years, usually five. The strictness of the contract is in striking contrast with the American corporation's arrangement with its executives. Tenure of the American executive is often loose and uncertain. In a rough way, it is "on good behavior"; whatever the exact legal relation, the appointment is expected to last indefinitely. Yet it is subject to change at short notice if the stockholders (that is, the directors) become dissatisfied. The continental contract, on the other hand, is elaborately and carefully drawn, and provides

[1] The details vary in different countries, and again vary in different concerns according to their by-laws. In Germany there is commonly, in addition to the board of directors (Aufsichtsrath), another body called the Vorstand, which is made up of the leading officials and a few members of the Aufsichtsrath; these last also receive a tantième. The Vorstand corresponds roughly to the executive committee of the American board of directors combined with what corresponds roughly to the American "management."

A typical arrangement is the following: out of the net earnings of the concern there is allotted (1) something to reserve, until the reserve amounts to (say) 10 per cent of capital; (2) a dividend of 4 per cent to stockholders; (3) 5 per cent of the remaining earnings, as tantième, to the executive or executives; (4) another 5 per cent to the Aufsichtsrath (among whose members some will be on the Vorstand), divided among these as they decide; (5) finally, a superdividend to the stockholders.

unequivocally not only for the salary and for the tantième but also for the period of service.

There are variations of detail between different concerns and different kinds of concerns, and between different countries. In Germany the contract is nearly uniform in its character (not as to the figures, of course) for all corporations proper (*Aktiengesellschaften*). For the limited liability concerns, *G. m. b. H.* (*Gesellschaft mit beschränkter Haftung*), which are similar to our limited partnerships, there is more variety. These are more in the nature of firms or at least close corporations; their shares are usually not transferable by the holder at will, but only with the consent of the corporation, that is of the majority of the stockholders. The executives of such concerns commonly receive a tantième but not so universally as with the corporations proper. Sometimes they receive a fixed salary. Frequently, too, they are themselves holders of shares; which is in general not looked on with favor in the case of the executives of corporations proper. But these variations, interesting in many ways, are of no great moment for the present purpose.

The tantième system is found not only in Germany but in Austria, the Scandinavian countries, Holland. It is equally prevalent in France, Belgium, Italy. All over the Continent it is applied not only in manufacturing concerns of moderate size and simple character but in the large industrial enterprises and combinations, in the great banks, in insurance companies—thruout the range of business.

Something of the kind is frequent in Great Britain also. It is true that in the case of "public companies"—what Americans call public utilities—the plan of fixed salary is universal; and the same is the case with banks, insurance companies, and the like. But among manufacturing industries there is considerable resort to a profit-sharing arrangement analogous to the tantième. So far as I can learn, this is as common as that of a fixed salary. Corporate organization, it must be remembered, has not ramified as far in Great Britain as in the United States or Germany. A very large proportion of the manufacturing concerns of moderate size is still in the hands of firms and individuals. British industry, in this respect as in others, shows more variety and flexibility than that of the Continent, and lends itself less readily to description in general terms. The most striking contrast is that between American practice and that of the Continent.

The tantième system, it is evident, implies an attitude toward the "profits" of a corporation different from the American. It is not in accord with the notion that the business profits of a corporation go solely to the stockholders. The executives also share in them. Their fixed salary is deliberately made moderate; it is less than a first-rate man might be expected to earn year in and year out. Like the member of an American firm or partnership who has his "drawing account," the continental manager gets enough from month to month to pay his ordinary living expenses. At the end of the year he may prove to have earned much more. His tantièmes may then serve to build up a property, even a fortune. Part of the rewards of enterprise, of risk taking, of the exercise of judgment, go directly to him. How much of his total earnings is to be regarded as "wages" for labor and how much is something different and in the nature of "profits" it would be hard to say. He takes risks, as do the stockholders. He ventures his whole energy, taking as guaranteed pay a sum less than he expects to get and is expected by the stockholders to get. He exercises judgment, he must show enterprise. The line between his salary and his tantième is sharply drawn in his contract.

It is to be observed that the German practice makes an overt distinction also as regards the receipts of the stockholders. Their "ordinary" dividend—that which they get before the tantième is reckoned—is at the current interest rate and stands for a return on capital. The superdividend which may finally come to them is rather in the nature of business profits; a reward, if there proves to be any, for enterprise and judgment. *If* business profits are to be sharply separated from wages and interest the profits are to be found, in case of the continental corporation, in the tantième and the superdividend combined.

In the United States, as has been noted in the preceding pages, the almost universal practice long was to pay the managers of corporations, large as well as small, a fixed salary; which implies a belief or tradition that the income is in the nature of wages. The same seems to have been the case with the "Managing Directors" of the British Joint Stock Companies. After the war of 1914–18 something in the nature of the tantième system came into wide, tho by no means universal, use in the United States. Fixed salaries were supplemented by a so-called "bonus." [1] At first the extra payments were made merely because they were thought to be called for by disturbed and unusual conditions; hence the term "bonus." Gradually it came to be perceived that there might be ground for a permanent system of supplementary payments, and contractual arrangements of the kind were adopted in a number of large corporations. Yet the crust of custom is not easily broken, and the arrangements were often concealed because of their very novelty. Another ground for concealment was that they were often on a scale and under conditions that might have aroused hostile comment; being proposed by the management and virtually settled by the management, and thus in the nature of allotments by these persons to themselves.

It was soon perceived that if a plan of this kind was to become general it must be not discretionary but contractual; not a quiet inside arrangement between directors and managers but one made known to the stockholders and so to the public. How far they should be completely open to view is another question and a less simple one. The traditions of private property are that a man's wealth and income are his own affair and not to be spread abroad —open to inspection only so far as may be necessary for the collection of taxes. On the other hand, the feeling has steadily grown that where a business or corporation is "affected with a public interest" (the legal phrase) it is subject to regulation and thereby necessarily to inspection in all its doings; and further that the huge corporation of modern times is affected with a public interest by virtue of its very size. One's opinions or prejudices on these matters are a part of one's general attitude on property and on

[1] The term "bonus" seems to have been applied because of the extraordinary price advances and fluctuations of the war period. These led to readjustments of salaries, partly because they were called for by the higher cost of living, partly because it was thought fair that management should share in the large windfalls (extra dividends) of the stockholders.

inequality. As regards the matter of management contracts and bonuses it cannot be questioned that, if they are to be entered on, concealment is no more justified than in the case of fixed salaries.

§ 6. We turn now to questions of a different kind. They relate to the ways in which the organization and management of the great corporations affect the production of wealth and the distribution of income.

First, as to efficiency of management. The tantième plan would seem to be in accord with the principles of individualism and of private property. In general, the world now pays people according to their efficiency—their contribution to production, their ability. The individual or firm that manages a business for itself, so it has been commonly said, is likely to be more efficient than the corporation, for the very reason that hired managers are less keen, less efficient. If the corporation none the less has displaced the firm it must be because it has some offsetting advantages: not only those of limited liability and legal simplicity but of permanence and continuity, and the potentiality of vast capital and indefinite expansion. In discussions of the *pros* and *cons* of public ownership, for example, it has been often remarked that both alike are at a disadvantage compared to individual ownership, because both rely exclusively on hired labor. Does the tantième system present a middle course, combining the advantages of corporate organization with the stimulus of individual ownership and interest?

The matter is not simple. The head of the great concern may receive a fixed salary. And yet, as has just been said, he is in a sort of *de facto* profit-sharing situation. His salary in the long run depends on his efficiency. Not less, his prestige and the attitude of associates toward him depend on the same thing. This can indeed be said of all who are in the upper tiers of a large concern's staff. But there is in the case of the guiding leaders a special element. More time is needed to make sure how great his efficiency is. It may be best to leave him free to carry out a long-range plan, undisturbed by any immediate effects on himself during the germinating period. If his salary be fixed once for all he is under no temptation to follow short-sighted policies. It is not so clear as might seem at first sight that a year-by-year sliding scale arrangement tends to bring the most efficient management.

In the great American corporations the alternatives unfortunately were often less simple. It was not a case of choice between a fixed salary contrasted with a combination of salary and specified sharings; it was one of a combination of fixed salary with sundry gains or pickings, ranging all the way from "honest graft" to downright corruption. Graft that is honest may be said to arise when the head of a large concern is enabled by his connection with it to handle his own affairs to better advantage. He cannot but learn much about other concerns like his own and perhaps competing with it, about new and old ventures and their prospects, about "the market" generally. He may invest prudently or speculate profitably, and is more likely to do either or both with profit than persons of the same business quality less closely in touch with what is going on.

It is not easy to say how far this taking advantage of a favorable position is to be condemned. When is it on the right side, and when on the wrong side, of the shadowy line that separates honest dealings from dishonest? Something on the verge of dishonesty is approached if a manager buys and sells the securities of his own corporation. Yet even here the line of division between the legitimate and the illegitimate is not necessarily reached or passed. At first sight one may be disposed to say that here is a plain case of playing the game with loaded dice. The managing leaders, and the directors also, are better informed about the concern's position and prospects than the stockholders at large, and are at an advantage if they choose to speculate. It is notorious that often they did so. Yet the mere fact of buying and selling the stocks is not necessarily speculation; or, if so to be dubbed, it is not necessarily speculation of a harmful kind. It has often been pleaded, and I think with good faith and some truth, that these operations have been designed not so much to enrich the officers as to keep the stock quotations on the Exchange at a more even level, and prevent the ordinary stockholder from being dismayed and so from selling at panic prices. A panic starts and spreads more rapidly and disastrously on the Stock Exchange than in any other part of the economic sphere. Moreover, it has ill effects not only on those directly concerned but on the business community at large. A general collapse in stocks tends to make depression more benumbing all round, just as a soaring stock market makes for reckless activity. I would not undertake to say how far the stock dealings of insiders are often or commonly meant to have some good effects in this direction, or in fact do have it. But it is probably true that not all of them are even semi-corrupt.

Certain it is that in other directions semi-corrupt things were done, and too often things quite corrupt. Misleading statements and figures were published about earnings and prospects, deliberately designed to entangle unwary speculators. Similar was the practice of organizing (or joining) subsidiary corporations, which made profit thru dealings or connections with the parent concern; construction companies, equipment companies, what not. This sort of practice may have at times led to quicker and even better handling of the main concern's business than could have come by direct appeal to stockholders and to the general public for funds to be invested in these ancillary concerns. But it was a plain "milking" of the corporation and quite beyond the pale of the law. The doings were in violation of fiduciary obligations, and a suit in equity might lead to unpleasant publicity and even to the disgorgement of gains—a retribution which rarely came.

It must be added that the shady sides of corporate management, and indeed of business management in general, are not to be regarded as solely or even chiefly a result or sign of a particularly low moral standard in a few leading individuals or a few conspicuous groups. An enormous speculative public fomented it, condoned it, even admired it. The rigging of the market for stocks and the speculator's profits from inside information were condoned in business circles for the simple reason that so many played the same game or tried to play it. It was part of the froth and scum which arose in a period of rapid and feverish development; the result not merely of bad character in individuals but of the aims and ways of the business community at large, nay, of the whole American public. Nowhere has the craze for wealth pervaded so large a portion of the population, and nowhere has it shown itself on so great a scale as in the creation and management of large corporations and speculation in their stocks by any and every kind of person. To develop the country and exploit its resources was accepted on all hands as the one aim of industry and legislation. All played the game with zest and with little scruple. Those who played it best were envied and imitated, and if they made fortunes were almost glorified.

As time went on betterment set in. Partly this was because the industrial pace began to relax; partly because higher standards of conduct began to be followed; in no small part because research by students and writers on economics laid bare the unsavory situation. Legislation was demanded and was applied.

§ 7. The question now may be asked: how classify the incomes that are thus dubious? They are often large, sometimes enormous; always irregular; in many cases defensible on the grounds of accepted middle class morality, in as many others quite indefensible. Are they to be regarded as merely a kind of "profits," or do they show a sharply marked difference from the business profits of the simpler industrial structure? These latter, too, have a wide range as to amount; they also are irregular; often enough they have their questionable side. The difference seems on strict analysis to be one of degree—merely a greater amount of hazy and shifting stuff in this case, concealing a core essentially the same. Yet so great is the difference of degree that a separate caption as well as a separate treatment does seem to be warranted. In the same way the difference between the earnings of the modest farmer, who tills his own land with the aid of a hired man or two, and those of the manufacturer, who owns and runs a large plant in which there are hundreds of workmen, is merely one of degree. Both are "entrepreneurs" as a matter of logical classification. Yet there are differences of various sorts—in the nature of the apparatus of production, in the range of the incomes, in the traditions of education and culture—which are indicated by saying that the income of the first group is mainly a matter of wages, that of the second mainly one of business profits. What really matters in such attempts at distinction and classification is that thereby we prepare the way for a better understanding of the meaning of the doings for the human beings who constitute the social body.

§ 8. We come then to the other side, that which may be regarded (in a somewhat special sense) as *the* "social" side. What is the relation of corporate organization and management to inequality of wealth and income? and what to another kind of inequality, that of position, repute, power?

Great inequality and great fortunes cannot be said to be brought about—caused—by the great corporation. Usually such corporations are rather result than cause. The fortunes at their foundation have their beginning in operations which lead to the eventually mature and widely owned corporation. They arise from the money making of the founders and fosterers. True it is that in modern times these adopt at a very early stage the corporate form for their ventures. But at that stage they are closely held concerns; both management and ownership being in the hands of a small knot, often with one dominant personality. The corporate form serves chiefly for legal and business convenience, not for the gathering of funds from a large number of persons who are primarily investors. If a successful "big business" develops the founders or their heirs possess great blocks of the corporate securities. As time goes on the heirs usually drop from the management and dispose of large parts of their holdings. Sometimes they become the indolent rich, described by such a term as "capitalist" in lists of directors.

Corporate organization, however, thru its concomitant of a huge volume of stocks and bonds, has an effect on inequality of another kind. While the legal and industrial form does not in itself serve to build up great fortunes, it does contribute to their permanency when once built up. And this holds not only of great fortunes but of moderate ones, and to a considerable extent even of small ones. Investment by the individual in corporate securities becomes a quick and easy matter, can be readily shifted and rearranged, above all can be spread over many fields. The ingenuity of the financial middlemen in vying for the custom and support of an army of property owners has provided more and more diversified ways of investment. All sorts of securities are offered; not only those with risks and with possibilities of large returns but those with low return and safety. Government securities still possess a special prestige as to safety and hence yield the lowest rate of interest. Corporate securities are also offered which are hardly less safe. There are plenty of baskets, and the eggs can be divided among them in such way that there is insurance against risks; the more varied the baskets the more complete is the insurance. The position of the property owner, if he is content with a modest rate of return, is relatively secure. It used to be said, and is still occasionally repeated, that the maintenance of a fortune calls for as much ability as the making of it; that riches have wings; that it is but three generations from shirt sleeves to shirt sleeves. This is far from being the case in modern times. Inequality, once well established, tends to persist; the result, in good part, of the amount and variety of the securities issued by the great corporations. Such was, at all events, the situation during the comparatively quiet period from say 1890 to 1914; the period when—not entirely an accidental association—the monetary situation of the world was thought to have attained stability thru the definitive acceptance of the gold standard by all the important countries. Like the gold standard, it was much shattered by the events of the later period, and especially by the collapse of 1929. But it seems likely to be maintained so long as private property with its concomitants persist.

A different matter is that of power, control, dominance. A leading position in the hierarchy of a huge corporation, while it does not necessarily bring great wealth, brings well-recognized power and prestige. And power is prized by mankind in every sphere; not only in war and in the world of politics but in the economic world as well. The large lists of directors often published conspicuously by corporations—the window-dressing lists—commonly contain some persons who have been put on the board merely because they are large shareholders, heirs or successors of the founders. Sitting with these is the small group of active managers, who pay lip homage to their opulent associates but enjoy a consciousness of being the real leaders and of being recognized as such in the business community. The managers of a great, well-established, mature corporation do not usually owe their power to the ownership of a large part of the shares. Much the largest part is usually in the hands of numerous and scattered investors. These habitually send their proxies—are asked to send them—to the management. While the managers are very prosperous individuals, or are in course of becoming so, their position in the community rests less on their riches than on their control of the huge agglomeration of resources. What they do and think has an enormous influence not only on the operations of the individual concerns but on wider matters. The kind and amount of a country's concrete capital—plant especially; its geographical distribution; the "capital structure" of a corporation as well as the physical structure of its property—all this bears on savings, investments, overinvestment and overproduction, industrial fluctuations. Thereby it bears also on monetary and banking practice and legislation. The same no doubt was true of the individual business man and firm of older days. But the power is more concentrated when there are a few huge corporations, each managed by a comparatively small knot of leaders. A decision by one of these or by a small group has wide effects. And their influence on the welfare of the community is not always—nay, not commonly—matched by their understanding. Ability to handle industry so as to make money is a different thing from grasp and intelligence for the large economic and social problems. On these the utterances of big business men, sometimes paraded as if conclusive, are often commonplace and naive.

No doubt the power of the corporate heads has been exaggerated, as for example in the political and legislative field. It was sometimes said during the last decade of the nineteenth century and the first of the twentieth that the few hundred men at the head of the great American businesses constituted a ruling oligarchy. "What they say, goes." And true it was that big business and its big men had much to do with politics and exercised considerable power on legislation—so much so as to be thought ominous not only by zealous reformers but by cool-headed observers. Yet the power was rather to brake than to steer; it was on the pace of law making and on the details of the laws, not on the large movements. The longer the power lasted and the more it was used the weaker it became. In the end the large questions of social and economic policy were determined by public opinion—by the convictions of the electorate.

As regards the relations between a great concern and its thousands of employees the power of the head (or the management) again is great and again has its limits. And in these matters it is most obviously of wide social import. Whether the labor policies of a large concern shall be sympathetic, broad-minded, far-sighted depends largely on the education, the traditions, the temperament of the man at the helm. Of course the rates of wages are no more determined by mere decrees of the employers than are the rates of interest; they are determined by the slow-working forces which have been considered in the preceding pages. But it is only the general range (accepted both by employers and employees as a matter of course) which is so determined. The particular rates around which disputes arise are much affected by bargaining and compromise. And how these are settled, in what spirit and by what methods, is immensely affected by the attitude and the policies of the managements.

On all these matters more will be said later.[1] They are taken up here because they help to show how many are the ways in which the modern development of great-scale corporate operation has affected the industrial and social world.

[1] See particularly: Chapter 56, on Inequality; Chapter 65, on Combinations and Trusts; and Chapters 58, 59, on the Wage System and Labor Unions.

CHAPTER 51

MONOPOLY GAINS

§ 1. Absolute monopolies; industrial monopolies. Patents and copyrights as instances of absolute monopolies; the grounds for creating them by law.—§ 2. "Public service" monopolies. Increasing returns and increasing profits.—§ 3. Combinations and "trusts"; uncertainty as to the extent of their monopoly power.—§ 4. Monopolies rise and fall, as dynasties do; yet so many endure for considerable periods that their gains remain among the abiding elements in the distribution of wealth.

§ 1. THE differences between natural agents, bringing about the phenomenon of rent, constitute one great cause of variations in the yield from labor and capital. Monopoly is another. Rent has often been said to be merely one case of monopoly. This is not an accurate statement. The characteristic of monopoly is single-handed control over the total supply. Rent is not the result of control over the supply by any one landholder or by any organized combination of landholders; it arises because of the scarcity of the better sources of supply. But monopoly is similar to land scarcity in that it causes unusual gains to some enterprises and so contributes to inequalities in the distribution of wealth and income. Of its regulation we shall say little here. The present chapter is concerned only with its relation to other gains from the ownership of capital and with its place in the theory of distribution.[1]

Sundry classifications of monopoly have been proposed. The simplest, and that which will suffice for such a general survey as is undertaken in this book, is into absolute monopolies, on the one hand, and industrial monopolies on the other. Absolute monopolies are those in which, by law or by ownership of all the sources of supply, the holder's control is complete. Industrial monopolies are those in which the control over the supply, while not complete, is yet effective enough to bring a state of things different from that of competition; in which, even tho there be no legal or

[1] Compare the chapters on Railroads, Combinations, Public Ownership; Chapters 63–66.

natural restriction, the nature of the operations is such that competition either is wholly removed or is operative only to a limited degree.

Where there is an absolute monopoly the situation is comparatively simple. The general principles involved have been sufficiently stated in the chapter on Monopoly Value.[1] The monopolist, if vigilant and shrewd, will fix that price at which his net profit is greatest.

Copyrights and patents supply the simplest cases of absolute monopoly by law. During the term of the exclusive privilege the holder is affected by competition only in so far as substitutes are available—often a considerable limitation, yet by no means such as to prevent very great gains from some patents and copyrights. Among modern patents those of Bessemer for making steel, of Bell for the telephone, of McKay for the sewing machine used in shoe manufacturing, the Northrop automatic loom, the Mergenthaler linotype machine, the Edison light, have been conspicuous for success. The justification for the high incomes from such patents is that the prospect of securing them has been a spur to invention and that, tho prices may be above the competitive level during the term of the patent, the public in the end gains. Patents are granted for a limited period, usually for about fifteen years (this is the term in France, Germany, and Austria; in Great Britain it is fourteen years, in the United States seventeen). When they expire the unrestricted use of the device is expected to bring to the community cheaper or better goods than it would have had otherwise.

The assumption underlying patent laws, namely that the improvements would not have been made but for the monopoly privilege, seems to be justified. I say, seems; we face here one of the many questions about economic motions and economic behavior to which no unqualified answer can be given. It is true that some persons are born with an instinct for contrivance and will be impelled to invention as irresistibly as others will be to literature or science. Yet in most cases the prospect of a reward is an indispensable stimulus; indispensable, that is, not so much in order to evoke

[1] See Chapter 17.

contrivance as to direct it into channels of service to the community.[1] With patents this is the more the case because they almost always involve considerable risk, both for the inventor and for those who supply capital for working the invention. Of the patents actually taken out—thousands of them annually in a country like the United States—the immense majority come to nothing. Tho most of the failures were certain from the start (all sorts of absurd or insignificant devices are patented), the future of a large number, involving much thought and labor, is uncertain. They may prove valuable and may prove worthless. After a patent has been secured and launched there must often be expensive experimenting with further devices and improvements. For at least two of the inventions just mentioned—the Northrop loom and the Mergenthaler machine—hundreds of thousands of dollars were spent in preparatory and experimental operations. In other words, risks must be run and there must be prizes to offset the failures. If every process that had been worked out with much labor and large expenditure were, when perfected, at once open for use to every comer the original inventors and investors would have much less prospect of reaping a sufficient reward. Here, as elsewhere, occasional windfalls which may seem out of proportion to the desert of the particular fortune winner must be accepted as part of the encouragement of enterprise.

Much the same can be said of copyrights. It is true that in this case, more than in that of mechanical inventions, the inborn bent of some individual is likely to produce its effect irrespective of rewards. But literature as well as art shows not only all degrees of quality but all shades of motive. In the making of most modern books the stimulus of individual gain plays no small part. The great works of the imagination and the great works of science have probably been written primarily because of the all-absorbing interest of creating. But in the making of most modern books the stimulus of gain plays a large part; such as novels, "popular" books of travel and biography; the literature of a pedagogic kind—text-books, handbooks of reference and so on. No doubt there is a mixture of motives thruout—some inborn urge, some love of dis-

[1] I venture to refer on this subject to *Inventors and Money-makers,* Lecture I.

tinction, some love of money. It is not certain that copyright protection improves the quality of books, but the system does stimulate the output of books of the kind desired by the public. Legal protection for the book writer is peculiarly necessary; for a book can be reprinted verbatim at once, whereas a new mechanical device may be often shielded from competition for some time even without a patent. Given the principle of reward in proportion to useful activity, then copyright is a natural and consistent application of it; and those who, in the absence of legal protection to authors, print their books without making payment are not inaptly termed pirates.

Absolute monopolies resting not on legal restriction but on control of natural resources are rare. The diamond mines of South Africa, to which referencc has already been made, afford an instance. The owners of the nitrate beds in Chile effected a combination, and the owners of the world's nickel and aluminum supplies consolidated into a single concern. In the last-mentioned cases the natural resources were supposed to be limited; they seem to be so at the moment but there is always in the background the possibility of the discovery of new supplies or of the successful utilization of others that are known but are of poor quality. Not least, there may be far-reaching changes in the arts, such as the chemical process for procuring nitrogen from the atmosphere, which deprived the Chile beds of their once dominant position. The unusual situation is that so-called monopolists of this sort are in the possession not of the sole sources of production but of the best, and hence that their gains are more in the nature of economic rent than monopoly gains in the narrower sense.

§ 2. More important in the modern world are industrial monopolies. These also are rarely quite unfettered; but the limitations on their prices and profits come not so much from the existence of poorer sources of supply as from public regulation and the possibility of competition. Broadly speaking they are of two sorts: "public service" industries and the familiar "trusts."

"Public service" industries is a convenient phrase to designate water supply, gas supply, railways and street railways, the telephone and telegraph, electric lighting, and the like. These are operations which affect great numbers of people, which usually call for some special grant or privilege such as the right of eminent domain or the use of the public highways, and which are best carried on under single management. The last-named characteristic is the important one for our present purpose. The advantages of single management are so great that, even tho there be an initial period of competition between two or more establishments, consolidation is certain to ensue. The community may as well accept once for all the fact of the monopoly and adjust its policies accordingly.

Increasing returns in the strict economic sense are a usual characteristic of these industries. A single great plant can do the work more cheaply as it gets larger and larger. It is a wasteful process merely to duplicate a railway line, the mains of a water or gas system, the wires of a telephone or telegraph system. Sometimes, it is true, when the stage of very intensive use is reached the duplication of a plant may become necessary; there may be need of a second set of main pipes, of duplicated railway tracks or an additional line. Even then there are almost always appreciable economies in managing the several plants as one; and in any case it is certain that so small a number of competitors will form a combination. In the case of telephones and telegraphs there is the further circumstance that all customers are better served if all are connected with a single system. Chiefly because of increasing returns in production and in any case because of the small number of possible competitors the emergence of single control is inevitable.

Some inventions of modern times served greatly to increase the gains in such industries. The application of electricity to traction enormously increased the efficiency of labor in street railways. The improvements in gas manufacture were hardly less important. The growth of cities would in any case have tended to make these industries more lucrative. Cheapened as their operations were by great advances in the arts they became sometimes fabulously profitable.

It is part of the irony of fate that the half-fortuitous gains which accrued for a while from this situation, and which were expected in most quarters to persist indefinitely, were interrupted, sometimes permanently wiped out, by causes hardly less fortuitous. The very circumstance which promised to maintain large profits proved under the unexpected conditions of a monetary revolution the cause of financial distress. So long as prices in general remained stable and expenses therefore not subject to general increase—invention and improvement meanwhile steadily continuing—the stability of the price of these products and services had promised high returns. But as the prices of most other things and the rates of wages tended to rise the fixity of the street railway fare or gas prices became a cause of financial embarrassment. Not only tradition but the growing effectiveness of public regulation prevented a rise in charges. The slow but steady advance of the price level during the early years of the twentieth century tended steadily to pare down profits. The abrupt advance during the war of 1914–18 brought the tendency to a sudden climax. The public furiously and vociferously opposed changes from the accustomed scale of charges. Increases finally had to be accepted; they were as inevitable as those in salaries, in taxes, in rentals of dwellings and shops; but they were sparingly allowed. The problem for the owners and investors was no longer how to conceal and pocket profits but how to avoid losses; and the problem for the public became for the time being that of assuring the maintenance and extension of essential industries, not that of controlling the profits of monopolies.

§ 3. More troublesome problems of economic theory and no less difficult problems of public policy are presented by the so-called "trusts"; that is, the great horizontal combinations, under single management, of a series of separate establishments. The difference between the monopoly industries considered in the last section and the trusts lies in the fact that here there are usually a number of physically separate plants. A street railway, a gas system, a telephone and telegraph net, a railway system—each is a physical unit. But when a dozen sugar refineries or chemical works or lead factories are united in a trust the separate plants, tho now managed as one, remain separate.

It must be confessed frankly that we do not know in the present state of economic inquiry to what extent permanent monopoly is likely to develop in such industries. If there were a general tendency to increasing returns from the mere fact of concentration in ownership and management we should expect monopoly to develop without fail.[1] Yet even in the absence of such a tendency continuously in operation some degree of monopoly control may appear. The great combination or trust—"big business"—may keep out rivals by cutthroat competition, by sheer weight and power. On the other hand, large gains do tempt interlopers, and the constantly swelling volume of accumulations in search of investment causes every chance of securing large returns to be sought out. There is the crucial question of management too; the possibility of nepotism and ossification when once the founders of a great combination (usually men of exceptional ability) have left the field. New blood may appear in competing enterprises and an apparently secure position of dominance may be lost to the later generation of business leaders. To repeat, we are much in the dark as to the future of this remarkable economic movement and cannot be certain how far the range of monopolistic control and monopoly profit will extend.

This much, however, is clear: that competition acts more slowly in many directions than was believed by the economists of a generation ago. If not complete monopoly, a quasi-monopoly enduring for a considerable time is likely to appear wherever industry is conducted on a very large scale. For a long period something more than ordinary or competitive gains may be secured. If there be constant enlistment of fresh ability of a high order in the management of the great combinations, the gains may be kept very large by mere force of great size, great capital, great overawing of would-be competitors. There is the possibility, even the probability, of a gain which is in excess of interest and of economic rent, as these have been analyzed in the preceding chapters; in excess, too, of "business profits," as this sort of income was analyzed in the chapters preceding; a gain, therefore, which is to be classed as a monopoly return.

§ 4. As regards all of these monopolies—mines, public utilities, trusts and combinations—it is to be remarked that they are rarely invulnerable; they rarely rest on unshakable foundations. They

[1] Compare Chapter 14. Also Chapter 65.

may shrink, totter, even crumble away. The discovery of new mines may put an end to the control of output and price by a mining monopoly which had seemed firmly established. A public utility may be brought to financial decline, even collapse, by new inventions. Railroads, once thought to be the most stable of monopolies or quasi-monopolies, were deprived of their commanding position by the invention of the automobile and the enormous development of highway transportation. The same economic overturn brought it about that the carriage of passengers within urban areas by rail, once thought the source of secure and growing monopoly gains, became a precarious industry, suspected and avoided by promoters and investors. The owners were forced to turn to public bodies for aid, on the ground that without it their services, while still called for, could no longer be rendered on the old terms. Combinations and trusts fall as well as rise. Sometimes the cause of decline is that upstarts and rivals discover new and better technological methods; and this in turn may be accompanied by a deterioration in the quality of their own leadership and management. Market progress in technology or in management usually comes first at the hands of new concerns which leave the beaten path; these reach their zenith, then stand still or decline, and are in turn succeeded by others which open new ways. Thru it all no sharp demarcation can be made between that which is in the nature of business profits and that which is monopoly gain.

These reflections are not to be understood as suggesting that monopoly gains are negligible or are a matter of only temporary concern. What they point to is that the modern world is not so much in the grip of settled and enduring monopolies as is often supposed. Concern after concern reaches the stage of great-scale operation, aims at complete control, seems to be firmly established in its control, yet in time faces new ways, new processes, rivals and competitors. It ceases to command the field; rarely is there persistent complete monopoly. And yet at any given period, if one makes a cross-section of the economic structure, a large part of the field shows monopoly or something close to it. It is as if there were not indeed hereditary dynasties but a succession of aspirants to dictatorship. Each of them holds sway for a while and then is supplanted, yet many a one holds sway for years. Fortunes are accumulated and inherited. While there is not a perpetuation of power there is perpetuation of inherited wealth.

So far as concerns the phase of economics with which we are here concerned—the distribution of wealth—an industrial system in which there are many tempered or half-way monopolies means much the same as one in which there are a moderate number of more complete and abiding ones. Inequality arises and continues in the one case about as much as in the other. Those in control of some kinds of physical capital secure gains greater than are secured under competitive conditions. The returns are at a higher rate than at the competitive margin. As in the case of rent (in the "classic" sense), it is often hard to say just how much of the gain is differential, above the competitive level. As in the case of the more common and less ambitious business ventures, it is not easy to demarcate exactly how much is business profits, how much is in the nature of wages, how much mere interest on capital at the going rate. But it is not to be doubted that gains of this monopolistic kind form a large element in the possessions and incomes of the well-to-do and of the rich.

CHAPTER 52

DIFFERENCES OF WAGES. SOCIAL STRATIFICATION

§ 1. Differences of wages which serve to equalize attractiveness of different occupations; domestic servants, university teachers, public employees.—§ 2. Irregularity of employment and risk in their effect on relative wages. Expense of training.—§ 3. Obstacles to free movement bring about real differences. Full monopoly rare.—§ 4. Expense of education as an obstacle to mobility.—§ 5. Inequalities of inborn gifts and social stratification. Uncertainty of our knowledge concerning the influence of inborn gifts.—§ 6. Non-competing groups, roughly analyzed as five. The broad division between soft-handed and hard-handed occupations.—§ 7. Tendency to greater mobility in modern times. The position of common laborers.—§ 8. What differences in wages would persist if all choice were free?—§ 9. Why the wages of women are low, and wherein the labor of women is socially advantageous.

§ 1. THE present chapter is concerned not with the general level of wages (already dealt with in Chapters 41 and 42) but with differences of wages between groups and between individuals.

Wages are commonly thought of as a separate and clearly distinguishable form of remuneration, appearing when one man is hired to work for another. Very often, however, they are part of a mixed or combined return, as when a farmer owns his land and capital and gets rent and interest in addition to a return for his labor. In almost every case where a worker is not hired by another—a physician or lawyer, or an artisan working on his own account—there is some combination of returns. The theory of wages should cover the remuneration of every sort of labor, that constituting a part of the complex earnings of such independent workmen as well as that constituting the sole earnings of a hired laborer. But many of the problems are sufficiently dealt with by an examination of the case of hired laborers, with incidental consideration of those not hired.

Differences of wages proper—not involving the complexities just noted—may be classed under two heads: those that equalize the attractiveness of occupations and those that persist irrespective of their varying attractiveness. If choice between occupations were perfectly free only differences of the former sort would exist. We may begin with these, which may be called equalizing differences.

If choice were free an agreeable occupation would command a lower rate of pay than one not agreeable. Something would need to be given in the way of premium to offset unattractiveness. As between occupations of similar grade open to persons of the same class we find differences that are explicable on this principle. A woman or girl working in a factory or shop receives in the United States a lower rate of pay than a domestic servant. Tho the payment in money to both is often very nearly the same, the servant receives in addition her food and lodging, and her total remuneration is very much higher. The main explanation is that in a democratic community domestic service is repugnant; it has the associations of a menial position. While the shop girl often has longer hours and harder work, her work is of a more impersonal sort and her hours are strictly defined. When the day's work is done she is her own mistress. In European countries, where the spirit of freedom and the yearning for equality are less awakened than in the United States, considerations of this sort count for less; and domestic service there receives no such comparatively high wages. American housekeepers of the well-to-do class complain of the scarcity and the high wages of servants, usually without an inkling that these are the results of the spirit of democracy.

In another range of occupations the principle is illustrated by the pay of university teachers. Much has been said of late years in this country of the low range of professors' salaries. Very possibly it is true that as compared with earnings in other occupations of the same grade and for persons of the same training and ability the range has been low—perhaps so low as to make the occupation less attractive than it should be to capable men. But the calling has great charms. The respect which it enjoys, the settled and moderate routine, the pleasure of intellectual interest and achievement, the long vacation—these make it attractive, even with pay less than that of competing occupations.

Peace of mind and industrial security are valued by most people;

hence governments and large corporations able to promise continuous employment can secure their employees at comparatively low wages. Where indeed public business is not managed on strictly fiscal principles this consequence does not show itself. In most democratic communities, and especially in the newer ones like the United States and Australia, the government is expected to pay more than the private employer, irrespective of the steadiness and attractiveness of its work. The great bulk of the workmen, tho they are not in government employ, nevertheless approve of the favored position of those who are; partly because of general class sympathy, partly because of ignorance of the economic effects. Nothing is more certain than that higher wages to public employees come out of the pockets of the rest of the community. But such wages are none the less welcomed by other employees because of a notion that they have an uplifting effect on wages at large.

§ 2. Irregularity of employment, on the other hand, may be expected, so far as competition is free, to make wages higher. It is said that bricklayers receive higher wages than carpenters largely from this cause; their work being more likely to be interrupted by the weather and the seasons. So far as the higher pay per day or per hour merely offsets the smaller time actually given to work there is here no difference in the total remuneration. But if the greater uncertainty makes the occupation unattractive to most men it will cause the total remuneration to be higher. Unfortunately most manual workmen have not the foresight and intelligence necessary for discounting wages which seem high but are uncertain. It may be doubted whether irregular or hazardous work usually yields wages in proportion to its actuarial worth.

This same undervaluation of risk shows itself in the attractiveness of occupations in which there are prizes. The law is a profession in which there are great possibilities—the chance of a large income and, not least, the glittering possibility of success and fame in those public posts to which the law is the usual pathway. Hence, notwithstanding the need of an expensive training and the probability of a slow rise to full earning power, it draws more men of promise and capacity than any other of the professions. Again, the training of an opera singer is highly elaborate and costly, and also involves a large possibility of complete failure. Yet the great prizes—the extraordinary fees of the notable few and their conspicuous tho short-lived fame—attract so many that for the occupation as a whole there is probably but a very moderate return.

An occupation which calls for a prolonged and expensive training will have, *ceteris paribus,* a relatively high reward. Physicians, engineers, lawyers, must equip themselves by years of study, and ordinarily must serve some sort of apprenticeship even after the period of set study has been passed. It is obvious that people will not incur the required outlay unless there is a prospect of earnings at least in some degree commensurate. This factor operates in combination with others and there is great irregularity in the final outcome. Not only do prizes in an occupation affect the resort to it and lead people to undertake a costly preparation without a coolheaded calculation of the chances of success; but parents, thru whom the decision to enter on a prolonged training is commonly made, are not solely actuated by mere calculations of gain, nor are they the best judges of the probabilities of gain. Their first wish is generally to provide for their children greater happiness in life, and they will often pay for an elaborate education chiefly for the sake of the supposed social advantages. Rarely do they weigh with impartiality the question whether their children have the inborn qualities to profit by such an education. On the other hand, any occupation which requires expensive training is by that fact closed to the immense majority of the people—a circumstance which, as will presently be noted, is of at least as much importance as any other in explaining the effects of education and training on variations in wages.

§ 3. It requires but the most cursory observation to show that such explanations of the variations in wages as have just been given do not tell the whole story. The broad fact is that the attractive and easy employments do not in general command the lowest pay. It is more nearly true that they command the highest pay. The common laborer or the miner receives less for his hard, dirty work than the skilled workman for his lighter and cleaner work; and this even tho the latter's hours are usually the shorter and his employment no more irregular. The work of the lawyer, the physician, the business man, is easier as well as intrinsically more interesting, more varied, more attractive, than that of most sorts of manual laborers. Yet even after allowance is made for the expensive training called for by these so-called "liberal" professions, their earnings are large as compared with the sacrifices they involve.

This discrepancy between sacrifice (work) and reward could not exist if choice between occupations were free. The day laborer would be glad to become a mechanic or engineer, or to advance his children to these more attractive occupations, if the choice were open to him. The obstacles are in some small degree due to a quasi-monopoly in certain occupations; but in the main they are based on the great fact of long-established social stratification.

Set monopoly for labor of any sort is becoming less and less important in the modern world. Legal monopolies, such as those of the craft gilds of the Middle Ages, have disappeared. Something analogous to craft monopoly is occasionally aimed at by trade unions, admission to a union being restricted by high fees or by limitation of members and permitting employment, so far as the power of the union extends, to members only. In some trades which retain the handicraft character and in which skill can be acquired only thru careful instruction and long practice such restrictions have sometimes proved effective. But in most industries the machine tends to displace the tool. General ability rather than specialized skill is required for attaining mastery; no small knot of mechanics can keep under their control the art of doing any one kind of work. Attempted labor monopolies have usually broken down.[1] The permanently important forces are not those intentionally set in motion by any group of workmen but the varied influences, direct and indirect, patent and obscure, which set up barriers between the different classes of society. They may be considered under three heads: expense of education and training; the subtle influence of environment; and, finally, differences in inborn gifts.

§ 4. Expense of education, as we have already noted, would

[1] Compare Chapter 59.

bring about, even under free competition, higher wages. This is most obviously the case where the parents or the young persons themselves pay for the training. It is so even if the training is supplied gratuitously in public schools and colleges; for tho instruction itself be gratuitous, support must be provided. Only if the state were to supply education of every kind on the terms which it grants in the United States for the army and navy cadets at West Point and Annapolis, would the burdens which education entails be taken entirely from the individual's shoulders. As things stand this burden is not only heavy but is one which, as it becomes heavier, the poorer members of the community can less and less undertake to bear. When the day laborer's child reaches the age of thirteen or fourteen (in some countries even earlier) the increasing expense of support and the possibility of some earnings cause him to be taken from school and set to work. Only rare conditions —great altruism and persistence on the part of parents, evidence of exceptional ability in the child, charitable aid—enable him to go beyond the elementary school. The gateway to a more advanced education is virtually closed. The child of the mechanic and clerk goes a little farther in his schooling and is more likely to find his way into the secondary school. Even so, the completion of the secondary school curriculum is unusual; the path forward is cleared but a little way. As a rule those only who themselves have enjoyed a higher education and its fruits provide for its completion by their children also. Hence differences in reward, and the social classes which rest mainly on these differences, tend to perpetuate themselves. The very fact that a man has had an advanced education tends to secure it for his children. The very fact that a laborer has not had it is an almost insuperable barrier to his children's securing it.

Expense of education thus affects differences of wages doubly. It affects them, thru the working of competition, in lifting rewards to a level at least high enough to make the expense worth while. It affects them also, thru the restriction of competition, by impeding access to the better places for multitudes who, were they able, would gladly seek it.

Environment, the second among the barriers to free movement, cannot be sharply separated from education and training. To the factor of expense in education it adds another that keeps potential competitors from trying to enter the more favored ranks. All the associations of nurture and family, all the force of example and imitation, keep a youth in the range of occupations to which his parents belong. In a highly mobile and democratic community like the United States environment tells less than in older countries. But it tells much in all countries. A few who are alert as well as gifted may feel ambition to rise but the mass accept the conditions to which they are habituated.

§ 5. Finally, we have to consider differences of inborn gifts. Undoubtedly they are of great and far-reaching effect, yet their influence on the broad phenomena of social stratification is not easy to weigh. Some fundamental questions relating to this topic still await positive answers.

In the eighteenth century the common belief was that men were endowed by nature with the same mental and moral gifts. "The difference between the most dissimilar characters, between a philosopher and a common street porter, seems to arise not so much from nature, as from habit, custom, education."[1] Rousseau believed that with proper education he could shape men's capacities at will; and Robert Owen rested his optimistic social experiments on the belief that, given favoring conditions, all men would prove equally industrious and equally virtuous. During the nineteenth century the effect of biological investigation, under the leadership of Darwin, was to turn opinion the other way. It laid stress on the inborn differences between individuals of the same species, the transmission of variations from ancestor to descendant, the close association of physical and mental traits. A possible corollary was that the better position of the more favored classes resulted, in part at least, from inborn qualities transmitted from generation to generation. In recent years more and more attention has been given to the bearing of such reasoning upon social phenomena, with the result that no certain proof or disproof has been given as to the part which natural endowment plays in separating social classes.

[1] So said Adam Smith, *Wealth of Nations,* Book I, Chapter II, p. 17, Cannan's edition.

Some differences in remuneration and in consequent social station are beyond question due to inborn gifts. Within any one grade in society, still more certainly within any one profession, some individuals have exceptional capacity and thereby gain exceptional rewards. There are lawyers, physicians, scholars, poets, inventors, business men, whom nature endowed with rare qualities. Education may aid them, environment may hamper, but innate capacity proves decisive. The influence of heredity is often traceable; yet the degree to which a given talent or combination of talents shall be transmitted from ancestor to descendant seems subject to no ascertainable law. The fact of varying endowment, whether in the way of genius or of high talent, is as unmistakable as its causes are inscrutable. And from this fact it follows that some individuals earn more than others, and that great differences in wages under a régime of competition are inevitable.

The more difficult question is whether there are broad differences in gifts of mind and character between the several social classes. More particularly, are the well-to-do possessed on the whole of qualities not possessed by manual laborers? If we could go back to the very beginnings of social differences we should doubtless find that those who first swung themselves into favored positions did so by virtue of natural gifts. The earliest savage chiefs rose to command because of superior strength or cunning. The feudal lords were at the outset the natural leaders of the clans. The city merchants in whom we find the origin of the bourgeoisie were the shrewd and capable men of their towns. The analogies of heredity suggest that the qualities of such ancestors were transmitted to their descendants and that the so-called higher classes of modern times constitute a born aristocracy. Tho heredity is irregular in its individual manifestations, for large numbers it shows regularity and persistence. Take a thousand children of gifted parents and a thousand children of mediocre parents; the former will prove the superior class, even tho a sporadic genius may emerge among the latter. Can it not be inferred that the broad differences between social classes rest on differences in their inherent intellectual and moral endowments?

Further, it is maintained that the distribution of success in life proves the greater average gifts of the higher classes. Statistics concerning the notable men of several countries show that the aristocracy, the well-to-do classes and the town dwellers, have furnished the immense majority of the men of mark—the writers, statesmen, soldiers, industrial leaders. In proportion to their numbers and as indicated by achievement, talent has been vastly more abundant. Even genius has been recruited chiefly from their ranks. Such evidence is adduced as strengthening the view that inborn gifts vary with social classes.

On the other hand, it is argued that this very evidence shows the commanding influence of opportunity and environment. Anyone of intellectual capacity who consorts with persons of the "superior" classes, and observes how common is narrowness, dullness, fatuous self-content, essential vulgarity, must hesitate before believing that they and their descendants achieve success solely because of unusual gifts. He cannot but suspect that their favored position must be ascribed in large measure to training, advantageous start, fostering environment. And he is further led to suspect that if few among the lower classes rise it must be because of the repression of many who are talented. Only those of very unusual vigor and ability can escape from the trammels of a deadening environment. Many ardent reformers are convinced that a great fund of capacity, no less in its possibilities than that which is found among the well-to-do, remains undeveloped. Tho variations between individuals are unmistakable, variations between classes are declared to be unproved.

To this it is added that any higher or favored class tends not to transmit to descendants the qualities by which the ancestors achieved success; rather it becomes itself enervated and weakened by continuance in privilege. The later generations of the stock deteriorate. It is only by the infusion of fresh blood from below that vitality and strength are preserved. Such is said to be the lesson of history as to royal and noble houses; such is perhaps the tendency among the successful bourgeoisie. When the conditions of life are made easy and the struggle for advancement becomes less strenuous the unfit are no longer eliminated and the moderately capable are enabled to hold their own. Tho conspicuous success continues to be attained only by those of unusual gifts (whether born in the lower classes or among the well-to-do), the advantages of an easy start and assured support enable persons of mediocre quality to remain in the favored class from which they sprang and to maintain their favored position.

The problem is unsolved and is likely long to remain so. The method of experiment cannot be applied to it, as indeed it cannot be in an accurate way to social problems of any sort. We cannot take a thousand children of the more favored classes and another thousand of the less favored, subject them to precisely the same influences of education and environment, and watch their careers thru life. Still less can we do so with successive generations of their descendants. The method of observation alone is available; a method hampered not only by the limitations of the evidence and the complexity of the data but by the prejudices of those who conduct the observations. Tho the analogies from biology (where experiment in the strict sense is applicable) strengthen the view that inheritance is all-pervading, the plain facts of everyday life prove that opportunity and environment are of signal importance. Those who have inborn gifts make them tell with immensely greater ease if they have the advantages of education and training, and of support during the early stages of their career. Those of the very highest gifts are doubtless least dependent on adventitious aid. Generals probably are born, not made, but colonels and captains can be trained. In the ranks there may be many men who have it in them to become good officers, yet are kept in the ranks because no way is available for bringing out the sterling qualities which they do possess.

§ 6. At all events, whether from natural causes or as the result of existing social conditions, the movement of labor from grade to grade is not free. Amid the great variety of occupations and of wages certain broad groups may be distinguished. These may be called, in the phrase introduced by Cairnes, non-competing groups; non-competing in the sense that those born or placed in a given grade or group usually remain there and do not compete with those in other groups. For most men it is difficult, for many it is impossible, to move from the group in which they find themselves into one more favored. We may enumerate, for simplicity and convenience of exposition, five such groups. They are not distinguished by sharp demarcation, for they shade one into another by continuous gradations; but they are distinguished sufficiently to bring into relief some important questions as to the relations between social classes and the fundamental causes acting on distribution and on value.

(1) In the lowest group belong the day laborers, so-called: the diggers and delvers who have nothing to offer but their bodily strength. No doubt among these there are gradations. The very capacity and willingness to labor continuously, even at the simplest tasks, thru eight, ten, twelve hours a day, are not possessed by all men, still less by all races, and indicate something beyond the quite unskilled grade of common labor. But laborers of this sort are common enough. Almost any adult is able to do the work. For this group, even in the most advanced countries, education is rarely carried beyond the minimum which the law requires. Children are set to work at the earliest age at which they can earn something. The maximum wages of any individual are earned as soon as he is full grown, and become less rather than greater as middle age is reached.

In the same group belong those factory employees whose work is of the simplest sort. In every factory there is a certain amount of "heavy work" to be done, for which the common laborer is needed. In agriculture there is always a sharp demand for such labor at harvest time and some demand for it thruout the year; tho the planning and direction of farm work calls for much more than simple muscular effort.

(2) In the next group belong those who while not needing specialized skill yet bear some responsibility and must have some alertness of mind. Such for example are motormen on the street railways. Most miners belong here, certainly in England and in Germany. In the United States there has indeed been a tendency (except where machinery is used underground) to put coal mining into the hands of unskilled workers. The development of machinery and of large-scale establishments has created a demand for an immense number of factory workers whose tasks are com-

paratively simple and often are desperately monotonous but who yet must have some intelligence in watching and applying machinery. Wages in this group are commonly paid by the week, not by the day; a circumstance indicating a greater continuity of employment, which in itself constitutes a considerable advance over the situation of the first group.

(3) In the third group belong the aristocracy of the manual laboring class: the skilled workmen. Such are carpenters, bricklayers, plumbers, machinists; the whole range of occupations where there is need for a sure eye, familiarity with tools, a deft and trained hand. Tho machine processes have displaced in large degree the handicrafts, the workman skilled at a trade is still in many directions indispensable. Further, the development of machinery has itself called for a great class of workmen capable of making, repairing, and adapting machines. Specialized skill in a particular trade may be less certain to command as high a reward as in former days because so largely threatened by competition from the machines; but general mechanical ability is in constantly growing demand. It is among workmen who possess such ability that trade unions are strongest. Some accumulation of property is possible, by deposit in the savings banks or by ownership of a dwelling. Some pride in the occupation is developed and a strong spirit of independence. Education too is carried further than in the lower classes. The children are usually put thru the entire curriculum of the elementary (grammar) school and are prepared by apprenticeship or otherwise for a particular trade.

(4) Next comes the group that approaches the well-to-do: the lower middle class, which avoids rough and dirty work and aims at some sort of clerical or semi-intellectual occupation. Here are clerks, bookkeepers, salesmen, small tradesmen, railway conductors, foremen, superintendents, teachers in the lower grades. Education in this group is carried further; for parents are more ready and better able to support children thru a long period. The secondary school (high school or academy) is usually entered and very often attended thru its entire course. Marriage takes place at a somewhat later age; and some endeavor at saving or accumulation is almost always made. There is commonly a feeling of

contempt for the manual laborers of all sorts, whether skilled or unskilled, and a demarcation of social feeling that does not correspond to differences in wages; for in modern communities the rate of pay in this fourth class is often little different from that in the third class.

(5) Finally we reach the class of the well-to-do; those who regard themselves as the highest class and certainly are the most favored class. Here are the professions, so-called—the lawyers, physicians, clergymen; teachers of the higher grades; salaried officials, public and private, in positions of responsibility and power; not least, the class of business men and managers of industry who form in democratic communities the backbone of the whole well-to-do group. The associations are with property and accumulation, and the common aim is not merely to procure a suitable support but to save money or to make money. Education is carried to the highest level, commonly thru the secondary school, often thru the college or university. Earning power does not begin early. Not only is there a long period of training and education but an additional stage of slow start and slender beginnings; while an increase of earning power thru life or at least thru middle age is confidently expected. The wives are largely ornamental; they are not expected to do household work or even to undertake the full care of their children but are given the aid of servants.

The first three groups, including the manual laborers of all kinds, constitute a class by themselves, not only because the gradations of wages are continuous but because their members have the same point of view and the same prejudices. They expect usually to live on their wages, not looking to the accumulation of property or to an income derived from property. They are held together by a common sense of dependence on manual labor and a common sense of separation from the well-to-do and possessing class. The last two groups have similar feelings of solidarity. Even tho there are great variations in possessions and income among them, all have the habits and hopes and prejudices of the well-to-do. They share a feeling that manual labor is beneath them and their garb indicates their freedom from it—no jumpers or overalls. Their hope is for accumulation and investment, and their ambition is primarily to swing themselves into the position of the leisure class. Business—that is, the management and direction of industry, and work close to such management—is the core of their place in the social structure. We may thus divide the workers into the two great classes of the soft handed and the hard handed. Those who do not labor at all—the idle owners of property-yielding income—belong in the strict economic sense in a group by themselves: their income is not wages of any sort but interest or rent or monopoly gain. But in a larger sense they are in the same class with the upper groups of the wage earners and especially with the highest and most favored group, sharing the same traditions and, not least, intermarrying with the members of that group.

§ 7. In modern times, and especially in democratic communities, the barriers which separate the groups tend to be broken down and passage from one to another becomes more easy. We may consider first how these changes affect the lowest group, that of common laborers.

There always has been and there always will be much hard, dirty, "common" work to do; and there always has been and there always will be a desire on the part of the powerful or favored social classes to get others to do this work for them. Hence slavery in ancient times and serfdom in the Middle Ages. In modern times we have had negro slavery, coolie labor, unskilled common labor. For such there is an insistent demand: in building railways, digging sewers, handling the crops, delving in the mines—all the tasks for which simple muscular energy is needed. Here are the helots of society. As to them, it is far from being true that unattractiveness in an occupation causes wages to be high. The reverse is more nearly true. The hardest, dirtiest, least attractive work gets the lowest pay.

Evidently in a free society the explanation of the low wages of this group must be that there are very many persons who can do such work and can do no other. Their offer of abundant labor forces wages down, and they are prevented from making their way to the more favored group by the obstacles of environment and lack of training or by the deficiency of inborn qualities. So far as these obstacles are absent or are weakened there will be a constant endeavor to get out of the lowest group; therefore a constant seepage into the groups above and a tendency towards equalization of wages. This movement for escape from the lowest group is strong in the United States. All the influences of a democratic society —the absence of rigid class distinctions, the atmosphere of freedom, the education of the public schools—tend to break down the barriers between groups. The position of the common laborers in the United States (that is, in the northern and western states) has been kept at its low level only by the continued inflow of immigrants. Those of the second generation among the foreign-born usually swing themselves into the second and third groups. The public schools, both by the direct effect of their training and still more by their indirect effect in breaking the thralls of environment, open the way to something better. But during half a century and more, ever-fresh streams of immigrants have brought new supplies of common laborers, taking the places left vacant as the children of their predecessors have made their way into the higher groups. First came the Irish, whose great movement set in after the Irish famine of 1846; then the French Canadians; later the Italians, Hungarians, Poles, and the varied races of eastern Europe. These constant new arrivals kept down the wages of the lowest group, and accentuated also the lines of social demarcation between this group and others.

That the rate of pay for common laborers should be much lower than that for other laborers is assumed by most people to be part of the order of nature. But it is by no means a matter of course and it is inconsistent with the aspirations of democracy. Freedom in the choice of occupations is one of the most important conditions of happiness, and the traditional position of common labor rests on the absence of such freedom. It is probable that even with the removal of all artificial barriers to free movement common labor would still remain, as its present name implies, the most common and the least paid. But such marked discrepancies as the world has hitherto accepted as a matter of course are not inevitable. They bring grave social dangers, in the intensification of class prejudices and class struggles. They bring a false attitude in the rest of the community toward all manual labor—an unworthy contempt for indispensable work. An elevation of this group to a plane of higher pay and better social regard would indeed mean that other groups were relatively worse off—they would no longer secure the fruits of hard labor on terms as cheap; but it would mean a better distribution of happiness.

It is on grounds of this sort that the restriction of immigration into a country like the United States is to be justified. Such labor as that of the Chinese was much "needed" on the Pacific coast in earlier days—"needed" in the sense that there were very few who could be got to do it for the wages deemed by tradition adequate for the work. On strictly economic grounds it was advantageous to the rest of the community. But a permanent group of helots is not a healthy constituent of a democratic society. It is on the same grounds that the position of the negro in the southern states is matter for grave anxiety. His indefinite continuance as a semi-servile laborer is not consistent with high social ideals; yet his freedom to move into better conditions (so far as his innate qualities permit) is resisted not only by the selfishness of other groups but by all the strength of bitter race prejudice. The question of a general restriction of immigration into the United States is to be decided chiefly from this same point of view. If immigration means the perpetuation of a low economic and social stratum it should be restricted. But if those who come in are transformed before long—their children, if not themselves—into free and mobile members of the community the country may accept them with less misgiving. The immigrants themselves certainly gain from the very beginning by finding better conditions and better pay than in their native countries; they do hard work on cheap terms for the rest of the community; their stagnation in the lowest group may be condoned if it is but a temporary stage.

The spread of education and the breaking of the shackles of environment, which make it easier for the lowest group to rise, have had their effects on the relations of other groups also. Clerks, salesmen and the like were formerly shielded in some measure from competition, and so maintained a favored position, because of the difficulty of getting the book learning (simple tho it may be) which their calling requires. The public school and especially the public high school have changed all this. There is a plethora of persons qualified to do such work and a consequent tendency for their wages to fall rather than to rise. The earnings of a good mechanic are in the United States higher than those of the average clerk. None the less the resort to the clerk's trade shows no sign of abating. This is due in good part to its association with the management of business and to the possibility of advancement to a post of command—the alluring tho deceptive chance of a prize. But it is due chiefly to a traditional contempt for manual labor. The externals of the leisure classes are aped. This conventional and irrational feeling against "dirty work" may indeed give way as the pecuniary advantage of the mechanics' group becomes more pronounced and more familiar. People's notions of social superiority are in time adjusted to incomes. Any occupation that pays well is likely in the end to be respected, just as any person (or family) having a sufficient fortune is likely in the end to be accepted by the so-called upper classes. Yet such changes in the conventional hierarchy of society take place but slowly. The esteem in which an occupation is held for the time being is a powerful part of its attraction; and the more open is competition the more will people move into those occupations which are supposed to bring social superiority.

§ 8. What would be the differences in wages, and to how great an extent would groups and classes persist, if all had the same opportunities and if choice of occupation were in so far perfectly free? Would wages then differ only so far as they might be affected by attractiveness, risk, and other causes of equalizing variations? Would coarse manual labor, for instance, then receive a reward nearly as high as any other labor, nay conceivably (since the work is dirty and disagreeable) higher than any other? Would the soft-handed occupations lose entirely the advantage in pay which they now commonly have?

The answer must depend on our views concerning the limitation of natural abilities. It is clear that some gifted individuals—a few men of science and letters, inventors and engineers, business men and lawyers, physicians and surgeons—would tower above their fellows and would obtain in a competitive society unusual rewards. But would physicians as a class secure higher rewards than mechanics as a class? They would do so only if the faculties which a capable physician must possess are found among mankind in limited degree. And mechanics in turn would receive wages higher than those of day laborers only if it proved that but a limited number possessed the qualities needed. On this crucial point, to repeat, we are unable to pronounce with certainty. What are the relative effects of nature and of nurture in bringing about the phenomena of social stratification we cannot now say.

One thing, however, is clear: it is much to be desired that this fundamental question be put to the test. The removal of artificial barriers to the choice of occupation is the most important goal of society. Given this, the innate faculties of all will be brought to bear and all will bring to the social dividend whatever it is in them to contribute; while at the same time the most perfect freedom will be secured and thereby probably the most even distribution of happiness.

§ 9. The wages of women are lower as a rule than those of men. This results from a variety of causes.

Partly it is due to their lower physical strength and less general efficiency. They are in many sorts of work less productive than men and therefore paid less highly—an instance of inevitable differences in wages such as would persist even if choice of occupations were entirely free.[1]

In some degree choice of occupations is not entirely free for women. Custom and lack of training long have shut them out from some occupations. But in modern times, and especially in a country like the United States, obstacles of this sort are becoming steadily less and probably have no longer any far-reaching effect. Education for women is widespread and accessible, and

[1] To cite one item of characteristic testimony: among the shirt-waist workers of New York "The testimony of both employers and employees was unanimous that if a man and a woman, who had worked the same number of years at the trade, sat side by side at the same machines, and had been paid precisely the same rate per piece, the man would earn anywhere from 25 to 75 per cent more than the woman. The explanations were that a man worked faster, was stronger and more enduring; that women couldn't do the higher parts of the work; that a man works harder and faster and longer because he has to, has a family to support, 'while a girl is only working until she gets married.'" Mr. Woods Hutchinson in *The Survey,* January 22, 1910.

tradition does not stand obstinately in their way for any occupation for which they are really qualified. Some women, indeed, may be said to be in a non-competing group having an unfortunate place within the occupations of their own sex. Such are needlewomen, able to do this familiar work of their sex and unable to do anything else. Not so very long ago such work held the same place for women that common day labor does for men. It was the one thing every woman could do and the only thing that most women could turn to when they had to earn their living. But the range of available occupations has greatly widened during the last generation or two and there is less congestion of work-seeking women in any one corner.

Most important of all in the modern competition of women for work is the circumstance that as a rule they have to support themselves only, and often not even that. Most women employed in factories or shops are at work for but a limited time, looking forward to marriage. They live in their homes and their earnings are part of the family earnings. They are "subsidized." Not a few married women are subsidized in the same sense; they earn extra pennies. For a man, wages must normally be enough to enable a family to be supported and reared. The great majority of working women are not in this case. Hence they are willing to work for wages less than would suffice to maintain a family; and there being many of them, they must offer their services on terms that will secure the employment of all. Some among them, it is true, do have to support a family—widows, elder sisters, and the like; and these must accept the same wages as the rest. Conversely, among men, bachelors get the same wages as fathers of families. Such disparities between needs and earnings are the inevitable outcome of competitive industry.

Since women work for lower wages than men it might be expected that they would displace the men wherever they could do the work. So far as the women are really as efficient as men this result ensues; in such occupations for example as typewriting, stenography, light factory work, much selling over the counter in retail shops. The men who formerly did this work must find something else to do, and tho the shift is not often easy or quick it usually takes place in the end without serious loss. Sometimes, however, while women displace men in part they cannot do so entirely. A certain proportion of men must often be maintained. Thus in the composing room of printing establishments women can do much of the work as well as the men; they can operate some of the typesetting machines as well and can set most type as well. But for the heavier or more exacting work men must be kept and they then are employed side by side with the women. The situation is similar in the public high schools. Most high school teaching is done in the United States, by women. But some men there must be, if only for the better maintenance of discipline; and indeed the juster opinion is that secondary education would be much improved if the proportion of men were greater. When men and women thus work side by side, doing apparently the same work, they yet receive different wages. The specious cry of "equal pay for equal work" is sometimes raised in such cases; tho in fact the work is not equal, for the men could not be completely replaced by women without loss in efficiency. Where work (that is, efficiency) is in fact equal, the action of competition will in the end make pay equal—equal at a lower level if enough capable women can be found, and equal at a higher level if men must still be enlisted. This, we say, will be the outcome in the end. But, as in all such adjustments, there may be a period of transition and experiment, during which the practices of industry have not yet accommodated themselves to the forces of competition; and during such a period the mere tradition that women's wages are lower than men's doubtless has its effects on relative wages.

The employment of unmarried women is in the main a gain for society and a gain for the women. This is even more true of women from the well-to-do classes than of their poorer sisters. It is better that they should be at work, rather than idling, during the period when they are looking forward to marriage; and what they produce, even tho it be not turned out with great efficiency or for wages as high as they would like, adds to the social income as well as their own income. Their being at work is often opposed by the men, and by some well-meaning reformers, on the ground that it takes the bread away from someone else—a phase of the pervasive fallacious notion that the community is worse off if its labor force is utilized to the utmost.[1] What is true of women awaiting marriage is even more true of women who do not marry at all; their own happiness as well as their usefulness in society is immensely promoted if they have stated work, paid for at its market value.

But women's work, and especially the work of young unmarried women, must be safeguarded in such a way as to conserve health and character. There should be regulation as to the permissible age, the hours of work, ventilation and sanitation in workshops. No utilization of productive forces can be more wasteful than that which impairs the moral or bodily soundness of future mothers. The circumstance that they are usually poor bargainers—partly for the very reason that they are at their tasks temporarily—renders them liable to exploitation and makes legislative regulation of their labor the more imperative.

[1] See Chapter 41.

CHAPTER 53

WAGES AND VALUE

§ 1. "Expenses of production" and "cost of production" again considered. If there were perfect freedom of choice among laborers, value would be governed by cost.—§ 2. There being non-competing groups, demand (marginal utility) governs relative wages. How this principle applies to a grade or group; marginal indispensability.—§ 3. Qualifications: earnings may be so divergent as to cause seepage from one group into another; the standard of living may affect numbers within a group.—§ 4. The lines of social stratification are stable; hence changes from the existing adjustments of value are not usually affected by them.—§ 5. The theory of international trade brought into harmony with the theory of value under non-competing groups.—§ 6. Analogies between international trade and domestic trade.

§ 1. In the present chapter we return to the theory of value and its connection with the theory of distribution. So close is that connection that the two subjects might be properly treated as one. It is chiefly for convenience and clearness in exposition that they have been separated in this book.

Let the reader recall the distinction indicated by the phrases "cost of production" and "expenses of production." [1] By expenses of production we mean the outlays that must be made to bring a commodity to market—what must be paid for wages, materials, and the like. Since the materials themselves are made by labor and the outlays of capitalists are resolvable into a succession of advances to laborers, the main expenses of production in the end are simply wages.[2] By cost of production we mean efforts and sacrifices—mainly labor. The distinction between expenses and cost—between wages and labor—is an obvious one and an important one, tho unfortunately not indicated by any well-established phraseology. In everyday language people mean by "cost" employer's outlays; and this current usage was accepted in most of what has preceded. In what is to follow it will be helpful to keep these two

[1] See, especially, Chapter 12.

[2] Compare Chapters 5, 38.

notions distinct, and "cost" will be used in the sense of labor or effort.

If competition between laborers were perfectly free—if there were no non-competing groups—expenses of production, so far as they consisted of wages, would perfectly measure cost or effort. There could then be no differences of wages, except such as served to equalize the attractiveness of different employments. Higher wages in any one occupation would then signify that the work in it was harder, more disagreeable, in less esteem; in other words, that it involved greater effort or irksomeness, that is, greater cost.

Under such a supposition it would be possible to maintain a labor theory of value: that the value of commodities measured or embodied the labor given to producing them. Higher value would be the result of more outlay in wages, and more outlay in wages would mean either more labor or labor of a more irksome kind; that is, higher cost. This conclusion would assume also, to be sure, that competition among capitalists was free, and that all capitalists' outlays in the way of wages were weighted, or added to, in the same proportion, in order to yield a return on these outlays in the form of interest. As this weighting, or addition for interest, would affect all commodities equally, value would remain undisturbed; since value is only the expression of a relation. If ten per cent for interest were added to the wage bill for each and every commodity no one commodity would be affected more than any other, and each would exchange for the same quantity of any other as before.[1] For the validity of this conclusion it must further be assumed that temporary fluctuations, or "market values," may be disregarded. With free competition both of labor and of capital, supply would be so adjusted in the end that no one set of laborers or capitalists would secure higher rewards than any other set. Supply being so adjusted, value would be regulated fundamentally by quantity of labor, that is, by cost in the sense of labor exerted.

§ 2. In fact, however, as we have seen, the movement of labor is not free. Looking to this circumstance alone and disregarding

[1] The reader conversant with the history of economic theory need not be reminded of the qualification of this proposition which was so much dwelt on by Ricardo and his followers. See Ricardo, *Political Economy*, Chapter I; J. S. Mill, *Political Economy*, Book III, Chapter IV.

for the moment the same possibility as to capital—that is, assuming capital to compete freely—let us consider how value would be adjusted. Suppose a non-competing group of workmen which comprises a single trade, say glass blowers; what will determine the value of the commodities made by them?

The answer is simple: marginal utility or marginal vendibility; the reader will bear in mind the distinctions and qualifications suggested by this turn of phrase.[1] That will determine both the wages of the glass blowers and the selling price of the window glass and other articles made by them. The quantity of such articles put on the market will be limited by the number of workmen in this group. As the capitalists (by supposition) compete among themselves, they bid for the services of this particular group of laborers until nothing is left to themselves but normal profits and interest. A current high rate of wages for such laborers will establish itself. Every capitalist will regard his outlay for such wages as part of his "cost"; that is, of what we here call the "expenses" of production. The selling price of his wares seems to him to be based on what he has to pay to his workmen. People are constantly saying that they are "compelled" to pay the prevailing rate of wages or the ruling price for an article, forgetting that one of the things that establishes the ruling prices or wages is their own willingness to pay rather than go without. It is the bidding of the capitalists for workmen that causes a high rate of wages; but that bidding rests on the high prices which buyers pay for the wares—that is, on the desirability of the wares to them. Not quantity of labor but utility then would govern value: not the conditions of supply but those of demand.

This simple case gives the key to the phenomena of value under the conditions of non-competing groups. But before it can be applied sundry qualifications and amplifications must be considered.

In the first place, it is rare that the workmen in any single trade are able permanently to shut out competition. The case of glass blowers has been adduced, by way of illustration, because it approached that possibility. Glass blowing long was one of the few trades which preserved down to recent times the characteristics of

[1] See Chapter 9.

a highly specialized handicraft. In general, workmen are partitioned not into trades but into groups. There may indeed be temporary variations of wages, and these of a considerable sort, because of sudden changes in the demand for one or another kind of skilled labor. Activity in the iron industry, for example, or in building operations, may cause unusually high wages for the needed mechanic. Such variations endure longer than economists have been apt to suppose; and the workmen themselves, as well as their employers, often speak and act as if they would last indefinitely. In fact unusually high wages of this sort attract other workmen from the same group in society and so set in motion forces that bring them down to the level common for the group. Wages tend to be adjusted roughly to the same level for all workmen in any one social and economic layer.

The influence of demand in determining the range of wages in any one large group is far from simple. Labor of almost any kind has a *derived* utility. The glass blower's labor has a utility derived from that of the glass he makes; that of the ironworker a utility derived from that of the crude or finished iron. But it is an artificial simplification of industry to think of the glassware or iron as made by the glass workers or ironworkers alone. The iron, for example, is made not by the puddlers or rollers only but by them in combination with the miners who dug the ore, the railway workers who help to carry it, the common laborers who are employed in each of the stages—not to mention the managers, foremen, trained engineers. Only in comparatively rare cases—as with the services of physicians or domestic servants—do the workers supply single-handed the utilities on which their pay rests. Ordinarily workmen of different kinds and grades combine to make a commodity. All are equally indispensable; utility and marginal utility are attributes of the commodity as such: how say whether the skilled mechanic or the common laborer has the greater share in yielding the utility?

The principle of marginal utility is here applicable under the guise of marginal efficiency or marginal indispensability. Common unskilled labor, for example, is cheap because there is plenty of it. If there were very little of it, it would be in the highest degree indispensable and would be paid for at a corresponding rate. Being plentiful, it is applied not only to operations that are indispensable but to others that are less and less vital, until finally its marginal application is reached at the point where it is least needed. While in some directions it adds enormously to the output, in others it adds less. It is its marginal effectiveness that determines the pay which the whole must accept. So it is with skilled labor. In some directions it is in the highest degree important; the loss, were it taken away, would be very great. It is the loss, or diminution in output, which would ensue if the last installment of it were taken away that determines the remuneration of any one kind of labor. The principle, it is obvious, is essentially the same as that applied to capital in general and labor in general: [1] the contribution or addition which the marginal installment of a factor in production makes to the output determines the return per unit of it all. Similarly, the marginal contribution from any grade or group of labor determines the remuneration of all within that grade.

The ultimate determinant of value then, where there are non-competing groups, is marginal utility, not cost in the sense of effort or sacrifice. Between the members of any one group, it is true, exchanges are conducted and remuneration is determined mainly on the basis of cost. Skilled workmen in buying one another's products, and lawyers and physicians in buying one another's services, exchange roughly in proportion to labor exerted, and earnings within each of the groups are determined by an equalization of effort. Between groups, however, this is not the case. The range of pay in the "liberal" professions and in the occupations of the well-to-do generally is high because their members are limited in number compared to the manual laborers, and the marginal efficiency of their services is therefore high. So it is also in regard to mechanics and skilled workmen of all sorts when compared with the unskilled: their scarcity, relatively to the demand for their services, gives them an advantageous position and a higher remuneration.

§ 3. Some qualifications to this conclusion must be noted. The remuneration of a group may be so high as to attract laborers from

[1] See Chapter 38.

another group. The barriers between groups are not impassable, and with the progress of society they tend to become less and less so. The greater the difference in remuneration the greater the inducement to get over the barriers, and the more likely a movement of some laborers—the alert and ambitious—into the higher ranks. So far as the obstacles to movement are the result of environment and nurture, the differences between non-competing groups are thus subject to a check. So far as differences in inborn gifts underlie them (an uncertain matter, as we have seen), no such check can be in operation.

Even within a group numbers may increase, thru the growth of population. We may conceive that a high rate of pay among, say, skilled laborers would lead to early marriages, more births, and so eventually to an increased supply of such laborers. Conversely, we may conceive that if the rewards in a given group—say in the liberal professions—were low, marriages would be delayed, births diminished, and the supply of such labor lessened. Movements of this sort would depend on the standard of living within the group. A standard of living so tenaciously held as to affect natural increase may be a force in the background, fixing a sort of supply price and in the end affecting relative wages more fundamentally than marginal efficiency. There is evidence that a force of this sort acts on the numbers of the well-to-do in modern countries and aids in keeping them in their favored position; and there is evidence too that the same force is coming into operation in the upper tier of manual workers. On this topic and on the mode in which wages are affected by the increase of numbers and the standard of living more will be said later.[1]

§ 4. In the first volume of this work,[2] value was treated as if dependent on expenses of production, or on cost in the ordinary commercial sense. It has now been pointed out that the treatment is inadequate. These very expenses, being mainly resolvable into wages, depend on the play of value. Nevertheless the general principles, as they were stated before, are not so profoundly modified by the theory of non-competing groups as at first may seem to be

[1] Compare Chapters 54 and 55, on Population.

[2] Chapters 12, 13, 14.

the case. It still remains true that varying expenses of production in general are the causes of *changes* in value.

When once the broad lines of social classification are established, and the earnings of different groups adjusted to their numbers and their marginal efficiency, relative wages become comparatively stable. As Ricardo said, "The scale, when once formed, is liable to little variation." [1] Changes in demand cause labor to shift from one occupation to another within each grade, but rarely cause a noticeable change in the demand for all the laborers in the grade. Hence variations in expenses of production and variations in cost of production ordinarily run together. The employer is right in thinking that the wages he must pay to the unskilled, to mechanics, to trained engineers, are settled once for all by forces with which he has nothing to do. The forces determining them are so broad and pervasive that his particular demand, tho it forms part of the whole demand acting on each group, is lost in the total.

Only long-continued and far-reaching changes in demand affect the relations between non-competing groups; and only then do expenses of production (that is, relative wages) appear as results, not causes, of changes in value. If, for example, the arts of production should be so modified that common labor would need to be applied less and less; if machinery were so perfected that ordinary delving and hewing were done with intricate apparatus made and guided by skilled mechanics—the relative situation of these two groups would be changed. Unskilled laborers would be less needed, and if their numbers were the same the marginal efficiency of their labor would be less. The converse would happen as to skilled laborers: they would be more in demand, and the marginal utility of their labor would be greater. Possibly some such change is slowly taking place in the countries of advanced civilization. Common labor, it is true, can never be dispensed with; but in many directions the need for it seems to be becoming less.[2] If wages for this group are to rise it must be chiefly by a decrease of supply rather

[1] Ricardo's *Works,* p. 15.

[2] The demand for unskilled labor seems to be greatest when plant and machinery are being constructed. Once the railways, canals, factories, power plants, are completed and in operation the demand is more largely for a grade of labor above that level.

than by an increase of demand; by that process of escape into other and better-paid groups which is to be expected from universal education and democratic freedom.

To repeat, such shifts in the economic relations of the social groups take place so slowly that they may almost be disregarded. Possibly the time will come when the social stratification of our time will have been obliterated; when all sorts of work will be rewarded in proportion to the sacrifices involved; when all sorts will be in equal esteem; when the common laborer and his children will have the same opportunities for education and advancement as the mechanic and the lawyer. Then expenses of production or relative wages will have very different aspects from what they have now. Tho real differences in wages may still persist, because of the varying inborn qualities of men, they can hardly fail to be much less pronounced than they now are. Under existing social conditions, however, such possibilities may be disregarded. Differences in reward are the stable results of the generally constant demand for each different kind of labor. Changes in value are commonly due to changes in the quantities of the different kinds of labor called for, that is, to changes in cost; tho the general scale of values is the result of demand and utility, not of labor applied.

§ 5. Similar reasoning is applicable also to the theory of international trade. That theory, as it was stated in the preceding Book on international trade, rested mainly on a labor theory of value.[1] It assumed that those things were cheap in a given country, and hence likely to be exported from that country, which were produced with comparatively little labor; while those were dear, and were likely to be imported, which were produced with comparatively much labor. At first sight it seems that all these conclusions fail if we adopt the principle of non-competing groups and of marginal utility as the ultimate determinants of value. Things are cheap, and likely to be exported, not simply because their cost in labor is low but because of the complex social conditions that determine within a country relative wages and relative prices. Yet the correction called for in the theory of international trade is, after all, not far-reaching.

[1] See especially Chapters 34 and 35.

The correction would be vital if the phenomena of social stratification were very different in different countries. Then it might happen that one kind of labor—say skilled mechanics'—was cheap in one country and dear in another; whence it would follow that the former country would export the products of such labor. If another kind of labor—say routine factory labor—were cheap in the second country this country in turn would export the products of that labor. But in fact the phenomena of social stratification are not widely divergent. On the whole non-competing groups are arranged in the same series of grades in different countries. Such at least is the case in the countries of advanced civilization; they show essentially the same cleavage between the soft-handed and the hard-handed classes, the same steps from skilled mechanic down to common labor. Hence, as between the civilized countries, the broad social demarcations are more important within their own borders than in the exchanges with each other. The *international* exchanges still rest mainly on comparative efficiency of labor. True, it will happen more frequently than the older economists thought that peculiar differences in wages—wages in some one grade or occupation lower in one country than in another—will explain the exportation of a particular commodity. The so-called parasitic industries of Germany and England supply illustrations. Certain sorts of educated labor, again, are comparatively cheap and plentiful in Germany; such is the situation with German compositors trained to set up books in the ancient languages and with German makers of some musical instruments. But these are not the ruling or typical cases. The main currents of international trade are still determined, between the civilized countries at least, by the comparative efficiency of labor in producing the imported and exported commodities.

§ 6. The resemblances of the exchanges between different countries to the exchanges between non-competing groups within a country illustrate the play of the value-determining forces so well that they deserve fuller consideration, even at the expense of prolonging still further the present digression from the subject in hand—distribution.

As between nations, so between social groups, the range of money incomes is the instrument and the decisive test of gain; and that gain is realized in the purchase of the things or services provided by other groups. An American or Englishman secures the greatest advantage of international trade when he buys tea, coffee, spices—that is, things made by low-wage labor in tropical countries. Similarly, the lawyer or business man secures his greatest gains from the exchanges between social groups when he buys things made or services provided by those who are in the lower groups. His money income goes far in the purchase of the services of domestics—of choremen and chorewomen, maid-servants and chauffeurs. But it is of no special advantage in paying the bills of physicians and dentists: these are in the same group with himself and their services must be paid for at the higher rate there prevalent. If the labor of the physicians and dentists were peculiarly efficient their services would be cheap, while yet their incomes would be high in accordance with the standards of their social group. Not being efficient in any unusual degree their services are dear; precisely as, in any country of high money incomes, those domestic commodities are dear in which there is not special efficiency of labor.

The analogy between nations and non-competing groups may be carried further. The terms of exchange in both cases are settled by broad causes, acting slowly and little liable to disturbance except over long periods of time; and hence they are assumed by most persons, and indeed by most economists, as matters of course. That money incomes should be comparatively high in the United States and England and France and Germany is commonly accepted as part of the order of nature. That the money incomes of physicians and lawyers and the upper tier of business men are comparatively high is accepted in the same unquestioning way because of the familiarity and the permanence of the differences. In both cases the differences are due, none the less, to causes which are to be found proximately in the conditions of demand between groups and between nations. Lying back of these conditions of demand may perhaps be found deeper causes—inborn and ineffaceable differences in intelligence and character. We have seen how difficult it is, as between social groups, to decide whether acquired or inborn traits determine the lines of social divisions. So between nations it is not easy to say whether the advantages which one country may possess in a given direction are ascribable to unalterable racial qualities or to the accidents of historical development and acquired skill. Probably the racial causes tell more in settling the differences and the resulting exchanges between a civilized nation and a barbarous or semi-civilized; whereas between the civilized nations themselves acquired traits are of more importance. However this may be, the differences exist, and not only exist but maintain themselves thru generations and centuries; as do those between social groups within a country. At any given time, and for considerable periods, they may be accepted as settled facts and thus as causes.

CHAPTER 54

POPULATION AND THE SUPPLY OF LABOR

§ 1. The Malthusian doctrine, how far strengthened by biological science.—§ 2. The maximum birth rate, the minimum death rate, the consequent possibilities of multiplication. In what sense there is a tendency to rapid multiplication; the positive and preventive checks.—§ 3. The actual birth rates and death rates of some countries in modern times. A high birth rate ordinarily entails a high death rate. Explanation of exceptions. High mortality of children a sign of pressure.—§ 4. Countries having better conditions. The United States.—§ 5. Does a high birth rate cause low wages, or vice versa? Interaction of causes. A limitation of numbers not a cause but a condition of general prosperity and high wages.—§ 6. The standard of living affects wages, not directly but thru its influence on numbers. Fallacies on this subject.—§ 7. Mode in which the modern decline in the birth rate has taken place.

§ 1. The supply of labor depends on the increase in the numbers of mankind. The problems concerning the growth of population bear not only on the distribution of wealth but on other parts of economics also, not to mention wider social questions; and there is divergence of practice among economists as to the place which they should have in the exposition of the subject. Population is considered in this book at a later stage than is often assigned to it. Altho discussed in the following pages mainly in connection with the theory of distribution, it will lead to some digressions from that topic.

A long controversy has been carried on regarding the Malthusian doctrine. In the early part of the nineteenth century [1] Malthus set forth that the cause of low wages and poverty lay in the large numbers of mankind; that there was a tendency of population to press upon subsistence and keep wages low; that a permanent increase in wages could not take place unless the tendency to increase among the laboring classes was checked; that in the absence of such a check no plans for improvement in the condition of the

[1] The second edition of the *Essay on the Principle of Population* (1803) is that in which Malthus stated his doctrines in the form in which they continued to be maintained by him and his followers.

mass of men had any prospects of success; and that for these reasons all proposed reorganizations of society were doomed to failure. Moreover, Malthus was not hopeful that any salutary check would in fact be applied. It cannot be said that he was hopeless; but the drift of his teaching, and certainly the point of view of his followers, was that the number of laborers was likely to increase very rapidly and that wages would probably be kept down to a subsistence level. Given this situation, there was a serious obstacle, almost an insuperable obstacle, to any great improvement in the material welfare of the mass of mankind.

Some parts of Malthus's teaching have been sustained by the course of thought since his time. Man is an animal, physiologically like any other; and the possibilities of his increase in numbers are as unlimited as they are for any form of life. It is an odd circumstance that Darwin, reading Malthus's *Essay*, was led to the reflection that not man only, but any sort of creature, has the possibility of indefinite increase; and hence reached the conclusion that there is an unceasing struggle for room and sustenance, and a survival of those best able to cope with their surroundings. Darwin's own wider conclusion then reënforced Malthus's views as to the human species. The elephant can double his numbers every hundred years, man every twenty-five years; cats bring forth sixfold twice or thrice a year, and fishes can produce hundreds and thousands of their kind each season. Any species that multiplies at its maximum rate must eventually outrun the means of subsistence.

§ 2. Let us look more closely at the possible rate of human increase in numbers and compare it with the rates which we actually find. It is obvious that an increase in numbers can take place, aside from immigration, only thru an excess of births over deaths; that is, thru what is known as natural increase. The maximum rate of increase therefore must depend on the possible excess of birth rates over death rates. With regard to the birth rate, the practical maximum for a normally constituted population may be set at about 45 per 1,000; that is, for every 1,000 living persons there may be as many as 45 births per year. With abnormal age distributions, it is true, population groups may conceivably maintain even higher birth rates, but only for limited periods of time. For example, if a population were made up solely of men and women of the reproductive ages, 20 to 45 or thereabouts, the birth rate might well be much higher than 45 for a while. Even if a population contained merely a disproportionately high fraction of potential parents (as is the case in regions where there is a steady influx of young adults thru immigration) the rate might again be considerably higher than 45 per 1,000. Such abnormal age distributions, however, cannot be permanently maintained; large numbers of adult immigrants at one time lead inevitably to large numbers of old people a generation later, and high birth rates give a high proportion of children within a population; so that eventually the age distribution and with it the birth rate must return more nearly to normal. A birth rate of 45 per 1,000 is probably below the physiological maximum for a normally constituted population. The upper limit may be as high as 50 per 1,000, possibly higher. It is highly improbable, however, that any considerable population group ever approaches its theoretical maximum of fertility, so that for the present purpose, that of comparing possible increase with actual increase, it will be best to accept a figure which certainly can be attained in actual experience—say 45 per 1,000 per annum.

On the other hand, the minimum death rate is probably as low as 10 per 1,000 each year; a normally constituted population again assumed. It is apparent that a population having an undue share of persons in the prime of life would easily show a lower death rate; while one having—say as the result of emigration of the able-bodied—a disproportionate number of very old and very young would hardly be able to show a rate so low even under the most favorable circumstances. A quarter of a century ago a death rate of 15 per 1,000 appeared a reasonable minimum mortality; since that time improvements in medical and sanitary science, probably aided by an improving diet and standard of living, have so reduced the number of deaths from epidemic and infectious diseases that a minimum of 10 per 1,000 does not seem generally unattainable. Whether or not still further reduction in death rates is possible is an open question. Aside from further great advances in the medical sciences, a point of diminishing returns in public health work must eventually be reached. That such a point may actually be in sight is suggested by the fact that altho great reductions have been effected in mortality in the earlier years of life and from infectious disease there has been little improvement of the death rates at the upper age levels. Mortality rates from some of the organic and degenerative causes of death, such as cancer and heart disease, may even have increased. Altho prediction is dangerous, it would seem that for the present and immediate future a death rate of 10 per 1,000 per annum represents the practical minimum for most population groups.

The purpose of setting these upper and lower limits of mortality and natality is merely to indicate the possible natural increase, the maximum excess of births over deaths which can be expected. Actually the mortality figure in some populations may fall below 10 per 1,000. It is possible also that birth rates in excess of 45 per 1,000 may exist, particularly since the highest recorded birth rates, which are typically those of the more backward countries, may still be too low because of incomplete registration of births. However the existence of cases outside of the above limits of birth and death rates does not invalidate the indicated maximum of natural increase inasmuch as the countries maintaining high birth rates are with few exceptions if any precisely those having a uniformly high mortality. Similarly there is a marked association between low death rates and low birth rates. For the broad conclusions with which we are here concerned it is not necessary to be precise about the actual extremes. It suffices to indicate how wide is the possible range between the birth rate and the death rate, and how great is the possible increase of population. If births are at the maximum of 45 per 1,000 annually and deaths are only 10 per 1,000, the excess of births over death, or the increase in numbers, is 35 per 1,000. With this rate of increase, numbers will double every twenty years (compounding annually). Malthus himself deduced a somewhat similar rate of increase from what he found, or thought he found, in an actual case. "In the northern states of America . . . the population has been found to double itself, for above a century and a half successively [that is, from 1650 to 1800], in less than twenty-five years." Malthus thought that an increase even more rapid might take place and that the doubling period might be as low as fifteen years. This probably exaggerates the potentiality of increase. But it is certainly within the bounds of possibility that the numbers of mankind should double within such a period as has just been indicated—in a quarter of a century or less.

Not only is there a possibility of so rapid an increase as this; there is a tendency toward it. By tendency here we do not mean what is often meant by the term—probability that in the long run a given result will be reached. This is the sense in which we can say there is a tendency that commodities, freely produced, will sell for a price determined by their expenses of production. In speaking of the tendency of the population to increase at its maximum rate we mean something different—that there are forces in operation which, unless counteracted, will bring about the stated result. In this sense we say that there is a tendency for all bodies to fall to the earth; not that they are in fact likely to do so, but that they will unless something prevents. Such is the tendency of population to increase. It results from the reproductive instinct and the love of parents for their offspring. These are universal and powerful forces. They operate without restriction among animals. Each species of animals tends to multiply at its maximum; tends, that is, in the sense that it will do so unless by an intervening cause numbers are kept down.

But no species of animal can, in fact, increase at its maximum rate. If it did so it would in time crowd out all others and alone would occupy the earth. Nor is man an exception. A continual doubling of his numbers every quarter of a century cannot take place. Only under exceptionally favoring circumstances can such a rate be long maintained. When a civilized population, equipped with the tools and knowledge acquired during slow centuries of growing civilization, suddenly comes into possession of a new country it finds for a while limitless room for growth. Such was the situation in the North American colonies during the period to which Malthus looked for an example of the possibilities of increase. Such has been the situation of the people of the United

States during the greater part of their history, of the Canadians, the Australians, the Argentines. These are rare cases in the history of the human species. They are analogous to the comparatively rare cases where an animal—a moth, a bird, a mammal—migrates into a country hitherto strange to it and can multiply for a while without finding its food scare or its enemies too strong. In any long-settled country mankind cannot increase at anything like the maximum rate. The fundamental reason for this is to be found in the tendency to diminishing returns from the soil. On any given area that tendency shows itself for all agricultural produce. While it may be counteracted in some degree by improvements in the arts, a continuous doubling of numbers every quarter of a century must eventually encounter the obstacle of increasing difficulty in securing the food supply.

The tendency toward increase in population must then be counteracted; and it may be counteracted in two ways, to which Malthus gave the names positive and preventive checks. By positive checks he meant those which cut down numbers already brought into the world—starvation, disease, war, misery in all its forms. By preventive checks he meant those which prevent numbers from being brought into the world. The first operate thru a high death rate, the second thru a low birth rate; in other words, the first thru an excess of deaths, the second thru a limitation of births.

It would not be going very far astray to say that the extent to which one check or the other check prevails is a test of the advancement of civilization. The question, to be sure, is not one of yes or no but one of more or less. Mankind rarely exercises the power of reproduction to the full. Some limitation of births appears in every society which has progressed beyond the very lowest stage. As civilization advances, more and more forethought is exercised. Among all peoples there is some operation of the positive check also. Except among a small stratum of the well-to-do, more beings are brought into the world, even in the most advanced countries, than can survive. Numbers are kept down in part by a death rate needlessly high—that is, a death rate above the minimum from old age and irremediable disease. The more there is limitation of births the higher is the plane of civilization; the more excess of deaths, the lower.

§ 3. With these general principles in mind let a look be taken at the birth rates and death rates found in our own day in some of the principal countries. In the following table the maximum birth rates and the minimum death rates are first given, then follow figures for the rates in some selected countries. The "doubling period" means the number of years in which population would double if the given excess of births were steadily maintained.[1]

BIRTH AND DEATH RATES

Annual Averages per 1,000 of Population for the Period 1931–35

	Births	Deaths	Excess of Births	Doubling Period (in Years)
Maximum and Minimum	45 (Max.)	10 (Min.)	35 (Max.)	20
Egypt (1931–34)	43.6	27.9	15.7	45
Salvador (1931–35)	41.0	23.0	18.0	39
Roumania (1931–35)	32.8	20.6	12.2	57
Japan (1931–34)	31.6	18.1	13.5	52
Italy (1931–35)	23.8	14.0	9.8	71
Hungary (1931–35)	22.4	15.8	6.6	105
United States (1931–35) Registration Area	17.3	10.9	6.4	109
Australia (1931–35)	16.9	9.0	7.9	88
New Zealand (1931–35)	16.9	8.2	8.7	80
France (1931–35)	16.5	15.7	0.8	868
England and Wales (1931–35)	15.5	12.2	3.3	211
Sweden (1931–35)	14.1	11.6	2.5	276

Note the wide divergence in the birth rates. Those for Egypt and Salvador were not much below our supposed maximum, while other countries came close to the minimum. For example, Sweden had the lowest natality, a birth rate less than one third that of the maximum. In the death rates there were divergences quite as striking. Egypt with a rate of 27.9 per 1,000 had a mortality more than three times that of Australia and New Zealand, these being at the other extreme with figures well under 10 per 1,000.

[1] The data are from *League of Nations Statistical Year-Book*, 1935–36.

In general, a high birth rate is accompanied by a relatively high death rate. Such was, for example, the case in Roumania, Egypt, Japan and Salvador. This correspondence of high birth rates with high death rates means that Malthus's warnings and forebodings are applicable. Here are countries in which population is pressing on subsistence. Numbers are trying to increase faster than the means of support make possible and the positive check is in operation. Not the positive check in its most extreme form; the birth rate is not at the maximum; some limitation of births probably occurs. But more children are born than can survive and become adults, and more persons become adults than can survive to a peaceful old age. Among the countries listed the worst off as regards population increase were Salvador, Egypt and Japan, with Roumania not far behind. In all of these a necessary condition for any permanent improvement in the condition of the masses of the population is a lowering of the birth rate—a relaxation of the pressure of numbers on the means of support.

In such countries the death rate is always highest among the very young. The period of childhood is, under the best conditions, one of great sensitiveness to physical ills. Even where the general death rate was very low at the time of observation, as in the Scandinavian countries and Australia, from 4 to 6 per cent of the children died before completing the first year of life. From 6 to 8 per cent died in England, France and the United States, while for Italy and Japan the mortality in the first year of life exceeded 10 per cent (1933). As might be expected, reliable infant mortality rates are not available for the countries most backward in public health work. But reported rates of infant mortality in excess of 25 per cent are not unknown, and there are extreme cases where over one third of all children die before reaching their first birthday. Taking the children under five years of age, we find that out of every thousand born there died before attaining the age of five:

	Male	Female
in Italy (1930–32)	172	159
in France (1928)	143	123
in Germany (1935)	141	118
in the United States (white population, 1929–31) . .	83	68
in Denmark (1933)	113	99

A high death rate among children, such as appears in the countries having the high birth rates, means simply that babies are brought into the world who cannot survive. It means suffering, with never a chance of a happy outcome. Those children who do survive and grow to mature age must face low wages and hard conditions of life; yet they in turn marry early and procreate freely. The round of misery goes on without ceasing.

§ 4. Consider now some of the other countries. It will be seen that the rate of increase—the excess of births over deaths—was nearly as great in Australia and New Zealand as in some countries with considerably greater birth rates. A high birth rate, then, does not necessarily mean a high rate of increase; it may mean merely that there is a great wastage of life thru mortality. In the case of France and Sweden, which were distinguished by low birth rates, the preventive check was in operation to a greater extent than elsewhere. Obviously the condition of these two countries was in so far happier; thru the substitution of preventive for positive checks on the growth of population much avoidable suffering was escaped and the standard of living was protected. If their birth rates were to rise to the level maintained in many other countries an increase in the death rate would eventually ensue. In the absence of relief from population pressure thru migration a balance at a new level would sooner or later be reached, further increase being then prevented by a different and unhappier process.

The fact that population also increases in these more fortunate countries and yet does not bring with it higher death rates may be accounted for in various ways. In Sweden, before the adjustment to the observed low level of fertility, emigration was a major means of relieving population pressure. Figures of natural increase do not necessarily state what is the actual gain in numbers in the several countries; they indicate only what gain would have taken place by internal growth. The final effect on numbers depends also on the inflow and outflow—on immigration and emigration. The emigration from Sweden was large in earlier years relatively to the population. Except for this, either the death rate would have been higher or the birth rate lower; for Sweden was not a country with such possibilities of expanding production as to enable its numbers to grow as they would have done by natural increase alone. It is to be noted that some of the other countries also have found an outlet in emigration—notably Italy. But for a great stream of emigration Italy might well have had a death rate even higher than that which she showed in 1931–35; or else her birth rate would have been smaller.

England too has found some outlet in emigration; but not to a great extent since the beginning of the twentieth century. In the main, her excess of births over deaths has meant an actual increase of the number in the country. Numbers have been able to grow because England's powers of production have kept pace with them. This could hardly have been the case if England had supported them and supplied them with raw materials from her own soil. But she is a great manufacturing country, obtaining food and materials in exchange for exports of manufactures, as to which there is no obstacle from diminishing returns. Exchange of this kind was the basis of England's advance in population and wealth during the nineteenth century. So long as it continues, and continues for expanding numbers, she can maintain a high birth rate and yet a low death rate. When growth of this sort slackens—when it becomes more difficult to buy ever-increasing food supplies by exporting manufactured goods—England must either have a lower birth rate or a higher death rate. The former alternative will almost certainly be chosen; indeed, a slackening in the rate of growth has already shown itself. As will appear more fully in the sequel, this is the mode in which the populations of all advanced countries are likely to accommodate themselves to conditions of greater pressure.

France is the classic country of the preventive check. Her population has been practically stationary for several decades; or rather it has failed to grow by natural increase. Such slight gain in total numbers as appeared has been due to immigration. The death rate in France is not as low as it might well be. In part, it is true, her comparatively high death rate may be accounted for by the mere fact of her population having been for some time stationary. This brings about an age distribution with a large proportion of older persons, among whom the death rate must be higher. But it is also true that France, tho a great and prosperous country, yet has—what country has not?—strata in her population, both industrial and rural, in which the conditions of life are hard and the deaths are largely due to preventable causes. None the less, her birth rate on the whole is low and her population does not press hard on her resources. Especially in the rural regions the population of France is eminently thrifty, self-respecting, careful of the future; its condition, while not in every respect thoroly satisfactory, is vastly better than that of Italy, Hungary or other countries of rapid increase.

For the United States fairly reliable figures of both births and deaths are now to be had, since the completion of the Birth Registration Area and the Death Registration Area in 1933. In recent years the death rate has been declining gradually, remaining somewhat above 10 per 1,000, while the birth rate has gone below 20 per 1,000, falling as low as 16.6 in 1933. It must be remembered, however, that the United States is a very heterogeneous country and that any general averages for its vital statistics, even if based on accurate figures, need interpretation. For example, the birth rate of the colored population in the South has been observed to be high, as likewise their death rate. The white population of the South also has had a relatively high birth rate as compared to the rest of the country, altho on the average somewhat less than that of the colored. Comparatively low birth rates have been reported for the Pacific coast and for the eastern states. Thus in Massachusetts, the only state in which accurate registration has been continuously maintained for a long time, the birth rate, after remaining for some time in the neighborhood of 25, fell below 15 per 1,000 during the 1930's. The corresponding rate of natural increase was of the order of 3 per 1,000 per annum. Here again, however, the population was not homogeneous and the figures must be used with some caution. Massachusetts received a steady flow of migrants from other states and from abroad, so that the population of the state included a high proportion of people in the prime of life, a fact which accounted in part, at least, for the low death rate. Furthermore the foreign born had a birth rate high as compared to the native born—a phenomenon of which more will be said presently.

§ 5. High birth rates, high death rates, backward industrial conditions, low wages—these commonly go together. But which is cause and which is effect? The unqualified Malthusian view is that the pressure of population, indicated by a high birth rate, is the cause from which all the evils flow, and that the one effective means of permanent improvement is a lowering of the birth rate. But the situation is not quite so simple.

High birth rates and misery are largely interacting causes. A high birth rate commonly means, in an old country, misery; and misery in turn often increases the birth rate. When a people is poor and sees no prospect of escape from poverty, multiplication takes place without thought of the future, since the future seems in any case without hope; and that very multiplication shuts the door to hope. In modern times such a fatal round of interacting causes often appears in manufacturing districts where women and children offer themselves for employment because people are many and wages are low. The very opportunity for securing employment, on the other hand, promotes multiplication, since the income of the family is eked out by the earnings of mother and offspring. Where such conditions have established themselves the way of escape is hard to find; the causes of demoralization and misery become cumulative. Even in countries where the general conditions are good there is commonly a low-lying stratum of the population in which there are high birth rates, high death rates, pressure for employment, low wages—connected phenomena, yet no one clearly the cause of the other.

None the less, it is certain that restraint on the increase of numbers is one essential condition of improvement. Stated in this way, the Malthusian proposition is impregnable. A limitation of numbers is not a *cause* of high wages, but it is a *condition* of the maintenance of high wages.

High wages depend fundamentally on high productivity of industry. In new countries where the increase of population is not confronted by limited natural resources, and where capital also increases rapidly, laborers may multiply rapidly without having to face hard terms. A long period may elapse before signs of pressure appear. But in countries already well peopled the fundamental limitation from diminishing returns on land is ever present. Unless there be some exercise of the preventive check no measure toward general improvement can be effective.

But mere exercise of the preventive check can accomplish nothing. Only if there be the other conditions needful for prosperity —improvements in the arts, increasing capital, greater productivity of industry—will the social income, and wages as part of that income, show a tendency to rise. Then restraint on multiplication, tho not in itself a cause of gain, will enable the gain to be maintained. It is certain that if population increases at its maximum rate, or anything like that maximum, high birth rates will bring not only high death rates but low wages also. But if there be forces in operation which raise the productivity of industry a lowered birth rate will enable more favorable conditions to be attained and held.

§ 6. The standard of living is often spoken of as the fundamental cause determining wages. There is a sense in which it is a fundamental cause. Yet it acts not directly but thru its effects on numbers. A high standard of living does not in itself increase wages. It may serve to lower the birth rate or to keep it low, and thereby create one of the conditions on which maintenance of high wages usually depends. But unless other conditions are present— a large demand for laborers, which comes at bottom from a large productiveness of industry—a high standard of living brings nothing to pass.

There are curious fallacies on this subject. A notion is prevalent among many workmen of the upper tier (mechanics and the like) that cheap living is bad for them and free expenditure good. They suppose that if they economize (use cheaper food, for example) advantage will somehow be taken of them and their wages reduced; whereas if they "live well" their wages will be kept up. Hence persons who propose economical ways of using and cooking materials for food have been suspected of a covert conspiracy to bring down wages. Nothing is more irrational. Every way of getting as much as possible with your income—of so directing expenditure that the maximum of utility is secured for each outlay —serves to increase the effectiveness of the forces which make for prosperity. What laborers get depends in no direct way on what they spend or on their standard of expenditure. It depends on their numbers as one factor; and the standard of living has an effect on their wages only in so far as it has an effect on their numbers. Some economists have been no less guilty of confusion on this topic than the laborers themselves. They have discussed the standard of living as if it were a force acting directly; whereas it acts only indirectly.

This proposition, like so many others in economics that are essentially true, needs some qualification. Tho a high standard of living exercises an influence on wages chiefly thru its effect on numbers, it does have some effect also on the bargaining process. The first step in the settlement of the wages of hired laborers is a contract with an employer. All sorts of factors bear on the contract; not only labor organizations—of which more presently—but established traditions as to what are "fair wages" or "living wages." These are vague and often question-begging phrases; men's notions of what is just pay or living pay are usually settled simply by the rates to which they are habituated. But the fact of habituation counts as one of the elements in bargaining. An established standard of living will cause workmen to stick more stubbornly to a demand for what they regard as decent wages. Within the debatable ground subject to the higgling of the market, a high standard of living may have some direct effect on the outcome.

Tho a high standard of living—showing itself in a lowered birth rate—establishes itself with difficulty in a population steeped in poverty, the difficulty of raising the standard is not so great as many of the older writers supposed. They thought that a real advance could come only by some sudden uplift, such as would give time for the establishment of new habits. From this point of view the outlook gave little hope; for nothing is more difficult to bring about than a sudden change in social and material conditions. Happily this opinion has been shown by the course of history to be unfounded. During recent generations there has been in the more advanced countries a slow and gradual improvement in welfare, and with it a slow and gradual fall in the birth rate. All the leading countries show a declining birth rate, side by side with a declining death rate. The change is most unmistakable (as will presently appear) among the well-to-do, but it appears also in the upper strata of the workmen and, more faintly, among the lower tiers of the laborers. It is gradually affecting all classes and all countries. It is both a cause and a result of greater prosperity, and both a cause and a result of a higher standard of living. It bids fair to have more and more important consequences as time goes on.

§ 7. The birth rate in all civilized countries has shown a decline since the middle of the nineteenth century. Thus in England it was 35 per 1,000 in the decade 1850–60; in 1931–35 it was 15.5 per 1,000. In France during the same period it went down from 26 per 1,000 to 16.5. In Germany the decline was no less unmistakable, from 36 or 37 to 16.6. There is evidence that a similar change has been going on in the United States. In other words, there has been an application of what Malthus called the preventive check. But the change has taken place by a process different from that which Malthus recommended and expected. Malthus desired that the time of marriage should be postponed,—that marriages should take place at a later age. Were this done, the marriage rate would decline because of the deaths of some persons who might have married; a change, however, which would be slight unless the postponement was very marked. The birth rate too would decline somewhat because of the shorter duration of fertile married life and because of the lesser fertility of the later age periods. But it is not by these measurable physiological influences that the result desired by Malthus has come to pass. The main cause has been deliberate interference with the natural biological processes. The marriage rate in most countries, tho it shows a slight tendency to decline, has varied little. It is usually not far from 8 per 1,000, and very nearly the same in France, in Germany, and in England; yet these countries have very different birth rates. Nor has the average age at marriage shown a sensible change. It is the number of children per marriage, varying tho it does from country to country, that tends to become smaller in almost all countries; indeed in France it has reached a minimum, where it just balances the number of deaths. There is no question that this general situation—marriage rates virtually stationary and yet declining birth rates—is due to deliberate abstention from propagation. It is by intent that married couples have fewer children than before. The tendency is more marked in some countries than in others; more marked, for example, in Protestant countries than in Catholic. It appears among the well-to-do more unmistakably than among the poor, yet it is spreading to all classes. It raises some large questions, both as regards the general problems of population and as regards those of social stratification. To these questions we turn in the next chapter.

CHAPTER 55

POPULATION (*Continued*)

§ 1. Differences between social strata in birth rates and marriage rates.—§ 2. Their relation to varying standards of living.—§ 3. The main cause of the general tendency to lower birth rates is social ambition. Its connection with private property and individualism.—§ 4. Native born and immigrants in the United States.—§ 5. Eugenics.—§ 6. Race suicide, birth control.

§ 1. It was mentioned in the preceding chapter that considerable differences exist in the birth rates and in the death rates of various countries. Even more significant are the equally great divergences between the rates for different social classes within any one country.

The relative rates of natural increase in two or more groups depend upon several factors—the fraction which marries, the age at marriage, the average number of children born per family, and the death rate. Earlier age of marriage may be expected to bring more children because of the longer period of marriage during the fertile age period. And there is still another effect of the age at marriage upon the rate of natural increase. With earlier marriage the age of the parents at the time of the birth of their children will tend to be less; therefore, even if the number of children per marriage is no greater than for later marriages, numbers will nevertheless increase more rapidly (assuming that there is actually an excess of births over deaths) because of a shorter interval of compounding.

A higher rate of natural increase within a given population group may thus be the result of earlier marriage, a lower fraction of celibacy, more fertile marriages, a lower death rate, or a combination of several of these factors. For the population of the United States as a whole all of these factors have been known with some degree of accuracy. But it is only recently that much has been learned concerning their variation between different social and occupational groups. Even now the evidence is fragmentary and on some important points far from conclusive. In the following pages only certain representative figures are given and the general conclusions indicated.[1]

The information concerning the extent to which the members of different social strata remain unmarried is very incomplete. In the United States the Census Bureau publishes no cross-tabulation of occupation and marital status, so that little is known for this country beyond what can be learned from occasional special studies. In the English Census of 1911, however, such a tabulation was published, giving the following figures for England and Wales.

Occupational Group	Number Married[a] per 1,000 Population
Upper and middle class	523
Bourgeois	556
Skilled workers	577
Intermediate	565
Unskilled workers	533
Textile workers	573
Miners	581
Farm laborers	487

[a] Computed for a standard age distribution.

The data probably can be accepted as typical, showing as they do, after allowance for variations in age distribution, little marked difference between the various occupational groups in the fraction married.

Postponement of marriage is probably a more important factor in its effects upon the relative fertility of social strata than is celibacy. In fact, separation of such figures as are in the preceding table according to age groups indicates that the slightly lower fraction which married in the highest category was the result of a longer postponement of marriage rather than of any permanent avoidance. The existence of differences in the average age at marriage has long been observed, the age being higher among

[1] For a summary of the evidence on social and occupational group differentials in fertility the reader is referred to special books such as Lorimer and Osborn, *Dynamics of Population;* Thompson, *Population Problems;* and to the numerous articles on differential fertility which have appeared in the *Milbank Memorial Fund Quarterly.*

the well-to-do than among the working classes. For example, the average age at marriage of bachelors and spinsters (i.e. for first marriages) in Great Britain in 1890 was: [1]

	Bachelors	Spinsters
Miners	24	22.4
Artisans	25.3	23.7
Shopkeepers	26.6	24.2
Professional and independent classes	31.2	26.4

More recently [2] it has been found that the average age at marriage in the United States for a large series of urban and rural families was as follows: [3]

Urban		Rural	
Professional	24.8	Farm owners	22.3
Proprietary	23.3	Farm renters	20.9
Clerks	22.9	Farm laborers	20.1
Skilled workers	21.8		
Semi-skilled workers	21.2		
Unskilled workers	21.4		

From these and other similar data it is safe to conclude that marriage tends to be postponed until a later age in the upper social classes. This postponement accounts at least in good part for the unquestionable differences in the fertility of the different social strata.

With regard to the actual fertility of marriage according to social or occupational class, abundant material has been obtained in recent years. The information is derived, as a rule, from sporadic private or special investigations but nevertheless is to be relied upon in view of its high consistency. While the amount of the differences observed in the intramarital fertility of different social strata varies according to the basis of social classification and the particular area studied, an inverse relation of fertility to social status appears invariably. The average size of family is least in the upper classes, however defined, and greatest among the poorest.

[1] Figures from Ogle, *Journal of the Royal Statistical Society,* 1890, pp. 274–275.
[2] Notestein, "Differential Age at Marriage According to Social Class," *American Journal of Sociology,* July, 1931, pp. 22–48.
[3] The data refer to native white women under forty years of age at marriage.

It is part of the same phenomenon that in the United States the birth rate is regularly lower for the native born than for the immigrant groups, since the native born are on the whole those of more favorable social and economic position. In the same way the birth rate of the colored tends to exceed that of the white population within any given area.

It is of interest that occasional exceptions to the usual situation have been discovered in very recent years, notably in limited sections of the population in Scandinavia. Whether or not these exceptions represent a merely local phenomenon or point to a wider trend it is too early to decide. They may represent a new development in social class differences in fertility—an adoption of preventive checks by the lower classes as well as by the upper.

Parallel figures showing social group differences in mortality are available and point the same way. Mortality is lowest among the most favorably situated and is greatest among the poorer classes, especially in the younger age groups. And yet, in spite of the higher mortality, the natural increase of the poorer sections of the population, altho declining, is probably still above that of the upper social and economic groups.

§ 2. These variations are the evidences and the consequences of differences in the standard of living; and they bear the same relation to the standards of living among social groups as the similar variations do to the standards of living in different countries. The reason for low remuneration in any given group is that the numbers in that group are large relatively to the demand for the services yielded; in other words, because the marginal utility of the work of the group's members is low. The numbers in any group continue to be large or small according to multiplication within the group. Not solely, it is true, according to this factor; there is transfer from group to group, and especially some swelling of the numbers in the higher ranks thru inflow from the lower. Yet in the main each group is recruited from its own members. Certainly in the lowest of all, that of unskilled laborers, growth proceeds almost wholly from within. The wages of day laborers are low because there are so many of them; and there are so many of them because, notwithstanding low wages, they continue to marry and multiply, and as a rule marry early and multiply rapidly.

Here again the relation between standard of living and wages is not direct but indirect. The mere fact that the well-to-do are habituated to comfortable living and wish to maintain comfortable living does not make earnings large. But the fact that there are comparatively few physicians, lawyers, architects, engineers, business men of the upper tier—this serves to keep high the incomes of the class. The wages of common laborers are not low because they are used to coarse food and cheerless living; it is the maintenance of their numbers in face of these conditions that keeps wages low. There is a correlation between standard of living, birth rates, supply of workers, and, finally, earnings.

It is possible to conceive of the standard of living as fixing wages at a precise point—as having a determinative influence analogous to that which cost of production has upon the long-run value of commodities. Thus a given group—say that of the upper set of manual workmen, the mechanics and skilled craftsmen—may be supposed to have a specific standard of living, to multiply rapidly when earnings exceed the amount so defined, and to check multiplication when earnings fall below it. But such a conception of the situation conforms to the facts only in a very speculative and uncertain way. Other circumstances than a foreseen and calculated rate of remuneration affect marriages and births. The influence of the purely economic motives is irregular, often only half-conscious. These motives are more likely to act in checking multiplication than in increasing multiplication; they are more likely to keep wages from declining than to prevent them from rising. When a moderate increase of wages in a given group is made possible by greater demand for its services it is improbable that higher birth rate and internal growth will check the advance quickly, not certain that there will be a check even in the long run. It is much more likely to be kept within limits by seepage from without—by the success of some individuals from other groups in finding their way into the more prosperous employments.

§ 3. The general decline of the birth rate in advancing countries; the accentuation of that decline among the well-to-do; the probability, almost certainty, that with wider diffusion of prosperity the tendency will spread more and more to all classes—all this has been the result mainly of social and industrial ambition. Some writers have discussed the change as if it were automatic, as if the lower birth rate among the well-to-do were the natural and necessary consequence of their having a larger income. The connection between income and birth rate is the other way; rising prosperity is rather the effect than the cause of declining pressure. The fundamental cause is the wish of each family to promote its own material welfare. Malthus spoke of the desire of each individual to improve his condition as the *vis medicatrix* of society. Certainly with reference to the growth of population he spoke with truth. When some chance of better conditions is visible; when a better-paid occupation, education, some savings and some accumulation appear within reach; when it is seen that more mouths to feed mean a lessening possibility of utilizing such an opportunity —then the propensity to multiplication is more and more held in check. The causes of the declining birth rate are to be found in the intellectual and material forces which have so wonderfully stirred the people of western civilization during the last century or two: the spread of education, newspapers and books; cheap movement by railway and steamship; the quickening of stagnant populations by the new modes of employment, by large-scale production and the factory system, by the changes thru emigration. Not all of these forces have been steadily at work in the same direction. The factory system has been at times simply demoralizing, even tho in the long run it also has had an awakening and uplifting effect. Where the ownership of land has been widespread, or the conditions of tenure secure, the agricultural population has responded most surely to the new opportunities, as in France, the United States, western Germany. Where the agricultural workers are divorced from the land, as in eastern Germany, England, southern Italy, and Hungary, they have needed a stirring from the other world, thru emigration, to rouse them to the outlook for improvement. Thruout it has been awakened ambition in the individual that has caused the standard of living to rise.

Malthus was led to write on the question of population because he believed that here was an insuperable obstacle to utopian schemes. His followers steadily maintained that the tendency of population to outrun subsistence was an obstacle in the way of socialism. In a socialistic society the obstacle may not be insuperable; but it is certain that it will have to be overcome there in a way different from that which has in fact appeared in individualistic communities. On the one hand, inequality and the familiar spectacle of a higher economic and social stratum; the stimulus of self-interest, on the other hand, for oneself and one's children—these are the factors which have limited the movement of population, have spurred ambition and imposed restraint, and so sustained the advancement and diffusion of material well being. Individualism is at the root of the phenomenon.

§ 4. All the individualistic forces have been most strongly at work in the United States. Nowhere has there been more freedom of opportunity, more spur to individual ambition, more stirring from education and from the consciousness of larger possibilities. In those parts of the country and in those social strata where the pressure population portended danger, pressure has begun to relax.

In New England, for example, the native-born population has long been multiplying at a very slow rate. The total population of New England has indeed continued to increase, but the increase has been the consequence of immigration and a high birth rate among the foreign born, rather than of natural increase of the native stock. In the latter part of the nineteenth century the difference in the fertility of native and foreign-born women was striking, as the following figures show. The birth rate among the foreign born was three times that of the native born.[1]

ANNUAL BIRTH RATES

	1883–87	1888–92	1893–97
Native parents . . .	17.1	17.1	17.0
Foreign-born parents .	48.4	49.6	52.1

[1] R. R. Kuczynski, in *Quarterly Journal of Economics*, Vol. XVI, pp. 143, 146, 183. Compare some equally striking figures given by A. A. Young for New Hampshire in *Publications of the American Statistical Association*, September, 1905.

These figures are for the crude birth rate (births per 1,000 of population) and exaggerate the difference in the fertility of the two classes; for among the foreign born the proportion of persons in the age of reproduction is greater. But even comparing the births in proportion to women of child-bearing age, the rate of increase among the foreign born for the above periods was twice that among the native, the figures being:

BIRTH RATES PER 1,000 WOMEN AGED 14–49

	1883–87	1888–92	1893–97
Native mothers . . .	63.7	62.8	62.6
Foreign-born mothers .	124.5	133.6	139.4

From figures for later years it will be seen that the fertility of the foreign born in Massachusetts, altho remaining well above that of the native born, nevertheless decreased in the twentieth century both absolutely and relatively to the rates for the native born.[1]

	Births per 1,000 Population		Births per 1,000 Women Age 15–44	
	1918–22	1928–32	1918–22	1928–32
Native born	16.5	15.5	73.8	65.4
Foreign born	41.4	21.9	139.4	85.9

The careful statistician, from whom the earlier figures are quoted, concluded (in 1901) that the native-born population of Massachusetts was not maintaining itself. The same conclusion applies to the later period, even tho the differential between the two nativity groups decreased considerably.

As regards the native born it has been said, not only of Massachusetts but of others among the older states, that if fertility con-

[1] The changes here indicated in the relative fertility of the two groups are to be interpreted in view of the fact that the "native born" of the later period (twentieth century) were a different stock from the native born of the earlier period (nineteenth century). They came to be in larger proportion native born of foreign parentage—the first generation descended from new immigrants. Among these the tradition of older days still largely persisted. Immigration of new comers had virtually ceased

tinues to be as low as it was in periods covered by the figures the stock eventually will become extinct. This is true; but in the frequent warnings and laments the "if" in a calculation and conclusion of this kind is often overlooked. It is not to be assumed as certain, or even as at all probable, that these trends will persist to the bitter end. Neither the movements in total population nor those in its distribution among classes and races and regions will be the same for 1900–2000 as they were for 1800–1900. The increase in total population will certainly become less in the course of the twentieth century. It is highly probable that fertility in the low-lying groups will not remain so disproportionately high and that the total numbers in these groups, while probably remaining large, will become a smaller fraction of the total.

In the native-born farming population of the central region of the country the same relaxation of the rate of growth has shown itself, tho not so strikingly as in New England. There, too, the average number of children per marriage has tended to decline because parents were solicitous not only to maintain but to raise the social and economic position of their children.

This movement is steadily extending and is gradually affecting not only those who are usually thought of as being in a more special sense "native born" but in time the descendants of the later immigrants as well. The influence of free institutions and of free opportunities is to lessen, possibly to destroy, the caste-like character of social classes. They lift the second generation of those who immigrate into the United States out of the lowest of the non-competing groups. In that second generation the birth rate, which had been high among the first arrivals, begins to fall. In the United States the rate of pay for common laborers and unskilled factory workers has been kept low not by a continuing high birth rate within the country but by a high birth rate and low standard of living in the foreign sources of supply. It is in European countries that the millions were born who steadily replenished the lowest stratum. Once they settle in the United States the leaven of social and economic ambition slowly but surely affects them. It makes well-nigh certain a relaxation of the rate of growth in population. In the course of time, as natural resources come to be more completely preëmpted and the possibility of increase is subjected to the conditions of an older country, the Malthusian difficulty, there can be little doubt, will be staved off by the increasing application of the preventive check.

§ 5. The question which now faces the advanced countries, and especially the more prosperous classes in those countries, is whether the preventive check is not likely to be carried too far. The population of France as a whole barely maintains itself; it is probable that the French well-to-do fail to maintain themselves at all. The native-born population of Massachusetts probably fails to maintain itself; it is not to be doubted that this is the case among the well-to-do in that state. The main cause of the phenomenon is an excess of social ambition—forethought to the point of timidity. People's notions as to what is a proper mode of living steadily become more exacting and the expense of maintaining a family on the conventional scale becomes greater. Marriages take place at a comparatively late age and the proportion of those who do not marry at all is considerable. Where there is accumulated property large families are avoided lest the inheritance be split up among too many. The very rich seem to multiply least rapidly of all.

This tendency brings evils. It takes away part of the stimulus which comes from competition and pressure. Children who are too carefully reared, too elaborately educated, too fully assured of support from inherited means, lack courage. A population which marries earlier and multiplies more rapidly, and whose newly accruing members are thrown more upon their own resources, is likely to have more vigor, more zest, a happier life.

Further, the more prosperous strata among the population are those in which intellectual gifts are most likely to appear. They are prosperous largely, perhaps chiefly, *because* they have such gifts. No doubt there are plenty of commonplace persons in the favored classes among whom multiplication is markedly restricted. But among them the able and the intelligent are a larger proportion than elsewhere. Hence in this tendency among the well-to-do there is a danger that the quality of the population will deteriorate. Less of the gifted are born, and those who are born are less stimulated by active competition to exercise their gifts to the utmost. The lower strata of the population, on the other hand, multiply most rapidly. Tho some individuals of high qualities emerge from among them, the proportion is less. The comparatively few whose unusual abilities enable them to rise, succumb to the social ambitions and inhibitions which prevail in the prosperous class and like their new associates fail to propagate freely.

More and more thought has been given of late years to the strange contrast between our care in breeding animals and our carelessness in breeding men. The human race could be immensely improved in quality and its capacity for happy living immensely increased if those of poor physical and mental endowment were prevented from multiplying. But it is very uncertain how far it would prove possible to make selection for propagation. Tho the great broad facts of heredity are unmistakable, the biological details are but dimly known, above all in their application to man. More light will come in time from what is called eugenics; that is, from systematic inquiry on the transmission of inborn and acquired traits from generation to generation with a view to the possibilities of selection. In the present state of knowledge no individual differentiation of the more capable is feasible; least of all do we know what are the conditions which lead to the birth of individuals having extraordinary gifts. And even if more accurate knowledge comes to be attained, any system of restriction and selection would probably be inconsistent with that striving for freedom of opportunity and for individual development which is the essence of the aspiration for progress. It is difficult to conceive any such system which would not imply the sacrifice of present happiness by countless individuals for the sake of a cold and distant ideal of ultimate racial improvement. Only some very limited applications of the principle, in extreme cases, seem now within the bounds of possibility. Certain types of criminals and paupers clearly tend to breed their kind, and society has a right and a duty to protect its members from the repeated burden of maintaining and watching the unfortunates. Some sorts of disease and taint are inherited, and it is merciful alike to would-be parents and possible offspring to put a check on their transmission.

Beyond this there is little prospect that mankind will deliberately select a portion among its members as alone privileged to perpetuate the race.

Some recent figures (of 1936–38) seem to show an unexpected trend away from "race suicide" in some American cities.[1] It has appeared that the birth rate is lower in those families having the highest income than it is in those of the middle class; higher in those having incomes above $3,000 than in those having incomes between $2,000 and $3,000. It remains to be seen how widespread this difference is, or how long it will persist.

§ 6. A generation ago there was much talk about "race suicide," a phrase invented by President Theodore Roosevelt and referring to growing restraint on numbers among the well-to-do. Both the extent and persistence of the drift were exaggerated. Tho prudence might possibly be carried to the point of impending annihilation of the higher social strata, in fact it probably will not be—as in fact it will not be among the native born of the country as a whole; even tho large families and rapid multiplication are things of the past.

"Birth control" is the phrase which came into use later. Not only is the phraseology different but the implications are wider. What is thought of is the welfare of mankind as a whole, of all social strata, and of the lowest stratum most of all.

As regards mankind as a whole the case is simple. Birth control bids fair to prevail not among the well-to-do only but in all social classes. The systematic avoidance of the biological consequences of the sexual act spread with extraordinary rapidity during the close of the nineteenth century and the first part of the twentieth. More than anything else it accounts for the almost world-wide decline in the birth rate which took place during that period. While it is still most habitual among the possessing and the prosperous it has reached the social stratum next below—the well-paid manual workers and the land-owning farmers—and is passing still farther down. Neither national nor religious opposition interposes effective obstacles to its diffusion. In England, France, Germany, the United States, Australia, it is becom-

[1] *Proceedings of the American Philosophical Society,* Vol. 80, No. 4, p. 503.

ing more and more pervasive. Only the ignorant and illiterate remain immune; as in southern Italy and the countries of central and southern Europe, which it has hardly influenced at all and which still have a very high birth rate. Among the immigrants who have come from these regions to the United States a high birth rate persists; yet in the second generation—the native born of foreign parentage—a marked lowering of the birth rate appears, the consequences in the main of their adoption of the practices which are about them.

Thus a new factor enters in the problem of the increase of numbers. Social ambition no doubt continues to affect all classes, not the well-to-do alone; indeed it tells more rather than less. But in the middle and lower classes a simpler and more elemental force is operating—the wish to lessen the ordinary cares of life, to hold fast to an improved standard of material comfort. As regards the countries which have been reached or are being reached by this silent but irresistible force even the modified Malthusian warnings have to be modified still more. Neo-Malthusianism takes the stage—the preaching of the possibility and the desirability of planned restriction.

It is too early to say with any confidence what may be the ultimate outcome of this uncanny development, both as regards its economic and its moral aspects. Among the economic consequences one is at once suggested—that population will take care of itself, so to speak. Instead of pressure on subsistence there will be adjustment to subsistence. The deliberate restraint of procreation which was preached by Malthus, and has been long practiced in one way or another at all times and by all sorts of peoples, will become more deliberate, more methodical, and well-nigh universal. And this, looking still at the economic side alone, is to be welcomed. For mankind as a whole, declining birth rate and lessened pressure of population mean material improvement, not deterioration. If the change really comes to have universal scope a low birth rate will be balanced by a low death rate and children will no longer be born in superabundant numbers only to die. Disease and suffering will more easily be lowered to the minimum, the average duration of life will become longer. The time is in sight when the population of advanced communities will not increase at all. Material progress will then slacken. Output per head will not indeed necessarily be stationary; the arts may be expected still to advance, even tho the pressure from growth of numbers be lessened.

More important perhaps, and at all events more distant and speculative, is the possible effect on the structure of society—on social classes and persistent inequality. It has appeared in the course of the preceding chapters that the remuneration of any occupation, any kind of ability, any class, depends on the numbers who offer to others the labor and the services of that occupation or ability or class. The fundamental reason why the "lower" social classes are lower is that the number of persons in them is relatively large; and they are numerous, and continue to be numerous, because they breed rapidly. Suppose they breed less rapidly and become less numerous relatively to other classes—will they not cease to be the lower classes? Will not the lines of demarcation between classes tend to be wiped out?

As regards the general lines of distribution, it may be guessed that the effect will be in the direction of lessening inequality but not removing it. Obviously the degree of lessening will depend on the extent to which birth control spreads. If it is equally practiced thruout the range of society the structure of distribution will not be affected. Other forces may indeed come to have more influence than they have now: education may be more freely extended so as to bring out to the full each individual's capacity; great incomes and great fortunes may be pruned by the taxation of incomes and inheritances, and by regulation of industry. But birth control, if practiced in each social stratum as much as in the others, will leave relative numbers as they are. Its greatest effect will presumably be on the very lowest stratum—that by which we are most distressed and perplexed. Here birth rate and death rate have hitherto been highest. The same control here as in the strata above will have most effect on relative numbers and will make it much more feasible to eradicate this, the oldest and saddest ailment of the social body.

But differences of inborn capacity will not be eliminated and those to whom nature has given rare ability will still command exceptional remuneration. Opportunity and environment and ease of start will indeed become of less importance. One among the causes which in the past tended to make the cleavage between classes persistent will be slipping away; and one among the factors which bear on the advancement of mankind—capacity for leadership—will be more abundant and of more effect.

On the moral side of the matter much is to be said—much more than comes within the scope of this book. The dangers of a general loosening of the relation between the sexes are obvious. The just mean between obscurantist prudery and intolerable license is not easy to hit. But the situation has hardly been made worse by neo-Malthusianism. In so far as the practice promotes early marriages, matters probably have been made better or at all events more readily susceptible of betterment. If there be proper legal and medical control of this insidious and powerful force the moral and social benefits will outweigh the evils.

CHAPTER 56

INEQUALITY AND ITS CAUSES. INHERITANCE

§ 1. The fact of inequality: distribution has a roughly pyramidal form. Figures indicating the distribution of income for Great Britain, for London.—§ 2. The distribution of property, as indicated by probates in Great Britain, by tax statistics.—§ 3. The distribution of income in the United States.—§ 4. Is inequality becoming greater?—§ 5. The causes of inequality: differences in inborn gifts; the maintenance of acquired advantages thru opportunity and above all thru inheritance.—§ 6. Inheritance to be justified as essential for the maintenance of capital under a system of private property.—§ 7. Possible limitations of inheritance, thru taxation and in other ways.—§ 8. Proposals for the radical restriction of inheritance.—§ 9. The grounds on which private property rests. The utilitarian reasoning.—§ 10. The leisure class; its economic and moral position.

§ 1. The overshadowing fact in the distribution of property and income is inequality. How great is the inequality and what are its causes?

On this subject our information was until very recent times surprisingly meager. It is still far from complete or exact. What we have is based mainly on income tax returns; but these exist for a few countries only, and in them need correction and explanation. Nevertheless, familiar observation, supported and supplemented by such figures as we have, suffices not only to assure us of the fact of inequality but to show its range and character. We know that the number of the rich is very small; that the number of persons who are well-to-do and comfortable, tho considerably larger, is still small; and that the persons with slender incomes are the most numerous of all. With only one exception of importance, to be noted presently, distribution both of wealth and income has a form roughly pyramidal. To put the analogy more carefully, its form is like an inverted peg top—the lowest range small, then a very large extension, and thereafter steady shrinkage as the highest point is approached.

It will suffice to give a few typical figures. The best estimates which we have to show the distribution of income among the individuals of a large country are for Great Britain and northern Ireland.[1] In 1928 there were judged to be in this area 21,685,000 potential recipients of income; among them incomes were distributed approximately as follows:

1,540,000	or	7.1 %	were unemployed and without income	
5,270,000	"	24.3 %	had incomes less than £147	
12,795,000	"	59.0 %	" " from £ 147	to £ 250
1,975,486	"	9.1 %	" " " £ 250	" £ 2,000
74,829	"	.35%	" " " £ 2,000	" £ 5,000
27,704	"	.14%	" " " £ 5,000	" £25,000
1,981	"	.01%	" " above £25,000	

If the line between those who were well-to-do and those who were not is drawn at £250, it appears that about 10 per cent of the people belonged to the well-to-do classes. This 10 per cent, according to the estimates, received approximately 45 per cent of the total British income; the remaining 19,605,000, constituting nine tenths of the total bread-winning population, received the other 55 per cent of the total income.

These estimates do not pretend to rigorous accuracy. Persons who are disposed to defend and justify existing inequalities usually reach estimates showing a smaller number of large incomes and a greater number of middle-class incomes. The details of the calculations are of interest and importance for statisticians but are of little consequence for the purpose of a broad survey. The figures cited give a sufficiently truthful picture of the inequality in the distribution of income in advanced countries.

An entirely different basis for gauging distribution was used by Mr. Charles Booth. In his monumental researches on London, not being able to secure direct information about incomes, he resorted to the test—obviously a significant one—of servant keeping. There is a broad line of demarcation between the class without servants and that with them; and, in the latter class, subdivision according to the number of servants. It appeared that four fifths

[1] The estimates presented are derived from a study by Colin Clark, *The National Income, 1924–1931*, Macmillan & Co., Ltd., London, 1932. Mr. Clark bases his estimates on: (1) supertax statistics, (2) numbers assessed under the income tax, and (3) numbers applying for state health insurance in Great Britain and northern Ireland.

of the population of London (80.1 per cent), or 3,372,000 persons in all, belonged to the non-servant-keeping class. The upper or servant-keeping class numbered 476,000 persons, or 11 per cent of the population (the remaining 9 per cent of the population included the servants themselves, and inmates of hotels, lodging houses, and institutions, and others not readily brought within the scheme of classification). The upper class proved to be divisible into sections, according to the number of servants per household.[1]

	Number of Persons	Per Cent of the Population
Servant-keeping class total	476,250	11.0
Subdivided thus:		
a. Servants kept, 1	222,000	5.5
b. " " 2	144,000	3.4
c. " " 3	57,700	1.3
d. " " 4	18,800	0.4 } 11%
e. " " 5	13,300	0.3
f. " " 6	7,100	0.2
g. " " 7	3,000	0.1
h. " " more than 7	4,350	0.1
Class keeping no servants	3,372,000	80.1

On the basis of direct observation, Mr. Booth classified the population of London as follows:

	Number of Persons	Per Cent of Population
Class *A* (lowest)	38,000	0.9
" *B* (very poor)	317,000	7.5
" *C* and *D* (poor)	938,000	22.3
" *E* and *F* (comfortable, working) . . .	2,166,000	51.5
" *G* (lower middle)	500,000	11.9
" *H* (highest)	250,000	5.9

[1] *Life and Labor of the People of London,* Second Series, Vol. I, pp. 5 *seq.* (edition of 1903). For brevity I have described section *a* as keeping one servant, section *b* as keeping two servants, and so on. In Mr. Booth's careful analysis, section *b* includes some small families with but one servant, as well as large families with two servants; section *c* some small families with two servants, as well as larger families with three servants; and so on.

These figures serve to indicate the exception, intimated a few moments ago, to the statement that distribution has a completely pyramidal shape. It is pyramidal only until the very lowest tiers are reached. In those tiers numbers are not larger than in the tier preceding. Not the very poor but the comparatively comfortable working class constitute the largest single element in the population of London. Probably the same result, as regards the lowest class, would be reached if we had trustworthy information or indications on the distribution of incomes in other of the advanced countries, such as France and the United States.

§ 2. The situation as regards the distribution of ownership of property is essentially the same. One or two sets of figures will suffice for illustration. The British inheritance taxes have been carefully administered on the same basis for many years; not thruout with the same rates of taxation but in a manner to show for a long period what are the numbers of estates of varying sizes.

For the fiscal year 1934–35 we find that the following estates were probated: [1]

Small estates, of a gross value less than			£500	51,000
Estates of a net value from	£100	to	£1,000	33,585
" " " " " "	£1,000	"	£10,000	41,133
" " " " " "	£10,000	"	£25,000	5,669
" " " " " "	£25,000	"	£50,000	1,908
" " " " " "	£50,000	"	£100,000	858
" " " " " "	£100,000	"	£150,000	230
" " " " " "	£150,000	"	£250,000	159
" " " " " "	£250,000	"	£500,000	78
" " " " " "	£500,000	"	£1,000,000	21
" " " " " "	£1,000,000			14

From statistics like these it has been possible to estimate the approximate manner in which property is distributed among the entire British population. During the period 1924–30 about 22,340,000 persons in England and Wales are supposed to have controlled property rights to wealth. Their holdings are estimated to have been distributed in roughly the following manner: [2]

[1] From the *Statistical Abstract for the United Kingdom.*

[2] The estimates have been taken from the study of G. W. Daniels and H. Campion, *The Distribution of National Capital,* Manchester University Press, 1936. The figures are the approximate arithmetic means of the high and the low estimates prepared by the authors.

17,307,000	persons	had	property	of less than			£100
3,665,000	"	"	"	from	£100	to	£1,000
992,000	"	"	"	"	£1,000	"	£5,000
190,000	"	"	"	"	£5,000	"	£10,000
120,000	"	"	"	"	£10,000	"	£25,000
56,000	"	"	"	"	£25,000	"	£100,000
10,000	"	"	"	over	£100,000		

Ninety-four per cent of the property holders (those in the first and second rubrics) hold wealth valued at less than £1,000 apiece; and their combined holdings aggregate only 15 per cent of the total wealth of the country. The 6 per cent of the people who held more than £1,000 of wealth apiece possessed 85 per cent of the total wealth. That a large proportion of the wealth is concentrated in a few hands is seen even more strikingly in the fact that the wealthiest 2 per cent of the population hold 67 per cent of the total wealth.

The general situation is clear. In countries of advanced civilization those who possess any considerable amount of wealth are but a small minority of the population. The number of millionaires is very small indeed; that of the rich remains still small; the numbers become larger as the properties become less; the very least properties are the most numerous of all. The greater part of the wealth of modern countries is concentrated in relatively few hands. The richest 10 per cent of the people control a preponderant proportion of all valuable goods.

§ 3. For the United States we have usable figures on the distribution of income, tho we have none such on the distribution of ownership. The income figures are based, here as in European countries, chiefly on tax returns. The federal government has levied a tax on incomes since 1913 and in connection with the administration of the tax has published statistics showing the size and number of the several incomes on which the tax has been levied. Altho in the twenty-four years of experience with this tax the law has been strengthened to make very difficult evasion or avoidance in reporting incomes, statistics based on tax returns still furnish a somewhat imperfect picture of income distribution. Those who are required to report their incomes to the government are still able in some cases to avoid revealing the full extent of their incomes. More important, only a small proportion of the population is required to file tax returns at all. A very large percentage of the people have incomes small enough to exempt them from payment of the tax.

The statistics which are presented below therefore cover only a modest proportion of the population, telling us little about the nature of distribution in the working and lower middle classes. During the year 1935 approximately 45,000,000 people in the United States were recipients of income. Of this number only 4,473,400 filed income tax returns. If omission to file a return could be accepted as conclusive evidence, it would follow that all of the remainder (making no returns) had incomes less than the amount exempted.[1] Doubtless a considerable number of those not filing had incomes above that limit; how many it is impossible to say. But their number can hardly be so great as to alter the social significance of the recorded figures. Taking these figures for the 4,473,400 who were taxed, we find the following distribution: [2]

Incomes less than	$5,000			3,992,600
" from	$5,000	to	$10,000	322,800
" "	10,000	"	25,000	121,900
" "	25,000	"	50,000	25,600
" "	50,000	"	100,000	7,875
" "	100,000	"	500,000	2,475
" "	500,000	"	1,000,000	110
"	1,000,000 and over			40

Of those filing returns the 89 per cent who earned less than $5,000 per year received about 60 per cent of the total reported income, while the 11 per cent receiving above $5,000 a year obtained the remaining 40 per cent of the taxable income. These figures of course give no indication of distribution among the nine tenths of the people who paid no income taxes. While we must rely largely on estimates for an analysis of the distribution of income

[1] Single persons with incomes of less than $1,000 and heads of families with incomes less than $2,500 were not required to file income tax returns. All employees of state governments are exempt from federal income taxes.

[2] These figures are taken from *Statistics of Income for 1935—Preliminary Report of Income Tax Returns,* Bureau of Internal Revenue of the United States Treasury Department.

within this group it is fairly certain that much the larger number of those in it had incomes near or below the exemption limits.

In drawing inferences from such data as these, account must always be taken of monetary standards and of the ranges of prices and money incomes. Such qualifications are obvious. Others are less so; they call for the critical application of general economic principles.

It is obvious that when comparing income distribution and living standards in different countries, allowance must be made for international differences. In Great Britain the line between the well-to-do and the great mass of the population may be roughly drawn at £250, or about $1,250. This dividing line in America falls at a higher money income and probably at a higher income as measured in purchasing power. A British citizen with an income of £250 may consume fewer goods and services than an American who receives $1,500–$2,500 annually, but he has a roughly similar social status. As is indicated by the statistics already given, and as will appear more fully from others presently to be cited, the proportion of national income going to the well-to-do is larger in Great Britain than in the United States.

Another correction is of a less obvious sort. It bears on the interpretation of the money income and the social position of a class which is large in the United States and has no counterpart in Great Britain—the independent farmer. Millions of American farmers have incomes which usually are much below the well-to-do line and indeed seem to be below the average of working class incomes. I say seem to be; for the method of calculating the farmer's income requires explanation and raises questions. The price of the farm produce consumed by him and his family is reckoned as part of his income and constitutes a considerable item. The only way to measure its amount in money terms is to ask what price would this produce yield if sold by the farmer and *not* consumed by him? If his farm supply of butter, eggs, fruit, vegetables, poultry and meat (not to mention the rental of his dwelling) would have sold for $300, his direct money receipts should be supplemented by $300 in order to show his effective money income. But—and here comes the troublesome point—this extra $300 means much more in commodities, in "real" income, than the same sum means for the workman who dwells in a city. What the farmer could have sold at his farm for $300 would have cost the urban dweller much more—doubtless twice as much on the average. The spread between the price got by the producer (using that term in the everyday sense) and that paid by the consumer is a standing source of wonder to economists; it is perhaps largest for farm products of the kind here under consideration. When judging of the farmer's income, then, we must apply a factor of correction similar to that needed in international comparisons. Tho the money income of an American mechanic be twice as high as that of an English one, and thrice as high as a Frenchman's, his real income is by no means higher in the same degree. Similarly, tho the American mechanic's money income be 50 per cent larger than that of the American farmer, the real income of the two may be substantially equal. These are matters to which little regard is paid in popular discussion, least of all as regards comparisons within a country. They illustrate the need of discrimination in the use of statistics, especially of statistics which purport to give the total of a people's income and the division of that total among different strata.

§ 4. Another question is whether inequality is becoming greater or less; whether it is true, as often alleged, that the rich are becoming richer and the poor poorer. Here again we have not much precise information. But the general trend of such data as we possess indicates that while the rich are probably growing richer, and certainly not less rich, the poor are not growing poorer.

A careful comparison made for Great Britain for the years 1880 and 1913 showed that during this interval (about a generation) the average incomes of the wage-receiving classes had risen 45 per cent, those of the well-to-do classes (having incomes above the sum exempt from income tax) 30 per cent. In that period the absolute number of the prosperous had nearly doubled, while the number in the wage-receiving class had risen by less than 25 per cent.[1]

This tendency toward the betterment of the working and lower

[1] See the analysis by A. L. Bowley, an admirable example of statistical technique, *The Change in the Distribution of National Income, 1880–1913* (1920).

middle classes is apparently continuing. From 1911 to 1931 the share of the British income received by non-wage earners (chiefly landowners and capitalists) declined from 45 per cent to 33 per cent of the total. The major part of the share thus surrendered by the well-to-do went not to the wage earners, whose proportion of the income changed only slightly, but to the recipients of salaries. These salary earners, a class intermediate between those receiving a considerable income from property and the receivers of wages, were growing in numbers and in importance. Since 1911 their share of the national income had more than doubled, revealing a tendency for a larger part of the population to ascend to the levels of the intermediate and prosperous classes.[1]

Further light is cast on changes in distribution by statistics of wealth. In the holding of property as well as in the receiving of income there has been a tendency for the poorer class in Great Britain to improve its position. Whereas in the years 1911–13 only 13 per cent of British property holders possessed wealth in excess of 100 pounds, by 1930 fully 23 per cent of them had 100 pounds or more. In the twenty-year interval the proportion of the people holding estates worth between 100 pounds and 1,000 pounds had nearly doubled.[2] The significance of these figures, it must be said, is by no means certain, if only because of monetary and price changes. So far as they go, the indication again is that the relative position of those in the lower income groups is becoming better.

For the United States we are less informed about the trend of inequality—whether it is becoming more or less—than about the existing situation. But we are able to identify certain general tendencies. In the twenty years between 1910 and 1930 the product per capita in American industry increased rapidly and this increase was shared both by employers and by wage earners. The real wage of the typical wage worker increased in the neighborhood of 30 per cent. On the other hand, the numbers of the very rich rose markedly.[3] The net result of the changes seems to be that inequality has not become greater and may have been appreciably

[1] Colin Clark, *op. cit.*, p. 72.
[2] Daniels and Campion, *op. cit.*, p. 30.
[3] National Bureau of Economic Research, *National Income*, Vol. XV, p. 152.

lessened. The fact that the wage-earning class has steadily increased its proportion of the total national income may indicate a tendency that as industry increases its product the workers receive a larger and the employers a smaller proportion of the resulting benefit. Whatever may be one's surmise as to the general significance of the changes which appeared in the United States, the main lines seem to be similar to those in Great Britain, a country with roughly similar industrial characteristics.[1]

§ 5. Such are the broad facts as to inequality. How are they to be explained? and how, if at all, to be justified?

The causes of inequality are reducible to two: first, inborn differences in ability; and second, the maintenance of acquired advantages thru environment and thru the inheritance of property. The origin of inequality is to be found in the unequal endowments of men; its perpetuation in the influence of the inheritance both of property and of opportunity, and apparently in some degree in the continuing influence of native ability transmitted from ancestor to descendant.

No doubt at the outset all inequalities of position and possessions arose from the inborn superiority of some men over others. The savage chief excels his fellows in strength and in cunning. Thruout history the strong and able have come to the fore. They continue to do so in the peaceful rivalries of civilized communities. In our present society the differences in wages—that is, in the incomes from all sorts of labor—are the results, in large degree at least, of differences in endowments. The striking case in modern times is that of the business man. Especially in the upper tier of this group, high native ability goes farthest toward explaining the exceptional earnings of the fortunate few among the business class. In other occupations, while training and environment count for much, inborn gifts are still of dominant importance in explaining the very largest incomes from labor.

At a very early stage in the development of society this original

[1] Figures on income and wealth in Germany were given in the earlier editions of this book but are now omitted because the anomalous conditions of that country in the post-war period make comparisons meaningless. Until 1914 the statistics showed a situation not essentially different from that in England and in the United States.

cause of difference is modified, often thrust aside, by the perpetuation of established advantages. In the feudal system, and in any society organized on a basis of caste, inequality is maintained by force of rigid law. In the supposedly free and competitive society of modern times, the advantage still tends to maintain itself. It does so in two ways: thru the influence of environment and opportunity, and thru the inheritance of property.

Environment and opportunity have already been considered.[1] Tho it is not certain how far social stratification rests on factitious advantages, how far on the inborn moral and intellectual qualities of the several classes, it is clear that the artificial causes play a great part. A multitude of forces tends to keep a person in the social grade of his parents. Only those of exceptional gifts rise easily above it and only those of exceptional defects fall below it.

More important is the direct inheritance of property. Its influence is enormous. It is this which explains the perpetuation of the incomes derived from capital, land, income-yielding property of all sorts, and so explains the great continuing gulf between the haves and the have-nots. It serves also to strengthen all the lines of social stratification and to reënforce the influences of custom and habit. Persons who inherit property inherit also opportunity. They have a better start, a more stimulating environment, a higher ambition. They are likely to secure higher incomes and to preserve a higher standard of living by late marriages and few offspring. The institution of inheritance promotes social stratification thru its indirect effects not less than thru its direct.

Nothing illustrates so fully the combined influence of inborn gifts, of property inheritance, and of perpetuated environment, as the position of the person dominant in modern society—the money-making business man. In the first stages of any individual business man's career the possession of means counts for much. After the initial stage native ability tells more and more. By whatever ways he gets his start, the leader of industry prospers and accumulates; and as he accumulates is again favored more and more by large possessions. When he dies he leaves a trail of descendants, who perhaps inherit ability and almost certainly inherit property.

[1] Chapter 52.

With property they inherit a new environment and new opportunities. It may indeed happen that the property will be dissipated thru lack of thrift or judgment, or subdivided among heirs into minute portions. But neither of these results is probable; and even if they occur the descendants have ambitions and surroundings very different from those of the poorer class from which the ancestor may have sprung. In every way inequalities, even tho they arise at the outset without favor, tend to be perpetuated by inheritance and environment.

§ 6. What can be said in justification of the inheritance of property, which acts so powerfully to maintain inequality?

Inheritance arose historically from the sense of the unity of the family. The ancestor in early times was not so much the immediate owner of the property as the head and representative of the family which owned the property. Its devolution to the surviving members was no change of ownership but a transfer to new representatives of the continuing owners. But this explanation of inheritance, tho historically sufficient, serves little to explain the institution as it stands now, still less to justify it. The ground on which inheritance is now to be defended must be frankly utilitarian. It is that in a society organized on the basis of private property, inheritance is essential to the maintenance of capital.

It may be open to question how far inheritance is necessary for the first steps in accumulation. The motives that lead to money making and to the initial stages of saving and investment are various; not only the safeguarding of the future for oneself and one's dependents but social ambition, the love of distinction, the impulses to activity and to domination. For sustained accumulation and permanent investment, however, the main motives are domestic affection and family ambition. The bequest of a competence or a fortune, tho often a dubious boon for the descendants, is a mainspring for its upbuilding by the ancestor. If we were to put an end to inheritance, decreeing that all estates should escheat to the public at death, the owner would commonly dissipate his property. One of the motives for its acquisition would be gone and certainly the chief motive for its maintenance. Why accumulate and invest for the benefit of the community at large?

This is the ground for maintaining that the taxation of inheritance should be kept within limits. As will appear later, the transfer of property at death gives a convenient occasion for the levy of taxes and for the application of progressive rates.[1] But such taxes tend to trench on capital. Unless kept within moderate limits they are paid out of the principal of the estate, not out of income; and this lessening of the individual's "capital" presumably leads to a corresponding lessening of social capital. More than this, the higher they become and the nearer they approach confiscation the more probable it is that the original accumulation of capital will be checked.

§ 7. It does not follow that inheritance should be unrestricted. Some limitations can certainly be imposed which do not affect the essential efficacy of the institution. Others, tho they may lead to a curtailment of capital, may bring countervailing advantages. By lessening inequality they may bring social gains outweighing the material loss.

There is no reason why intestate succession should proceed indefinitely to the most distant kin. Where a man does not trouble himself to make a will it may fairly be presumed that his property was not got together with an eye to distant heirs. Neither his accumulation nor that by others will be checked if the public appropriates a great slice, even the whole, of such windfalls. On similar grounds it is justifiable to make succession taxes heavier as the degree of relationship to the decedent, whether testate or intestate, becomes more and more remote.

A different proposal, and one having a different object, was made long ago by John Stuart Mill: that the amount transmissible to any single heir or devisee be limited. Let a maximum be fixed which a person can acquire by devise or inheritance or by donation *inter vivos*. The sum might be fixed at a million dollars or much less or something more; the precise amount would depend on the degree to which prevailing public opinion had become impatient of persisting inequality. Subject to this important limitation the successful money maker would be free to dispose of his property.

[1] See Chapter 70, and in general what is said in Chapters 69 and 70 on Progressive Taxation.

He might divide it among many recipients or erect a monument for himself by large gifts for public purposes. Left in command over his fortune to this extent he might refrain—so the proponents expect—from dissipating it during life. The accumulation of capital would not then be checked. But the devolution of very great fortunes and the perpetuation of an upper crust of plutocrats would be prevented. The greatest and most glaring of inequalities would come to an end.

The ground here is uncertain. It is true that the money-gathering motives, strong in themselves, would still be stimulated by the liberty to dispose of unlimited means in some way or other. Yet the restriction of the amount transmissible to immediate descendants might often operate to promote reckless expenditure during the owner's lifetime. We should have to fall back on the reflection that extreme inequality of permanent possessions is not only an ill in itself, inimical as it is to the largest possibilities of well-being, but is commonly dangerous for the supposedly fortunate beneficiaries. And there is the further consideration that what might be lost to capital thru this reckless expenditure might readily be made up from the growth of accumulation elsewhere. It has been remarked [1] that the forces that make for accumulation and savings proceed apace in modern societies and seem likely to provide in abundant and even superabundant measure the wherewithal for the upbuilding of their material outfit. Tho a few great properties might be less than their conceivable maxima, the great bulk of savings would go on as before and in the aggregate probably would provide enough. The loss would not be greater than society could afford.

§ 8. More radical in character and calling for quite different measures in their execution are proposals looking to the complete appropriation of devised property by the public after the lapse of a couple of generations. A novel and ingenious scheme is that of an Italian writer.[2] Successive stages of levy are suggested, to apply to everything above a decent or reasonably exempt minimum.

[1] See Chapter 39.

[2] E. Rignano, *Un socialisme en harmonie avec la doctrine économique libérale* (1909). The French version is the only one I have seen. The proposal is explained and considered by H. Dalton, *The Inequality of Incomes*, Chapter IX.

Let one third of the property (i.e. of the excess over the minimum, the "taxable" amount) be taken by the state on the first devolution; another third on the second devolution; the remainder on the third and last. The owner (testator) might dispose of as great an aggregate as he pleased and to as few or as many as he pleased. After the first devolution and presumably during the first generation most of the property would still remain in the hands of the beneficiaries. A smaller part would remain to them in the second stage, and finally in the third (or fourth or fifth, according to the stages selected) everything would go to the public. The assumption is that the testator is more concerned about his children than about his grandchildren and progressively less concerned about remoter descendants. So long as most of his property can go to those whose prosperity he has at heart he will keep it intact. Abrogation of the privileges of distant descendants will not influence him.

It is a variant of the same line of thought, involving the same questions of principle, when it is suggested that nothing but a series of life interests be allowed to pass by inheritance. Let the testator dispose of the income of his property as he pleases for two, three, four lives—as many as really signify to him. Thereafter the public is to take everything.

Of all such schemes it is to be remarked that they necessarily lead at an early stage in their operation to control and even management of the property by a public authority. They might succeed in keeping in operation the forces that led the original money makers to build up the large properties. But evidently there is nothing in them to induce the successive beneficiaries to maintain the properties intact. The several inheritors, and especially the last in the series, would be tempted to dissipate what was left in their hands. The state must keep control over the principal in order to make sure that it remains unimpaired. Unless this were done the probabilities are overwhelming that the capital sums in the hands of the individuals would waste away.

It is not at all unthinkable that the state should see to it that there is no such wastage. A public office might be created, charged with the administration of the subject estates. It could pay to the several beneficiaries annual incomes according to their ordained shares. It would gradually become the owner of a greater and greater mass of property, which could be put thru loans at the disposal of the managers of industry. Private management might conceivably persist under such an arrangement and the accumulation of large properties, even of fortunes, might still go on. But there would be an end to the quasi-automatic perpetuation of the wealthy leisure class thru the centuries.

A proper public office—this is the essential. There would have to be a staff of able, high-minded, permanent officials, a vast and elaborate organization completely separated from the ordinary financial operations of the government. And here we face the difficulty which confronts us in every proposal for social betterment. Is the public equal to the proposed tasks? Has it the needed intelligence and self-restraint? Is there good ground for expecting that great funds coming into the hands of public officials will be well handled? The history of public finance gives little encouragement. Capital sums which come into the hands of the state are usually "borrowed" by the state itself. They are turned over to some department or bureau and then spent. The money sums are dissipated; no permanent material gain accrues, still less any spiritual gain. It is easy to conceive how they *might* be advantageously spent by the bureau to which they are assigned, for useful public works, needed housing projects, great educational facilities. But it is far from easy to prevent their dissipation in the ordinary course of public expenditure. The public treasury is like an individual. What an individual earns by hard work he is likely to watch with care, to conserve, to invest. What comes to him thru windfalls he will probably spend with little thought. What the public treasury gets by methods that seem to be burdenless, and which at the moment are in fact quite burdenless for the great majority, is apt to be thoughtlessly applied to any and every project. The sums secured thru taxation which is felt to be burdensome will be applied much more critically and wisely. In both cases, gains easily got are quickly spent.

And even if the sums secured by the gradual appropriation of inherited property were rigorously maintained for investment.

how wise is that investment likely to be? The American business man would shrink with horror from the prospect of a vast public bureau, virtually a loan bank, making advances by millions and billions to borrowers singled out by elected or appointed officials. Not merely the economic problems and economic possibilities have to be considered but the far-reaching questions concerning the character of the community, its ability to reject demagogs and to enlist good public servants, its intelligence in holding fast to good policies and good legislation.

This sort of problem and this sort of doubt face us in every direction. The problem is one of the capacity of a democratic community not only to govern itself within the range of the traditional functions but to perform with success functions much more varied, more complicated, more exacting. It is easy to state attractive general principles; it is very difficult to devise the machinery and organization for their execution in detail; it is most difficult of all to assure the public intelligence and public spirit which alone can supply the motive power for successful operation.

There is little prospect that limitations on inheritance at all so revolutionary as discussed in this section will be applied in the near future, just as there is little prospect that the framework of the institution of private property will be completely made over. What is more probable is a further extension of the principle of progression in the taxation of inheritance, a cutting down of great fortunes by this process, some new and troublesome problems of public finance. Not least, there will be a tendency to curtailment of the community's capital, compensated by the net social gain thru the mitigation of inequality and offset, certainly to some degree and quite possibly to the full, by the growth of capital thru the ordinary channels.

§ 9. What now of the ulterior question—the basis of the whole régime of private property? Something may be said on this topic here, even tho the consideration of the closely related topic of socialism is postponed to a later stage.[1]

The theory that property rests on labor and therefore on what is conceived to be the "natural" right of each man to that which he

[1] See Chapters 67 and 68.

has produced has gone into the lumber room of discarded doctrines. It was elaborated by Locke, accepted more or less thru the eighteenth century, and used freely by the English economists of the first half of the nineteenth century. But it plays little part in modern discussion. "Natural" rights have quite gone out of fashion. Where there is a highly complex division of labor, such as characterizes existing society, it is impossible to distinguish how much any one individual has contributed to the whole output—to say, this is his specific output, therefore rightly his. Even if it were possible so to distinguish, no natural or inherent right would thereby be established. Least of all is it possible on such reasoning to justify inheritance. As the institution of inheritance can be sustained only on a basis of utilitarianism so can that of property in general.

The utilitarian reasoning may be summarized as follows: Men will not labor steadily and effectively except in their own behalf. Labor is irksome, the sense of common interest weak. Labor will not be exerted continuously and vigorously except for individual benefit. It is strenuous and well directed in proportion to the expected return.

This is the crux of the whole matter. If it be believed that the sense of common interest is deep and keen, that most men will be actuated by a strong motive of service for all their fellowmen, that they will be as active in promoting the well-being of distant strangers as of their kith and kin—then one's attitude toward all social and economic problems becomes fundamentally different. The truth, in my own view, is that tho men are neither exclusively self-regarding, as the extreme hedonists assume, nor imbued with a motive of service at all adequate as an impelling force for sustained productive labor, they are much nearer the first extreme than the second. How great are the possibilities of modification in human traits thru education, environment, a finer pervasive social atmosphere, we do not know nor need we here speculate. It may be granted that the possibilities are considerable; but they will develop slowly. Men are now actuated in the ordinary course of their daily work chiefly by those motives of narrower range which we call self-regarding.

Inequality arises even under the simplest conditions from the unequal endowments of men. It becomes accentuated with the growing complexity of the division of labor. Where there is no division of labor every man is led to do that which brings to him for his own uses the largest direct return to labor. In a varied society he is led to do that which brings indirectly the largest return; that which others value highly and for which they will pay highly. Competition and self-interest thus promote not only the vigor of labor but the effective organization of production. Above all, as the industrial situation becomes complex the middleman appears—the employer, merchant, banker; indispensable figures for the progress of industry. Inequality becomes more marked as increasing complexity gives play to very varying abilities. Whether resting on differences of inborn gifts or on the developing differences that arise from acquired advantage, inequality remains a spur to the full exercise of each man's capacities.

Wide variations thus arise; in earnings, possessions, available surplus. The essence of capital is surplus.[1] Accumulation takes place by many individuals and surplus means are utilized by those who see time-using ways of directing labor with effect. Sustained accumulation and investment on a large scale will not take place unless there be an inducement. The phenomenon of interest on capital appears. Not less than interest, inheritance, whatever its historic origin, operates as a stimulus to the saving of private means and the increase of social capital.

So the leisure class emerges—the result of inequality, accumulation, interest, inheritance. The immediate effect of idleness on the part of a fraction of the community is obviously that the great mass work not only for their own maintenance but for that of this privileged fraction. On the other hand, the prospect of being a member of the leisure class has proved a wonderfully powerful bait to effective exertion and permanent investment. False as the ideal of exemption from labor seems to the intellectual few, and doubtful as may be the happiness of those born to a life of leisure, the hope of privileged position for one's self or one's kin has been a main motive force for the material progress of society.

[1] Compare Chapter 5.

Property in land is part of the mechanism for stimulating effective labor and effective investment. Production cannot be carried on without land; all plant must be established on a site. Full title and ownership to land have been indispensable to the growth of capital. Such unqualified property right may not be essential in an ideally constructed society, and the possibilities of restriction in existing societies may be greater than is commonly supposed; yet, historically, absolute private title to land has been the sure means of securing its effective use. Thus rent develops as an element in distribution, in part intermingled with return on capital beyond possibility of discrimination and in any case a persisting outgrowth of the system of property.

§ 10. The reasoning of the preceding paragraphs, followed without flinching and without qualification, would lead to the conclusion that desert on the part of members of the leisure class is not necessary to justify the existence of the class. Its position of ease and comfort is a bait to stimulate ambition and accumulation. Direct service by the survivors and descendants of fortune founders would seem to be immaterial. Yet the current notions of justice, vague tho they are, connote some closer relation between service and reward; and the question persists whether the personal qualities of the privileged and their immediate contribution to the common welfare must not be considered in any judgment on existing inequality.

The question is answered in the affirmative by many thinkers,[1] who hold that there must be a continuing service from the class as a whole, if not from each and every member. It is pointed out that tho the origin of inequality is to be traced to the unequal endowments of men, it is to be sought also in varying services. In the earlier stages of developing stratification, social classes—whether priestly or feudal or industrial—sprang up because some individuals were in a great measure serviceable to the general body. Not merely predatory strength and cunning but abilities exercised in a manner to advance the common good or safety explain the universal differentiation of society. But during the later stages,

[1] See, for example, Schmoller, *Volkswirtschaftslehre*, Vol. I, pp. 409–411. Compare Paulsen, *Ethik*, Book IV, Part III, Chapter III, § 3 (p. 713, ed. of 1889); and Dewey and Tufts, *Ethics*, Chapter XXIII, §§ 1–3.

when the superior classes have attained an established position of privilege, it becomes doubtful whether ability and service are maintained and whether the justification of inequality stills holds.

Such questions go to the foundations of the theory of ethics. On strict hedonistic principles it may be consistently maintained that personal desert is immaterial. The coolly calculating economist may accept the idle rich as inevitable adjuncts of a system which is itself founded on the intellectual and moral limitations of men and he may leave their way of life to the preacher. I will not undertake to say what are the final criteria of justice for individuals or for society; but it is certain that any justification of inequality and of all its consequences becomes more effective when the leisure class is of service directly as well as indirectly. Tho the mere existence of a capitalistic aristocracy operates to spur ambition and to conserve capital, its position is immensely stronger if the individual members contribute actively to the general well-being, thru continued industrial leadership, thru the advancement of science, literature, and art, thru public service.

Whether contributions of this sort will, in fact, be rendered depends not only on ability (and this again on heredity) but on the public opinion of the privileged class and indeed of society at large. It cannot be said that the habits and ideals of the rich give great promise.

> Rapine, avarice, expense,
> This is idolatry; and these we adore.

Nor are the ideals of the great mass of the people essentially different. They are not at heart censorious of the rich but rather envious and ready to imitate bad ways. How far the spread of better education and the democratization of society will affect the prevailing ideals, it would be rash to predict. Something is gained if the situation is laid bare; and herein the growing attention to economic and social subjects promotes improvement. A wide-spread understanding of economic principles, of the broad facts of social stratification, of the singular position of the privileged few, of the public loss from useless lives, of the fallaciousness and emptiness of the talk now common on social subjects among the well-to-do—

such knowledge may do something to spur the fortunate to lead less empty lives. Certain it is that the opinions of most persons, and especially of those imbued with some sense of social obligation, will be affected by the immediate and visible contributions which the members of the leisure class may make to the general good.

CHAPTER 57

GREAT FORTUNES

§ 1. The development of large-scale production and the growth of numbers have been the fundamental causes of the growth of great fortunes.—§ 2. The scarcity of high business ability explains great fortunes accumulated out of business profits.—§ 3. Influences of a different kind appear in urban site rent, the exploitation of rich natural resources, monopoly gains. Unearned and fortuitous fortunes.—§ 4. Unearned gains are mingled inextricably with earned.—§ 5. Large fortunes as a spur to productive activity. The building of plants and of fortunes out of accruing profits.—§ 6. The need of better direction of economic and social forces.

§ 1. GREAT fortunes are among the conspicuous phenomena of modern times. In very recent days they have become portentously great. Thru most of the nineteenth century a millionaire was reckoned the possessor of a great property; but within the last generation multimillionaires have become common. Accumulations of ten, twenty, fifty, even hundreds of millions are familiar—not many, but much talked of. True, standards have changed. Allowance must be made for the depreciation of money; the five millions of 1930 mean no more than the million of 1890. Properties of all sizes, from small thru moderate up to great, have multiplied and the average has probably become larger. But when all is said, the number and the size of the very large fortunes set us aghast. How explain them and what of good or evil find in them? It is the first of these questions, explanation and analysis, that will be chiefly considered in the present chapter; the larger one of weighing the balance for and against will engage our attention further as we proceed.[1] And much of what is now said must be in the nature of summary and amplification of the preceding discussion of distribution at large.

Fundamental among the causes of great fortunes is the development of large-scale production. Manufacturing, trading, transportation, have been conducted since the Industrial Revolution on a scale never before known and with opportunities for profit never

[1] See Chapters 67, 68, on Socialism.

before known. Hardly less important has been the growth of numbers. In the civilized countries population took a great burst during the nineteenth century. Unprecedented numbers of people were supplied with steadily greater abundance of goods and the capable or fortunate leaders and innovators took their toll. These general movements, so familiar and long-continued as to be taken usually as matters of course, underlay the growth of the great fortunes.

Following the scheme of distribution which has been elaborated in the preceding chapters, the causes of fortunes may be classified more in detail as derived from one or the other of the following sources: business profits; economic rent; monopoly gains; illegitimate or predatory profits. Each of these may be taken up in turn.

§ 2. Simplest of all is the case where a fortune has been accumulated out of business profits. It is a common case. Every day we see large profits and large accumulations in the strictly competitive businesses. Such are any number of manufacturing industries —shoemaking, textiles, pots and pans, shirts and neckties. Sometimes the making of an apparently insignificant article, a small specialty, becomes the basis of a fortune: when the article can be sold to tens of millions of customers there is the opportunity for large turnover, for the economies of large-scale production, for profits great in the aggregate tho small on each item. Mercantile operations belong in the same class. The modern jobbing firm can cover a vast territory and reach an immense number of people. Often merchandising has been supplemented with manufacturing. Retail merchandising became a large-scale industry in the cities during the nineteenth century; and the same trend showed itself dramatically in rural as well as urban regions in the twentieth century with the growth of the chain stores. A distributing business once established with its circle of habitual customers, sets up a manufacturing adjunct and combines the profits of the two operations. Some older fortunes got together in this sort of combination are supposed by their inheritors and present possessors to have a reputable flavor not attaching to properties perhaps of larger size but of new-fangled origin. Banking is another field of the kind often regarded as more distinguished. Here too there are pure banking firms and, on the other hand, some that have linked their fortunes intimately with manufacturing or mining ventures.

The characteristic features of fortunes of this sort are that they are secured under the conditions of open competition, that they are essentially due to ability and efficiency on the part of the founders, that they may be fairly said to be earned. No restraint on competitors, no monopoly privilege attaches to them. The field is free for all; there is an unending procession of new entrants, constant withdrawal of fortunes, constant making of new ones. True, when once a large concern has been set going it keeps on for a time by mere momentum. Prestige, established connection, brands, trade-marks, enable profits to roll up thru an apparently automatic process. This is particularly the case, as we have seen, with banking operations; it is hardly less so with manufacturing enterprises. But in the end the master mind must be there; if not, the business begins to run down. The founder and owner may absent himself for weeks and months and things go on as well without him. But the very fact that they do so shows how well he has built and organized. This sort of care-free management never is possible in a budding enterprise. The death or definitive retirement of the founder sooner or later leads either to decay of the business or to the passing of control to new and again capable hands. It is the scarcity of high business ability that explains the fortunes; and it is this which, under the canons and presumptions of private property, justifies them. Under the existing economic and social régime the purpose and the trend are that reward shall be in proportion to efficiency; and the ground of justification for a high reward is that it stimulates efficiency. Certain it is that the bait of a fortune has been a tremendous incitement to enterprise, energy, persistence, the manifold improvements in the arts which have made the possibilities of production what they are in the modern world. Whatever be one's belief on the need of this sort of motivation for the future, no sober observer, no thoughtful socialist, can question that it has been powerful in the past.

§ 3. Questions in many ways different are raised by the fortunes accumulated under non-competitive conditions.

Such for example are those derived from rent in its most conspicuous form—urban site rent. Reference has already been made to the extraordinary windfalls which some ducal families in England pocketed when leases of London sites fell in. Not dissimilar have been the fortunes of such American families as the Astors, who also profited marvellously by the growth of urban population and the accretion of urban rent. In most countries, certainly in the United States, this particular form of gain has been diffused thru many hands; yet in plenty of cases it has left great amounts in the possession of individuals and families.

Analogous yet not quite the same have been the fortunes resting on such natural resources as ores, forests, oil. They are not quite the same because here we have more of the elements of investment, deliberate development, enterprise, risk. Usually it would be difficult to say precisely how much of a fortune derived from these sources is earned, how much unearned. But of the latter sort there have been plenty enough. Above all, the volume of the gains has been enlarged by the exploitation of rich natural resources. Unexpected growth of population, unexpected improvement of transportation, unexpected advances in the arts have caused mines and forests to yield surpluses of gain far beyond what the early proprietors could have expected and far beyond what could by the utmost stretch be imagined as necessary to induce their full development.

Next among the fortunes due to non-competitive conditions are those from monopoly. So far as resting on a patent or like legal protection they may be said to be earned. The law here expresses the deliberate conclusion of the community that prizes are needed to evoke invention. But the control of great industries which has resulted from the sudden growth of large-scale production and the concentration of an entire industry in a few huge establishments, perhaps a single one, has given rise to surpluses far beyond those of competitive businesses. In essentials the public service industries, so called, belong in this class; it is the technical advances which have led to operation on the great scale in railways, gas, electricity, and so to single-handed control and to monopoly gains.

In a third class, a sort of *omnium gatherum,* may be placed a series of fortunes having varying degrees of demerit but all alike in that there is no connection, or but the remotest, with operations useful to the community. Sometimes there is plain violation of existing law, as when great tracts of timber land are filched from the community by fraud or forgery. More often in cases of the fraudulent kind there is nominal compliance with the law but violation of its spirit and connivance with semi-corrupt officials. Tainted in the same way by unmistakable fraud are the fortunes secured by stock-jobbing speculators who gamble with loaded dice: insiders in a great corporation who play the game against the outside public in violation of fiduciary obligations. Here as in the case of timber thieves there is plain violation of law, no pretense that the canons of the existing system have been observed. Speculative dealings not of this tainted sort have already been considered; [1] they are not wholly devoid of advantage to the public but the price paid by the public must be admitted to be high when the twists and turns of trade land a million or millions in the hands of a daring adventurer. Again, fortuitous gains like those which are bred by a great war are not to be readily associated with activity that promotes the general good. And some ventures of peace which rest on the deliberate use of mendacious advertising belong in the same dubious class.

§ 4. The puzzling thing is that thru their whole range the unearned gains are mingled inextricably with those that are earned. Business profits of the sort that may be termed legitimate and even honorable are intermingled with the doubtful and disreputable gains. It has been remarked in a preceding chapter that men who are extraordinarily different in other respects may be alike in possessing high business capacity. A man may be a land swindler or stock-speculating railway manager and none the less have the business virtues—enterprise, vigor, judgment, organizing power. And even where there can be no reproach on the score of lack of probity there are gains not to be described once for all as earnings. Such are those arising from the seizure of natural resources and of unearned increments. The same qualities that make a man a good business leader make him a good business chooser. He has a keen eye for the economic possibilities. He judges shrewdly of mines,

[1] See Chapter 11.

timber tracts, oil, urban and suburban sites. Social institutions as they stand—the law, the accepted canons of conduct, the pervading attitude toward money getting—invite him to pick up the most he can find. At the same time, his skill and management are essential toward making the best of that which nature offers. How discern what is ascribable to his judgment and his management, what to nature's gift? It is easy to see that often the final fortune is greater than can be reasonably ascribed to the special effectiveness of the man's labor; but it is immensely difficult to draw the line.

Another circumstance promotes quasi-automatic accumulation and gives to him who hath. The prospering business man can wait. Midway in his career, when he has reached the stage of large means and large credit, he looks about for ventures outside of his first and more immediate business. He foresees what the future will bring; he buys cheap lands, cheap mines, cheap stocks; and then—to use the jargon of business—he *sits* on them. In time his foresight will be justified by the event; not without fail, for there are risks and disappointments in these ventures; but the far-seeing and discriminating in the end reap ample return for their patience and acumen. Nothing so well illustrates all the complications of fortune building as the history of American railways during the nineteenth century. Here we see able management, brilliant enterprise, speculative ventures, shrewd pickings, dishonest filchings. A great continent was opened, an unexampled system of transportation created. Extraordinary natural resources were uncovered; railway units of prodigious size built up; railway management of a special type and special effectiveness developed; consolidation was carried out and immense power, approaching monopoly, acquired by the railway kings; thru it all increasing speculation on the stock exchange, gambling by the multitude, shrewd purchases at bargain prices by the able and fortunate few, more or less of inside management and filching. The same round—not quite the same but of the same kind—was repeated in the late growth of the great industrial combinations and trusts. A like extraordinary jumble and a like climax—an array of conspicuous fortunes.

§ 5. What grounds there are for justifying large fortunes has been sufficiently indicated in the preceding pages. These prizes are a potent spur to productive activity; they promote new enterprises and improvements in the arts, lead to the increase of capital. Money making is part of the individualist system. That system such as it is, good or bad on the whole, likely to endure or certain to disappear, stands; and in it and in its forward movement the potentiality of fortune building is imbedded. Great advances in the arts of production are to the common interest. The public has been unable to achieve them for itself—why, it concerns us not here to inquire further. So long as reliance is placed on private initiative and individual gain wide disparities in earnings will persist and great fortunes will emerge. And as has been more than once said in these pages the accumulation of savings and the increase of capital are promoted by some measure of inequality. *So great* a degree of inequality as exists, so many and so great fortunes, are not indeed indispensable. But the plain fact must be faced that without marked inequalities in earnings and possessions the material progress of the modern world would not have taken place; nor is there any clear indication that this condition of progress can be dispensed with in the future.

The building up of great plants and great enterprises out of the net gains of a business is one phase of this matter of the increase of capital in connection with large fortunes; and it illustrates the complexities of the whole problem.

The stout defenders of things as they are often depict this process as if the owners of the properties were not getting their profits at all— as if they never got them. It is often suggested, too, that the procedure is really an altruistic one: the surplus is set aside for the public benefit. And there is a modicum of truth in all this. The owners in fact are not getting the whole income, at least not for the time being. They are setting aside part of a potential income and saving it, not enjoying it. There has been occasional debate among economists whether savings are income and the sound conclusion is that fundamentally they are not. In the last analysis, income is what is enjoyed or consumed; that which is set aside and invested is no part of current income. Further, it is true that a public benefit accrues from investment. The building up of the community's material outfit promotes the common good. It may be said, too, that the building up of plant out of accruing profits is in a special sense advantageous. In this way only is the growth of many a great productive unit possible. New and untried industries, enlargements and technical advances of a novel kind, take place most commonly in just this way. Funds for them cannot be readily secured by public subscription. "Outside" investment is attracted only after some proof of success has already been given. The process of putting earnings back into the business does mean that great efficient establishments are enlarged and the cheap and abundant production of goods promoted.

But the eventual outcome is the emergence of a fortune, perhaps a colossal fortune. In the end the owners do get the benefit of their earnings. Talk about their altruism may be swept aside. The plant at last is capitalized for all that has been put into it, very likely for more: the melon is cut. Often it is the descendants of the founders who reap the final harvest. It boots then little to inquire in just what way the saved earnings and surpluses of a past generation were secured—whether by sheer ability and efficiency or by such qualities mingled with intrigue, trickery, dishonesty; how far due to deliberate planning, how far the mere result of growing population and wealth. It is impracticable to make a separation and it is too late to undo thru any sort of expropriation the laches of the past. There the fortune stands, a warning that a repetition of this tortuous round must be guarded against for the future and a problem of its own for the present; at the moment, nevertheless, a persisting part of the social structure.

§ 6. The objectionable aspects of large fortunes are more obvious than their causes and the possible grounds for justifying them. The evils center about inequality and most of all about that sort of inequality, the result of the institution of inheritance, by which a few live in conspicuous luxury and idleness. Princelings and ducal personages were thought by the protagonists of the modern industrial system to be peculiar to the outworn system of feudalism and privilege. Precisely such puppets emerge under the "simple and obvious system" of natural liberty. No stretch of psychological analysis concerning the spur of ambition, the spice of constant emulation, the staleness and flatness of uniformity, can prevail against the universal conviction that the maximum of human happiness is not promoted by great, glaring, permanent inequality. The readiest immediate means of meeting this situation is heavy taxation on the inheritance of great fortunes: the carving out of large slices for the public as transmission takes place on death. But this is not an entirely simple matter. It raises one of the many problems concerning the working of the institution of property. Of these more will be said shortly; [1] for the present we are concerned chiefly with the bare analysis of the situation. Great fortunes and their causes illustrate better than any other single aspect of modern life how disordered is its movement, how unconscious it is of any goal, how disturbing are its phenomena. Nothing raises more difficult questions, nothing shows more plainly the need of girding ourselves for a better direction of the economic and social forces.

REFERENCES ON BOOK V

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[1] See Book VII.

pression (1939). Somewhat similar but limited in scope to a survey of the literature, the theories, and the data is W. C. Mitchell, *Business Cycles, the Problem and Its Setting* (1929). Of the first order, for searching analysis and sober judgment, is A. C. Pigou, *Industrial Fluctuations* (1926). The monumental and wide-ranging volumes of J. A. Schumpeter, *Business Cycles* (1939), give an interpretative history of cycles, a critical examination of theories and an independent constructive analysis.

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On inequality, H. Dalton, *The Inequality of Incomes* (1921; new edition, 1935), stands almost alone among the books on that one topic. On great fortunes in the United States, a lively book, without pretense of searching statistical or economic analysis, is F. L. Allen, *Lords of Creation* (1935).

BOOK VI

LABOR

CHAPTER 58

THE WAGES SYSTEM. STRIKES AND THE RIGHT TO STRIKE

§ 1. Introductory. The questions in this book involve the weighing of conflicting elements, and are affected by social sympathy.—§ 2. The wages system necessarily involves restrictions on the individual's freedom.—§ 3. It has material drawbacks and spiritual drawbacks, yet brings a net balance of gain.—§ 4. A strike is not a mere cessation of work but a fighting move. It is the set-off against the power of discharge.—§ 5. Should the right to strike be restricted?

§ 1. THE subjects to be taken up in this Book and in that to follow differ in important respects from the subjects of the preceding Books. They call in less degree for description and analysis, in greater degree for a judgment on the value of existing ways and institutions and for opinions on reform. Hence the conclusions depend, more than with previous matters, on a weighing of pros and cons. Many of the doctrines laid down hitherto have been definite and positive. Given the assumptions on which they rest, they are either true or not true. Such for example is the case with the principles of exchange, of international trade, of the value of money and the range of prices, of rent, and interest and wages. No doubt questions of policy also enter and necessarily lead to some balancing of conflicting considerations; as for example with regard to banking legislation or the circumstances under which protective duties may be advantageous. But such balancing is most of all necessary for the social questions which are now to be taken up. Something is almost invariably to be said on both sides; in favor of one course of action as well as in favor of an opposite course. No "law" can be laid down on them and no conclusions proved by irrefragable reasoning or convincing testimony. Of this there is ample evidence in the wide divergences of opinions and in the bitter controversies on problems where the facts are undisputed.

Again, the conclusions reached on such questions are immensely influenced by the point of view. It makes all the difference whether the problems are approached in a spirit of sympathy or of indifferentism. A great deal depends on the warmth of one's social feelings. Some men are born with a spirit of fervid altruism, some with but the slenderest strain of a moral sense. Between persons of widely differing temperaments there is little common premise for argument. There is no convincing a person whose whole point of view is different from your own. Largely, no doubt, the pervading atmosphere tells. Most well-to-do persons, tho by no means selfish or indifferent, are affected by their class feeling and are unconsciously disposed to be antagonistic to measures looking toward equalization of opportunities and possessions. It is true that they are not so critical and antagonistic as they were fifty or a hundred years ago; for the spirit of the time is becoming more reformatory, more widely sympathetic. None the less, an underlying opposition to schemes for social equalization appears among the possessing classes, and not least among the business men who now give the tone to these classes. On the other hand the representatives of the less prosperous strata of society are instinctively in an attitude of opposition. Many things in the existing order of property and competition are repugnant to them, regardless of the beneficial effects of that order and the unwelcome concomitants which the benefits entail.

In this Book labor problems will be dealt with; in the next, problems of public control and the reorganization of industry. Both sets of problems center about the inequalities of wealth and the ways of mitigating them. I shall try to consider these knotty matters as objectively as possible, not unimbued with the spirit of social sympathy yet constrained to face the limitations imposed by men's rooted habits and traditions, by the defects of governmental machinery, most of all by the moral and intellectual weaknesses of men.

§ 2. Most labor problems center about the relation between employer and employed. They arise in connection with the wages question in the narrower sense—the question of the remuneration not of all laborers but of those hired by the capitalist employer. The wages system in this form is so familiar that its existence is commonly accepted as a matter of course. Something needs to be said at the outset on the grounds for its existence, on its benefits and its drawbacks.

The wages system as it stands is the outcome of the division of labor; and its present most pressing problems arise from the increasing complexity which characterizes large-scale production. In ever-growing measure the modern development of industry has necessitated organization, direction, discipline—single-minded management. There must be a guiding and coördinating authority. The liberty of the individual workman is necessarily restricted. He cannot have such freedom in settling his daily routine as is possessed by the independent artisan or the farmer. He must work as part of an organization and his tasks, his hours, his speed, must conform to the plan of the whole. He must obey orders.

This limitation of freedom is often regarded as a special characteristic of employing capitalism and private property. But it is the inevitable result of highly organized production. It is as pressing under public ownership of industry as under private; it is an essential condition of the success of any coöperative organization by the workmen themselves; it could not but be as marked in a completely socialist society as under the existing régime. What is true in regard to its bearing on the present wages system is that this system has made the necessity plain and unmistakable; for it alone has developed the methods of large-scale production and thus arrived at the advantages as well as the disadvantages of the complex division of labor. In saying this I do not overlook the wide range of public industry. Public industry hitherto has developed no system or plans of its own—it has copied the essential achievements of private industry. It is private management that has pointed the way and perfected the methods of securing the needed organization, discipline, leadership. Most persons of the well-to-do classes think of the private organization of industry as inherently and forever indispensable. It is not so; but the unification of control and the restriction on individual liberty which characterize it are not to be escaped. In this sense the wages system cannot be done away with.

§ 3. The wages system entails serious drawbacks under any form of organization. Whether under private ownership and management or any of the non-private forms the interest of the laborer in his work cannot be as direct, as strong, as personal, as when he works for himself and under no one's direction. But the drawbacks beyond doubt are greater under control by capitalist owners. Capitalist control may indeed justify itself and continue to hold its own thru special effectiveness in securing the essential advantages. None the less the drawbacks must be faced.

The drawbacks are of two kinds, material and spiritual. The output of material goods is smaller than it might be. The spiritual ills are greater than they might be; the happiness of living is marred by many incidents of the wages system as it stands.

The failure to secure the maximum of effectiveness and of product is patent. The universal testimony is that hired workmen do not do as much as they readily could. To state it more accurately: unless the economic dominance of the employer is great and his power of enforcing strenuous labor is exercised vigorously the workmen fail to do their best or anything like it. It is not merely a matter of "making work"—of this something is said elsewhere[1]—nor is it primarily a matter of lazy repugnance to work. These factors enter but they are not the most important. The main thing is that hired men are directly interested not in their work but in their wages. What they turn out inures to the employer, not in any visible way to themselves. The far-away prospect of an ultimate enhancement of the social dividend and of their own eventual participation in that dividend has no effect on their imagination or their conduct. There is an obvious contrast with the attitude of the farmer or artisan who becomes the owner of that to which he applies his labor. The evil is not so great where production is of a routine kind, where output can be accurately gauged and controlled, where machines set the pace. It is surprisingly large even under these conditions. It is greatest where much must be left to individual discretion. And it is great thruout the range of the wages system.

This, be it observed, is not a net loss. It is a deduction from a conceivable maximum. It is a drawback, but one that is out-

[1] See Chapter 59.

weighed by the gains from division of labor, organization, management. While the laborers do indeed produce less than if they did their best wholeheartedly, they produce more than they could without the wages system. Were it not for this net gain the system would not have developed. The capitalist can pay the hired workman, even tho the man works with half spirit only, more than the latter can earn while working independently. The cobbler cannot do as well for himself as he can when hired by the shoe manufacturer.

The spiritual loss has received more attention of late years—one of the many signs of growing attention to the relation between psychology and economics. We are slowly becoming awake to the plain and simple fact that the happiness of all men is immensely promoted if their daily work be made interesting and in some degree pleasurable. Even at its best the wages system tends to choke that source of well-being. At its worst man's interest is not at all in his daily work; his interests and his personality are elsewhere. The more the "drive" method is followed, in an endeavor to secure by threat or force that which is not readily given, the more is the possible material increment from the drive offset by the spiritual loss to the driven.

There is danger of exaggeration, however, in all this; and moreover there are some questions connected with it concerning which, in the present state of our knowledge, we must speak with caution. The exaggeration comes because those who descant on the losses of human happiness are themselves persons with a bent, a marked personality. They are thinkers, speculators, writers; they have in themselves something of the spirit of poets, musicians, artists, inventors. No doubt some spark of individuality and creative instinct is in each and every one of us. Only in a small minority, however, does it call insistently for expression. Most men probably are not made unhappy by simple and monotonous work or by direction and command. Friendliness and congeniality in contacts with associates and immediate superiors may make conditions acceptable which otherwise would be intolerable. The charm of life which the medieval artisan is supposed to have had is much exaggerated; and so is the loss of happiness from prescribed tasks.

The temper in which power is exercised is more inimical to happiness than the fact of power.

Questions of a different kind, on which we must speak even more guardedly, are those on the relation between the present distribution of control and the qualifications of the persons who now exercise the control. That there are differences between individuals in their powers of leadership is not to be contested. Some are born to command, others to obey; some are happy in commanding, others in obeying. But are those in command of industry peculiarly fitted for leadership? And are those who now follow them designated by nature for obedience? Much of the ordinary talk of the well-to-do implies that this sort of natural and supposedly proper division of places now exists. Those who urge sweeping changes, on the other hand, commonly ignore the very existence of the problems of differentiation and selection. Elsewhere, when considering a related topic,[1] I have pointed out how inconclusive is our information on the whole question of social stratification. It is by no means indisputable (even tho some evidence points that way) that the possessing classes and those who manage industry for them are by nature different from the rank and file of hired workmen. The present distribution of functions may not be in accord with the abilities and the personalities of the several participants. Nor, on the other hand, is it at all certain that a radically different social system would bring a better adjustment of tasks to abilities, a fuller attainment of this condition for human happiness.

In any case it is to be remarked that on the spiritual side as well as on the material the loss of human happiness under the wages system is again no *net* loss. The facts of everyday choice indicate that it is not so. The cobbler's work may be more interesting, more consciously creative than that of the machine hand; monotony and routine may make the factory dull and lifeless. Nevertheless the cobbler will leave his bench and take his place in the factory if his factory earnings are higher—higher perhaps

[1] Business profits and the distribution of managing ability among social classes; see Chapter 49. Compare also the discussion of the same subject in its bearing on socialism, Chapters 67, 68.

by a small margin only. The agricultural worker, tho he be an owner or a secure tenant, drifts to the town; and this is not simply because of the diversions and crowds (which serve in some part to offset submission to orders and to monotony of tasks) but because his earnings are larger. The gain in output, and thereby in earnings, from highly organized industry is so great as to offset not only the material loss arising from uninterested laborers but also such spiritual loss as comes from repression of personality. In both regards the problem is how to minimize the losses; how to avoid the disadvantages of complex industry while retaining the advantages.

It is sometimes urged that there is no such choice as has just been mentioned. Under the wages system, it is said, there is complete lack of choice. The laborer must accept employment and submission; he cannot escape by betaking himself to work under other conditions. And true it is that when once the transition to the new order is accomplished, once the system is established, he has usually no alternative. But that it has been established at all is fundamentally the consequence of choices which have been repeatedly exercised. True it is, again, that the history of modern capitalism is full of incidents that spell compulsion—an ousting by stress of need from the simpler, perhaps more attractive, conditions of an older day. These, none the less, are exceptions. The main driving force that caused the older conditions to be superseded was the flocking of multitudes of men to workshops, factories, towns and cities, because life there has seemed to them, on the whole, more attractive. Not tyrannical power, not wage slavery, but the silent sustained exercise of preferences explains the modern industrial order and the existing wages system.

§ 4. I pass to some other aspects of the wages system on which there is loose thinking and vague talk: strikes and "the right to strike."

Tho it is the choice of more attractive conditions which explains the drift of laborers into the wages system, it is none the less true that once the system is established and all-pervading the choice becomes a restricted one and always remains a difficult one. The men can choose only between one employer and another; between work at wages and no work at all. In the right of discharge, in the power of saying whether a man shall be hired or not hired, shall be retained or turned off, the employer has a fearful weapon. He can deprive the laborer, for the time being at least, of his means of support. The alternative of looking elsewhere for employment is more or less precarious. Against the weapon of discharge the laborer exercises that of the strike.

A strike is commonly spoken of as if it were a mere refusal by individuals to accept the terms of an offer to enter on a contract of labor. This statement is sometimes varied by describing the strike not as an individual but as a collective refusal to enter on such a contract. It is more than either of these. It is a concerted withdrawal from work with the design of securing return to the same employment under better conditions than are offered at the time by employers. The betterment of the conditions may be in various directions: to get higher wages, to prevent a reduction in wages, to change hours or other conditions of work. But the intent always is to secure satisfactory terms while retaining the positions, not to leave the positions and go elsewhere. A strike is a concerted withdrawal for the purpose of bringing pressure to bear toward holding the same job.

This is not merely a matter of definition. It is one of recognizing what people really mean and intend, even tho they do not formulate with precision what they have in mind. In any consideration of proposals to restrict the right to strike—of the legal or the moral aspects of the problem—care must be taken to understand the real situation.

Restriction of the right to strike has often been opposed—to give an example of befogged controversy—on the ground that it would condemn men to a sort of slavery. To deny men the right to strike, it is said, is equivalent to holding them against their will to their places. Nothing of the sort is ever contemplated by those who propose restriction; nor is it the liberty of turning to another job which is in fact desired by those who go on strike. The essence of the striker's aim is to retain the same position. The strike is conceived to be successful when the strikers, after having left in a body, are reinstated on the terms desired by themselves.

If another employment has to be sought the strike is deemed to have failed, even tho the new employment be in fact secured, nay even tho the strikers in the end prove to be better off at their new places. In other words, the strike, to repeat, is a way of exerting pressure toward holding the *old* job on better terms. The pressure means damage to employers, perhaps to the public, probably at the outset to the strikers themselves; these being in their own eyes inevitable incidents, even tho regrettable, of the struggle for retaining their places on acceptable terms.

The familiar attitude of strikers toward newcomers and competitors—"strike-breakers"—makes plain what is the real intent, the real situation. The strikers, so far from quitting their jobs and saying that others are free to take them if the offered terms are satisfactory, aim above all to prevent others from replacing them on any terms whatever. Persuasion, appeals to class feeling and class loyalty, physical violence, are resorted to in order to keep away the interlopers. A peaceful and satisfactory conduct of a strike takes place, in their opinion, when no endeavor is made to fill the vacant posts and when both sides settle down to a process of dull waiting and sustained negotiations.

The strike, then, is a tactical procedure, a fighting move. It is mainly cherished, mainly used, because it constitutes by far the most effective weapon which hired laborers possess. It is the one great set-off against the powerful weapon which is in the employer's hands—the right of discharge.

How great is the power which the right of discharge puts into the employer's hands is little understood by those outside the industrial struggle. The fear of being turned on the streets is always in the back of the hired workman's mind. Much is said in all the books on economics about his bargaining disadvantages, his comparative immobility, the obstacles in the way of his readily turning to another employment; much is also said, and with truth, about the influences of those underlying forces which determine wages and serve in the end to lessen the bargaining advantages of the employer. No general statements can picture adequately the ordinary states of feeling: constant uneasiness, easily intensified to terror, on the part of the men; consciousness of power and determination to hold power among the so-called masters. The right to discharge on the employer's part probably is an indispensable part of the present order of industry. Tho some limitations on it may be set, tho abuses may be checked, it is essential to discipline and to effectiveness in production. But liability to abuse there is. The maintenance of the right without qualification is cherished by employers not merely because deemed essential for discipline but in no small measure because it satisfies the instinct for domination. That very spirit of domination brings about a state of opposition among the workmen, and this in turn a cherishing of their own instrument of offense and defense—the strike. Without that weapon they feel themselves helpless. Since men tend to make the means an end, the strike and the right to strike become matters not merely of tactics and expediency but of principle. As the right of discharge is regarded by employers as an inalienable right, so that of striking comes to be regarded by the men.

§ 5. How far the right to strike shall be allowed to go, what degree of pressure the law shall permit to be exercised by strikers on those ready to take their places, in what form the power of the law shall be applied—these are questions of the greatest intricacy and difficulty. The law itself, both statute law and judge-made law, has long been and still is in a state of flux and transition. There is no underlying set of principles so settled as to constitute a firm foundation for legislation and adjudication. In the last analysis all depends on one's attitude toward the existing industrial order. He who expects and desires far-reaching changes toward the remodeling of the social structure and the lessening of inequality will favor a wide extension of the right to strike; since this is a means of curtailing the power of employers and perhaps paving the way toward their eventual disestablishment. He who regards private property and employer management as indispensable will insist that strikes must be curbed. On this matter, as on many considered in the pages that follow, most people—legislators and judges not excepted—reason from premises which they have not formulated and of which indeed they are hardly conscious. Their attitude is determined chiefly by their prepossessions.

Yet there are some considerations important for the legislative problems involved which should be observed irrespective of one's views on the aim and ultimate outcome of social and industrial development.

Consider the strike not as a mere withdrawal from work but as a tactical move designed to bring complete cessation of operations. Those operations may be of vital concern to the community; as, for example, in the case of railways, urban transportation, light, water. Stoppage may mean peril, even disaster. On the other hand, in those very operations the tenure of the employees may be comparatively secure and the power of discharge regulated and restricted. Such is likely to be the case in industries which are directly under public management. Public officials rarely have an unfettered power of discharge. By custom or law the employee who is turned off has a right to a hearing and to some sort of trial. Something of this sort—some check on the arbitrary determination of the very fact of employment—should be made a part of the ordinary industrial procedure. It is but one phase of what is desirable on a larger scale and on wider grounds, participation by the hired workers in the settlement of the conditions under which they work. The possibilities and also the limitations of such participation will be considered presently. Assume for the moment that it exists in effective form. Then the strike and the right to strike have a different aspect. The strike is no longer indispensable as a weapon for securing a hearing, for combating absolute control over employment. The community is entitled to protect itself against efforts to stay the operation of vital industries. The workmen may be required not to strike, in the sense of not deliberately striving to bring the industry to a standstill. Precisely what forms of compulsion shall be applied is not so easy to say: whether to make the mere concerted cessation of work a punishable offense or only the overt endeavor to prevent others from engaging in the work. The question of principle is on the right to strike: shall it be restricted at all where the employer and employee are no longer separated as hostile parties dealing with each other at arm's length and where the employer himself is restricted in the use of his main weapon of domination?

This question of principle is most clearly presented in the industries managed by government. The community, by the very circumstance of putting them under public management, has expressed its conviction of their special importance for the public welfare. Here it would seem incontestable that on the one hand the men should be given a standing in the administration of employment, on the other hand that they should not be given a free hand in stopping the wheels of industry.

The same question of principles arises in other cases, as will be said more fully elsewhere. The line between public and non-public industries is not easily drawn.[1] Often there is a sort of half-way arrangement—control and regulation, as in the case of the so-called "public utilities." Are the same considerations applicable to these industries as when they are under direct government management? The public is quite as much concerned in continuity of operation whether a railway or an electric plant be owned by a corporation or be publicly owned. The conditions of employment and the right of discharge, again, may not be essentially different under private management from what they are under government management; tho in this respect the same protection of the men against arbitrary acts is by no means so readily instituted or so easily maintained. On the other hand, it may be contended that in putting or leaving an industry in private hands the community has assumed the risks and the consequences of that form of industrial organization. Private ownership carries with it the seeds of conflict—the inevitable clash between those who employ and those who are employed. Disguise it as we may, smooth over to our utmost, adjust where we can, there the conflict is, ever liable to break out. To this danger we can allow ourselves to submit only because the system on the whole is supposed to bring advantages more than countervailing. If private management of railways is preferred to public the ground must be that, on the whole, it works better; that the spur of self-interest, the incitement to enter-

[1] Compare Chapter 66.

prise, the freedom from political entanglement, cause transportation to be better conducted. If coal mining is left in private hands it is because there also private industry is believed to supply the community better than public industry would. The private employer, however, regards the business as his own, its methods of management as subject to his own judgment only. It is almost invariably urged by him and his spokesman that the effective working of the business machine depends above all on unfettered freedom in the selection and tenure of employees. So long as this attitude prevails the workman will feel in turn that he must retain his weapon of defense, the strike, even tho it entail injury to a wide circle of persons. If the public wishes to secure the gains which accrue from private property and private management it must accept the offsets which arise from strife and stoppage. To restrict the right to strike and leave absolute control of employment to private managers is to give strength to one side and take it away from the other.

All the preceding has been stated in general terms—terms too general to meet the diversified conditions of actual affairs. There are gradations, from well-administered public industry thru quasi-public and publicly controlled corporations all the way to the farthest extreme of unfettered private ownership and management. Public industry itself is by no means invariably conducted in a spirit of consideration for the rank and file of the staff. It happens often enough that the officials in charge accept the point of view and the methods of private industry, and are equally intolerant of any derogation of their power. An attitude of this sort is defended on the ground that it is essential for the maintenance of discipline; and in fairness it should be admitted that this is not always a mere pretext. At all events, where such is the state of affairs, the peaceful strike is not to be ruled out as *ipso facto* a punishable offense, on the ground that the industry is a public one. On the other hand it is quite conceivable that a quasi-public corporation—private in ownership but publicly controlled—may be required to operate under a modification of the ways of private industry not only as regards charges and profits but as regards labor policy as well. The conditions of employment, the power of discharge, the discipline of the staff, may be subject to such regulation as would be expected under ideal public management; and this may be part of the very terms under which private management is authorized. Such is the situation which has developed with regard to American railroads. When this is the case the strike becomes an inadmissible weapon. The public has then protected the employees and it is in turn entitled to protect itself.

The reader might gather from the preceding discussion the impression that discharge and strike should be treated as cards of equal value in the game—the one to be set off against the other, and given up if the other also is given up. No such mechanical method of dealing with the problem can meet its complexities or reconcile the convictions and prejudices of the contending parties. The right to strike is not cherished by all workmen merely as a means of defense under unequal conditions. More or less consciously, more or less widely, it is regarded by some of them and by many of their protagonists as the entering wedge for radical readjustment. Even if employers were to consent to restrictions on their power of discharge, contests would remain, strikes would brew. And on the other hand, discharge is but one of the matters in which the employer's absolute rule is to be questioned. Discharge is conspicuous because it is the outstanding weapon. All the conditions of employment may be subjected to some degree of control if control is to be applied to the workman also. Not only hiring and firing but standards of wages, piece rates, apportionment of tasks, the powers of foremen, shop rules, may be settled by conference, agreement, contract, not by the employer at his untrammeled discretion. When such methods of settlement, such participation in the contract of employment, are established and in effective operation the strike may be subjected to greater restriction than can be imposed in their absence. It is then quite conceivable that in its militant sense—the purpose to stop operations until the malcontents get their terms—the strike shall be made unlawful.

CHAPTER 59

LABOR UNIONS

§ 1. Bargaining power of laborers strengthened by unions. Weakness of the single laborer. Immobility of labor; lack of reserve funds; perishability.—§ 2. Monopolistic tendencies of trade unions of skilled workers; not often of permanent importance. The open union, such as alone can develop among the less skilled, an instrument for good.—§ 3. Closed shop or open shop? A strong case for the closed shop with the open union.—§ 4. A danger of a check to progress and efficiency under the closed shop? Limitation of output; piecework; the standard rate; labor-saving appliances; discipline.—§ 5. A division between open shop and closed shop not unacceptable. Grounds of employers' opposition often untenable. The question of union leadership crucial.—§ 6. The scab and the use of violence. The tie-up.—§ 7. The trade union and the industrial union.—§ 8. Company unions. The individual firm and its employees.

§ 1. The labor union movement is modern. It is mainly a consequence of the Industrial Revolution—of the factory system and the concentration of industry. The number of persons employed in a single enterprise and under a single employer has tended to become larger and larger. Hence personal ties between employer and employee have relaxed or disappeared and bargaining has become more impersonal and cold-blooded. At the same time concerted action by employees has become easier. Combined with this economic tendency has been the growth of democracy and of the aspirations that go with democracy. The union movement is one of the most important signs of social unrest and social progress. The laborers have become increasingly dissatisfied with a condition of dependence. They wish not only for higher wages but for emancipation from semi-patriarchal conditions. They demand that wages shall not be settled once for all on the employer's offer but by a contract in which their own action shall play an effective part.

We may proceed at once to the most important economic question presented by labor unions—their possible effect on wages. On this subject it might have been said fifty years ago that the opinions of economists and of trade unionists were far apart; for many economists then maintained that unions could have no effect on wages, while the unionists themselves ascribed every actual rise in wages to their own efforts. The labor leaders are still disposed to lay undue stress on the effects of concerted action; but a middle ground would now be taken by all economists.

It is certain, and indeed obvious, that the bargaining power of hired workmen is strengthened by their acting in a body. Where an employer deals with a hundred workmen, he may be said to be a hundredfold stronger in his bargaining position than a single workman. The difference to him whether one of his men goes or stays is only the difference between 100 and 99. But to the workman the alternative is between employment and—for the moment, at least—unemployment. True, the workman may turn elsewhere; and it may be contended that if he offers his labor at the market rates he will get employment from someone else. Probably he will; but only after an interval and with more or less uncertainty. It need not be said again how powerful is the weapon which the employer possesses in the threat of discharge and the workman's fear of losing his job. Where, however, all his workmen present a demand at once, and propose to quit work at once, he is in a correspondingly difficult position. Then he, too, will have to stop and for the moment will lose *his* job; and he will soberly consider whether he can find another set of men on the same terms. If he offers the market rate doubtless he can secure another hundred; but, like the individual laborer, only after an interval and with more or less uncertainty and temporary loss.

The advantage possessed by the large employer becomes clear when his position is contrasted with that of one hiring but a single person or very few persons. The typical middle-class householder with one or two servants needs each servant as much as the servant needs him or her. If the mistress gives notice, doubtless the cook can find another place at the going rates; but not at once or without inconvenience. If the cook gives notice, doubtless the mistress can find another at the going rates; but not at once or with no less inconvenience. Hence in a country like the United States, where the number of well-to-do persons who demand domestic service is great and growing and the number of those willing to give such service is limited,[1] wages are not only high but are kept at the high market level without organization among the sellers of labor. If each of the persons wanting such service commonly maintained ten, twenty, a hundred, domestics, the situation would be different. The single servant would then be weak as a bargainer; and tho the general level of wages would doubtless not be affected, the probability would be less that in each case the actual pay would conform to the general level.

The disadvantage which the laborer usually has to face in bargaining arises not only from the fact that he is immobile—cannot quickly find the best market for his labor—but from his lack of reserve funds and from the perishability of his commodity. In all these respects the difference between employer and employee is often one of degree only; it is none the less so great as to be of vital effect on their relative positions. Tho the workman as well as the capitalist may have reserve funds on which to fall back while waiting and bargaining, they are usually much less than those of the employer. In the case of most unskilled laborers they are virtually non-existent. So with perishability. There is a sense in which the employer also is like the vendor of a perishable commodity. Machinery and tools depreciate while idle thru the mere lapse of time and thru obsolescence; stoppage of production for a "going concern" means some definitive loss. But it is even more true of the laborer that working time lost is irrevocably lost. As regards some sorts of exacting mental labor a period of rest perhaps adds in the end to vigor and efficiency; but this possibility is negligible for most physical labor. If a man is out of work for a day or a week, so much of his earning power is gone once for all.

Organization and concerted action among workmen enable them to no small degree to lessen their disabilities. Labor unions can do much to mitigate the immobility of labor by collecting information about the demand and by aiding their members in reaching the right places. Public and private agencies act toward the same end; tho private agencies, managed for profit, are them-

[1] Compare above, Chapter 52.

selves likely to take advantage of the laborer's weakness. Labor unions, again, by accumulating funds give their members a better chance to hold out in the process of bargaining. Most important of all, concerted action in stopping work makes the employer feel that the workmen are as necessary to him as he to them.

Labor organizations are thus effective toward securing "fair wages"; that is, the current or market rates determined under the conditions of competition. They aid in enabling the laborers to get, in each particular case, the wages determined by the full competitive demand for the special sort of service. Where there is pressure all around they aid in bringing the general level of wages to the full value of the product of labor in general. If there should be universal organization and concerted action it might be argued with logical consistency that the pressure all around would serve to bring the general level of wages to the full "discounted" value of the total output. But this sort of general pronouncement would be of interest only to students of economic and social problems. It could not mean anything to the employers or to the employees, or even to mediators or arbitrators.[1] The general level, or the fair rate of wages at large, is not determined automatically or with any precision; and in any individual negotiation the "fair" rate means the going rate in industries under conditions similar to those of the case in hand. It rests on previous experience, not a little on tradition and habits that developed under local conditions, to some degree even on mere inertia and habit. The terms of settlement are commonly accepted as just once for all, without regard to origin or basis. The merit or the expediency of the terms cannot be brought into any understandable relation to the underlying forces that bear on the general wage level. Indeed they can be brought only with difficulty into a close relation even to the forces that bear on the particular work and the particular region. There is always a debatable ground and something of a compromise in the end. And in that debatable ground, laborers obviously are in a better position if they present a united front.

§ 2. The concrete problems connected with labor unions never relate to wages in general but always to the wages of a particular

[1] Compare what has already been said on this subject, Chapter 42, on Wages.

group. And they relate usually to the trade union as distinguished from the more generic type, the labor union. The trade union, long the most familiar and effective form of organization, is made up of workmen belonging to one trade or to a group of trades closely related. The wages of each such group in the specific case depend on the play of demand for the special kind of service rendered. Limit the supply of workmen in a given trade or group and the chance is bettered for getting higher wages in that group. This is what the trade union invariably desires to bring about. The most effective organizations are those of the skilled workmen —the machinists, bricklayers, carpenters, plumbers, electric workers, and the like. These are in any event more or less in a non-competing group. Their semi-monopolistic position, tho threatened by the spread of education and of the machine processes, is still strong and is sought to be maintained by various devices. The number of apprentices is limited. Admission to the union is restricted by high initiation dues. In some of the rougher trades brutal violence is threatened against would-be competitors. Trade schools are opposed. The unionists try to maintain themselves in a favored place as compared with the rest of the laborers.

For this they are not, humanly speaking, to be blamed; but they act against the general interest. Capitalists and employers are no less desirous of shutting out competition and securing monopoly profits. Either sort of combination works against the general good. Tho unionism, as a movement for uplifting the laboring class at large and bettering the bargaining conditions for all, must command sympathy, in its particular manifestations it is too often undisguisedly selfish, and so causes repulsion even among its warmest friends.

It is true that the instances of monopoly effective thru trade union exclusion are not many and are tending to become less. They occur chiefly in those occupations where the handicraft is still dominant. Such is the case, for example, or was until very recently, with the glass blowers. They had a tight union, succeeded in restricting apprentices, limited numbers and secured for themselves unusually high wages. As machine methods come to prevail and specialized skill counts less than general training and intelligence, it becomes more and more difficult to maintain such monopolies. In this very trade new inventions were introduced which accomplished by machinery what could formerly be done only by the expert glass man blowing thru his tube. None the less the skilled workmen as a class still jealously guarded, tho with lessened prospects of success, their privileged position as against other workmen.

This restrictive attitude has the sympathy and approval of workmen in general. Most of them are instinctively protectionists. Not only do they fear unemployment thru increase of competition but they generalize from the particular case and assume that what is advantageous to some laborers must prove advantageous if applied to all. The doctrine that everyone should do his utmost in a free field finds as little spontaneous welcome among the employed as among the employers.

Evidently the objectionable side of unionism here considered would disappear if there were the *open union;* that is, if all persons competent to do the work were admitted freely to the union. The union then would be an organization with no flavor of monopolistic exclusion but one simply for mutual aid and for collective bargaining.

This is the usual situation in the unions of the unskilled or partly skilled. The trade union, the earliest and most spontaneous type, has been supplemented by a great development of labor organization in the lower ranks, both among factory operatives and among the miscellaneous unskilled. Especially in the United States there has been a wide spread of organization according to mere propinquity of occupation; as for example the switchmen on railways, the longshoremen ("dockers" in England), and the freight handlers, the teamsters, the coal heavers. These are occupations needing at most but a few weeks of experience, to which any able-bodied man can turn. The unions therefore in the end necessarily become open unions and free from the reproach of selfish exclusiveness. At the same time they affect just those classes of workmen who as individuals are most helpless. Unionism among them, so long as it is kept free from the taint of physical brutality, brings a great preponderance of gain. No doubt their leaders are sometimes demagogs or (worse) traitors ready to accept bribes. During the earlier and formative stages of organization both leaders and men overestimate the gains which the union can bring and may be turbulent. On the whole these unions are potent instruments for good. They not only improve the bargaining position of their members and raise their wages so far as this factor can further the rise; they bring also educational benefits. During the last generation, workmen of these grades in the United States have been largely foreign born, often immigrants but lately arrived. For them the trade unions have been great schools, and with all their narrowness of outlook have been helpful in the process of uplift and amalgamation.

In the skilled trades the policy of opening the union is always resisted as long as possible. At the same time many of them have learned, and most of them probably will learn, that it is the only wise policy. Exclusion and limitations as means of forcing wages in particular trades to an abnormal level bring sooner or later their own breakdown. Employers are put to their wits' ends to find and train outsiders or to develop improvements which will make it possible to dispense with the skilled men. The spread of education, especially of manual training, combined with the steady extension of machine processes, make the position of the monopolistic union more and more precarious. Where trade schools are established—and notwithstanding the opposition of the unions they are steadily extending and will extend more and more in the future—the unions find that their only wise policy is to admit into their ranks the men so trained. Even without trade schools unusually high wages lead a multitude of employers to try to get on without the expensive unionists and tempt a multitude of other workmen to try their hand at the well-paid jobs; with the result that these mutually attracted parties get together and deprive the union of its monopoly. Reluctantly and unwillingly even the skilled men are in most cases driven to the policy of the open union.

§ 3. A hotly debated question regarding unionism concerns the closed shop. Shall all workmen be brought together in unions and all bargains as to wages be arranged by union representatives?

Shall non-union men be virtually forced to join the organizations by being shut out from employment unless they do so? The alternative is the open shop, in which the employers deal with their laborers individually or at least deal with them irrespective of their being members of the union.

Evidently the closed shop is a powerful weapon in support of the union of the monopolistic type. If the members not only refuse to admit newcomers to their ranks but refuse to work in a shop with them the difficulties of getting outsiders, even tho these be tempted by exceptionally high wages, are very great. In almost all enterprises the employer needs a trained and coördinated staff. If the union men leave in a body whenever he employs an outsider he must substitute another full complement. Even if the work is not very difficult to master and if plenty of outsiders are attracted by the wages offered, it is at the least a troublesome matter to break them in. If the trade be a skilled one and training in it hard to secure the union, insisting on the closed shop, has the situation well in hand. Only extravagant demands will lead the employer to break with them. Ordinarily he will prefer to join with them, pay high wages to keep them content, and reimburse himself by high prices to purchasers. There is an obvious limit to this process in the conditions of demand among the purchasers. But if the union also limits access to its ranks by restrictions on apprentices and like measures, it may find in the closed shop a cause —tho in large part also the result—of a profitable monopoly position.

Suppose, however, that with the closed shop there is the open union. This would remove one of the evils ascribable to the closed shop—the creation, or at least reënforcement, of a monopoly. If all qualified applicants were admitted in good faith to the union the primary effect of the closed shop would be simply to enforce collective bargaining. No contracts with individual workmen would then be made. All bargains on wages and the conditions of labor would be concluded thru union representatives.

The case, so stated, is *prima facie* in favor of the closed shop. So much follows from what has been said of the gains secured thru unions by laborers. They get better terms by bargaining in this way. They are the most numerous and the most needy members of our modern societies; what improves their condition increases most surely the sum of human welfare.

Let us consider more closely, however, the industrial situation as it would be if the closed shops were universal. A great power would be in the hands of the workmen or of their representatives. That power would be by no means confined to questions of rates of wages. The very settlement of wages involves many other things; not only wages and hours but the mode of payment, penalties, fines, and numberless details of administration and discipline. Where a trade agreement is drawn up between the representatives of employers and employees it is never a simple contract dealing with wages alone; it covers, necessarily, a multitude of matters of organization. In any case, if we imagine the closed shop to be universally established, one fundamental question is settled for the employer. He has no alternative as to whom he shall employ. It must be members of the union or no one.

The question whether the closed shop with the open union is to the advantage of society depends on the use which the workmen make of the power which is given them. If used simply to strengthen bargaining power and prevent exploitation (in the sense in which that term is here applicable) unalloyed good ensues to the workman. If used to hamper industry there is much evil also; and unfortunately in the present state of mind of workmen and their leaders there is so much reason for expecting evil of this sort that no dispassionate observer, however strong his sympathies with laborers, can look forward to the universal closed shop without misgiving. The grounds for this feeling need some further explanation.

§ 4. The inevitable attitude of the hired workman, as already remarked,[1] is to favor arrangements that seem to make work and to oppose those that seem to lessen work. Every improvement, every labor-saving device, means some shifting and readjustment and hence commonly entails hardship—perhaps temporary, but hardship none the less. Once settled in a job, the workman wishes it to last.

[1] See Chapter 41.

One familiar manifestation of this attitude is the limitation of output; that is, the limitation of the amount a man shall accomplish in a given time as, for example, the number of bricks he shall lay in a day. Such restriction is often defended on the ground that it prevents "driving"—the requirement of excessive stints by employers. There is a case to be made in favor of it on this ground. In the great majority of instances, however, it is simply a mode of making the job last and so a check on vigor and efficiency. It lessens the product of industry. Moreover, it saps the spirit of willing and cheerful activity and so contributes still more to those factors—in any case many—that make labor irksome.

So it is as regards piecework. The workmen, individually or when gathered in unions, oppose it. Here, too, the ostensible ground of opposition is often that piecework leads to "driving." The rate of pay is alleged to be based on the capacity of some unusually strong or skilled workman, which then is used by the employer as a ground for urging the average man to extreme exertion. Beyond doubt it happens that piecework is thus used as a device for getting too much work, or at all events more work at the same pay; and this supplies one more instance of the individual laborer's disadvantages in bargaining. But, after all, the underlying feeling about piecework is that it increases output per man and so seems to lessen the number of men who get jobs.

Something of the same sort appears in the demand for a standard rate of wages; tho in this case much more is to be said in favor of the trade union policy. Strictly speaking that policy is for establishing not a standard but a minimum rate, less than which no member may accept. In practice, however, the minimum rate is apt to be the uniform rate. The general drift among trade unions is against differences and so against any higher scale of wages for the capable and strenuous. This drift may be due partly to a widespread egalitarian feeling, a vague questioning of the intrinsic righteousness of that adjustment of reward to efficiency which follows from the strict individualistic principle. Mainly it is due to the same feeling that underlies limitation of output and opposition to piece pay—a fear that the highly paid man will accomplish much and so will leave less work to be done by the rest.

On the other hand, the unflinching adherence to a standard rate and even to a uniform rate is to be defended on the ground that it strengthens bargaining power. In the absence of a uniform scale many an employer will try to whittle away a rate that is supposed to be established by special agreement made with (and in practice perhaps forced upon) a particular workman or set of workmen. Any sort of discrimination or classification, tho ostensibly in favor of the highly efficient, gives color to discrimination against those who are supposed to be less efficient but who in fact may be simply less able to resist. It is probable, moreover, that the differences in individual capacity between able-bodied manual workmen are not very great and that the deadening influence which is alleged to be exerted by the standard-rate policy is in practice no great matter. Hence this policy, much as it has been condemned by those who see only the bad side of unionism, has probably done little to fetter general efficiency and has done something to aid the unions to maintain themselves against covert attack.

The opposition to labor-saving improvements and machinery rests unmistakably on the same ground as underlies more obscurely limitation of output and opposition to piecework—namely, the dread of unemployment. All hired workmen (barring perhaps agricultural laborers under some conditions) dread such improvements. In the old days they rioted and destroyed the hated competitors. In modern times a silent, stolid resistance is apt to appear, with a half-conscious endeavor to prevent the new devices from working successfully. It is true that many labor leaders and labor unions have given up the policy of opposing improvements and machines and advise the members to accept them and to become proficient with them; this is simply because they submit to what experience has shown to be inevitable. If the closed shop were firmly and universally established no entering wedge would exist for compelling acceptance of the better methods.[1]

The attitude both of employers and workmen as regards inven-

[1] On the possible effects which pressure from unions may have in leading employers to improve plants and organization, something has already been said, see Chapter 49 § 9.

tions and improvements is naturally that of trying to appropriate, each party for itself, the whole gain. The employers try to hire the men at the existing rates of pay, to sell the products for the existing prices, and to pocket a higher profit. The men—once they have made up their minds to accept the new ways—try to get for themselves part of the gain. Neither party thinks of the public and each is apt to talk of the "justice" of having the benefit go to one or the other. Justice, in the sense of promotion of general well-being, demands that the gain shall go to the community in the form of more abundant production and lower prices; which does not ensue unless there be competition among the producers and especially among the employers. If there is not competition but monopoly the workmen might as well gain as the employers. Experience shows that the benefit from improvements, tho accruing first as higher profits to the innovating capitalists, in time filters thru to the community. On the other hand, but for the prospect of higher profits (for a longer or shorter interval) employers would have no inducement to work out the improvements. In this sense it may be said that the employers rather than the workmen are "entitled" to the gains of the period of transition. Stated more simply and with less ambiguous phrase, the truth is that the immediate interests of the employers are more in accord with those of the public than are those of any one group of workmen.

The same general remarks are to be made of the attitude of workmen and unions toward discipline. The large-scale industries of our day call for semi-military organization—for punctuality, prompt obedience, submission to orders. Discipline in the employer's hands rests on the power of discharge. That power the workman naturally resents—as naturally as he resents machinery that threatens to deprive him of work. The strong union tends to hamper it and the universal closed shop would tend still more to hamper it. All depends on the character, intelligence, temper, of the men. The clannishness of class and the sympathy of the great majority of men in all walks of life for those who have been "caught" always bring a danger that the needful effectiveness of discharge will be broken down.[1]

[1] See, for illustration, Fitch, *The Steel Workers,* pp. 102–103.

Of the various objectionable policies of trade unions those which hamper progress seem to have had most effect in Great Britain, those which fetter discipline most in the United States. In the former country, unions have reached their fullest development and collective bargaining is most widely practiced. In many British trades it no longer occurs to anyone that the individual workman shall bargain with the employer; all is done thru the union. This growth, in most ways to the good, does seem to have been accompanied in Great Britain by a check on progress, chiefly thru limitation on output and thru silent but effective opposition to labor-saving appliances. The failure of Great Britain to maintain her former leadership in some industries, such as that of iron and steel making, was ascribable in part to union policies which put a brake on progress. In the United States this sort of influence has been little felt; partly perhaps because of the ingrained habit of accepting and welcoming improvements but probably in the larger part because unionism has hardly ever had complete sway in any industry. A demoralization of discipline has been more common in this country, especially in railways and similar industries, and has had more serious effects.

§ 5. This prolonged discussion leads, so far as the closed shop is concerned, to a compromise result. It is undesirable, with the present temper and intelligence of the workmen, that they should have that degree of control which the universal closed shop would give. Yet it is no less undesirable that the employers should have that degree of control which the universal open shop would give. The situation as it actually stands in many industries in the United States is not unsatisfactory—partly open shops, partly closed shops. The existence of the open shops prevents the unions from carrying their policies to the point of harmful restriction; they must face the competition of the unfettered establishments. The existence of the closed shops prevents the employers from abusing the advantage which they have in dealing with unorganized workmen; they must face the possibility of unionization.

It seems to be better, however, that no individual shop should be half open and half closed—employing half union men and half non-union. Employers sometimes take the position that while they will make no opposition to union membership on the part of their men they will not accede to the strict closed shop, which would compel all to join the union as a condition of being employed. This plan of letting the men do as they please—join or not join—rarely works well. So eager and vehement is the unionist spirit that where the movement has once taken hold there is constant nagging of the non-union men. Their lives and the lives of their wives and children are made miserable. Better one thing or the other—either the closed shop, with the possibility that the employers will "smash the union" if it becomes intolerably restrictive; or the open shop, with the possibility that the employees will strike and unionize if they are not dealt with fairly.

This sort of compromise conclusion is equally unwelcome to both sides. Unionism is the gospel of the labor leaders. It has the sympathy of the great mass of the workmen, whether they be unionists or not; its universal extension is their goal. To most employers, on the other hand, unions and closed shops are anathema, and in fighting for the open shop they believe they are acting not only in their own interest but for the better social order. Even the most humane and public-spirited among employers commonly have this feeling. The bitter opposition with which high-minded employers face the union movement is no doubt caused in part by the mistakes and extravagances of the workmen; extravagances not only in their endeavors to restrict and control but in their bearing and temper. The union leader, if he thinks he has the situation in hand, feels the itch of power and gives his orders in terms which the employer finds intolerable. In no small part the resentment of the employer arises from his own love of power. Human nature plays its part on both sides, often more than any close weighing of gains and losses. The generous-minded employer, disposed to do the best he can for his men, yet wishes to do it in his own way. He likes to have a patriarchal position, and precisely this is what the workmen tend more and more to resent. They wish to be dealt with as equals and to feel that they are in a position to command such treatment. No doubt the business man who is tactful as well as humane, who meets his employees as men, and who has enough ability and success to be able to pay full market wages without bickering, can carry on the open shop indefinitely without ever having "trouble." It is well that a good part of the community's industry should remain under the leadership of men of this type. But even the best of men are better when they know that it is politic to be good and the best of employers run the open shop better when they know that the closed shop is a possibility. A great many employers are not of the best type and as regards them the closed shop is a needed alternative.

A common contention among employers opposed to unionism is that they will deal only with their own men, not with any outsider. In this respect they seem to be quite in the wrong; or, to state it more carefully, the balance of social advantage is against them. The workmen clearly gain by having their case in charge of chosen representatives, whether or no these be fellow employees; and collective bargaining and unionization up to this point bring no offsetting disadvantages to society. As regards the immediate employee, there is often a real danger that he who presents a demand or a grievance will be "victimized." He will be discharged and perhaps blacklisted; very likely on some pretext but in fact because he has "made trouble." Further, the ability to state and argue the workmen's case and to negotiate with success is possessed by few. No doubt it often happens that the "outside" labor representatives do not themselves have the needed ability or understanding and prove inconvenient persons to deal with. Sometimes, as has already been remarked, they feel the itch of power and like to pose as persons whose orders must be obeyed. But they are the best the men can find and in the long run it is advantageous that they rather than immediate employees should conduct negotiations. The only case in which an employer is clearly justified on grounds of social advantage in refusing to deal with them is where they are corrupt. This case, unfortunately, is not unknown—where labor leaders are willing to be bribed; tho the cases are as common where employers are willing to bribe. The fact that a labor representative is found to be a blatant demagog or to present impossible demands may be reason for promptly closing negotiations but is no ground for refusing in advance to meet him if once he has been chosen by the workmen to be their spokesman.

The question of leadership is crucial. It bears on all the problems of the labor movement; indeed it bears on all problems of economic and social organization. Leadership depends essentially on the intelligence and moral qualities of the workmen themselves. Ignorant and unscrupulous men will choose bad leaders—bad perhaps in that they are ineffective, bad perhaps in that they are corrupt. Yet for the very reason that this factor is fundamental little reference is ordinarily made to it; partly because it is so obvious, partly because measures for its amelioration are necessarily slow in operation. It is the remedies easiest to apply and promising quickest effect that most readily enlist the interest of the ardent reformer. Such are the powerful labor union and the closed shop, ready ways of strengthening the position of the under man. Yet how they shall work depends in the end on the qualities of the men themselves as well as on the qualities of the employers with whom they deal. The human element is not to be escaped. The universal organization of labor in all-embracing unions means enormous power in the hands of labor leaders, just as universal combination of employers means enormous power in the hands of the business leaders. Neither alternative is to be contemplated without uneasiness; the two together would portend an imminent social conflict. He who looks forward to the continuance of the main features of the existing industrial organization must look with misgivings at any movement which leads to great concentration of power in the hands of men not selected by the public and not responsible to the community for the wise exercise of power.

§ 6. The attitude of the union members toward the "scab" is the inevitable result of class feeling on the one hand, on the other of that same specter of non-employment which explains the many contradictions between the laborer's point of view and the strict theory of the law of private property and free competition. In the workman's eyes the scab is not merely, as he is in the eyes of the law, a competitor who enters on a contract for wages which another has chosen to reject. He takes another man's job and deprives that other of work; he is a traitor to the cause of his class. And yet, as matters stand in the existing industrial organization, there is no other possible way of settling wages than thru competitive offer; tempered doubtless by collective bargaining and also by humanity among employers but fixed in the end thru competition. Notwithstanding the pressure of class feeling against the scab, competition in fact does settle wages. A demand for higher wages will not bring a permanent increase, strike or no strike, if plenty of other men can be found who are willing to do the work on the old terms. In such case the employer's embarrassment in getting together and drilling a new force and the scab's fear of taunts and a beating will enable only a temporary victory to be won.

Few openly defend violence; and it is probably true, as the friendly historians of the labor movement say, that it is usually a stage of young unionism, outgrown and discarded as organization becomes more permanent and effective. In the United States at least it has lasted long and has remained (there is too much reason to believe) a deliberate policy. Unfortunately it is apt to be cumulative in its effects; once begun, it breeds more.

When a strike occurs, especially if it be a sudden one and intemperately led, the employer makes the best show he can of filling the vacant places at once. There are always some floaters, not desirable or desired for permanent retention, who can be used for a while as stop-gaps. There are almost always, in addition, some really desirable substitutes; for in rapidly growing and changing communities a state of perfect equilibrium is never reached and there is always some labor (as there is some capital) which has not found its place. The question whether a force of efficient men can really be had by the employer at the old wages will be settled only by considerable experience. The employer may find in the end that he cannot secure and retain good men. In the first stages of a struggle, however, the long-run factors are little weighed. The temper of both sides is up and the employer, tho conscious that he is hard put, makes a bluff. The workmen then feel keenly all their disadvantages in bargaining. They cannot wait, especially if their reserve funds are scant. The tactical move of the employer in filling the places with anyone that comes along is met by the tactical move of violence against the hated competitor. If the work is carried on in the open and by scattered laborers—as in the case of trucking or railways—the likelihood and the effect of violence are so much greater. Then develops the curious phenomenon of the professional strike-breaker—the daredevil, very likely disreputable in character, who for a bonus will risk limb and life in the first clash with the angry strikers. The mere presence of such a person then tempts to violence so much the more. Worse begets worse and a state of something like civil war is threatened.

The "tie-up" is analogous to violence and often accompanied by it; especially where an industry of pressing importance to the public is affected, as a railway or street railway. The "sit-down" strike is essentially like it. The sudden cessation of work and the more or less disguised threat of brutality against any who would replace the strikers amount to seizing society by the throat and calling on it to stand and deliver. Yet the tactical weakness of the laborers, especially as regards the unskilled or little skilled among them, and the not infrequent callousness of the managers of the industries lead too easily to such a policy. The extremes, indefensible as they have been in themselves, have sometimes been the only means of forcing a hearing. They have bred in the managing class a wholesome desire to conciliate their employees.

§ 7. Different from the "trade" union and of wider social consequence is the "industrial" union. The distinction between the two is analogous to that between vertical and horizontal combinations in industrial organization; the trade union being a form of horizontal combination, the industrial union one of vertical combination. The industrial union is made up of all the workers in a given industry; not the skilled mechanics alone but all, from coal heaver and floor sweeper to the highest-paid "key" mechanic and perhaps also (tho not generally) the clerks and white collar men. All the employees in a given plant are to bargain as one with their employers. Eventually a further stage is likely to be reached: thruout any one industry all the employees are to unite as one large unit for bargaining, with all the employers as the other unit.

The two types of organization are not necessarily incompatible. It is quite possible that they should exist side by side and should act in harmony. They do interplay to a considerable extent in Great Britain; tho with a continuing dominance by the craft unions. In the United States the ambitions, bickerings, jealousies, open conflicts between the leaders of different labor organizations have stood in the way of community of action and purpose. This disorganization is largely the consequence of the wide geographical area and the great variety in social and industrial conditions. It would be hazardous to predict what form labor organization will take in the future; just as it is difficult to say whether the gulf between skilled and unskilled will eventually become more wide or less.

In one respect the industrial union is the better: it reaches down into the stratum which most needs the increase of bargaining power secured thru presenting a united front. Unions of workers who are unskilled or but little skilled, such as the longshoremen in the United States and the dockers in England, bring support to those most needing it. They help to prevent tyranny and overreaching, to mitigate irregularity and what may be fairly called exploitation. No sensible man would suppose that unionization by itself could solve the social problem which their case presents. But true it is that the craft unions have commonly gone their way for the advantage of their own members. They have remained indifferent to the rank and file and jealous of any intrusion from these into the preserves of the elect; and this indifference has added to the disabilities of the lower stratum.

Another question is that of the permanent effect of the industrial union on wage rates and on differences of wages. It would seem that under it the lower groups are likely to gain relatively as well as absolutely. The tendency of that kind of bargaining which is conducted with representation of all groups for the members of all can hardly fail to be toward lessening differentials, certainly against a widening of the differentials. And this sort of result might be reached without any conscious or overt policy. There would probably be emphatic denial of any deliberate policy in this direction. The effect might come nevertheless thru the unexpected and irregular working of successive changes, no one conspicuous at the time, in the price level and in money wages. The indications are that in the present decade (1930–40) and in the next following there will be monetary conditions which will lead to a higher price level and to a higher range of money incomes. These movements, always irregular, will serve sooner or later to bring a rise in the money wages arrived at by collective bargainings. With a rise of the money rates of wages all around the industrial union is likely to work for at least as great an increase in the lower ranges as in the higher; perhaps a maintenance of the absolute differential yet a decline in the proportional.

After what has been said in earlier chapters it is hardly necessary to emphasize that a far-reaching permanent change in the relative remuneration of the two groups can come only thru a change in the conditions of supply; fewer competent applicants for work in the group now paid the lower wages, more in those better paid. A substantial and sustained rise in the relative rates of the unskilled laborers, great enough to be of large social meaning, is not to be expected unless there be a decline in their relative numbers; either by lower birth rate, which means birth control, or by a climbing of more and more individuals into the upper ranks, promoted by public schooling in the manual trades and by the opening of the craft unions.

There are questions of wider range. Either kind of organization may come to have aims and policies that go beyond wages, strikes, labor conditions, the labor market. Both may plan to affect not only laws that are of immediate concern, as those on strikes, bargaining, health, unemployment, but also social and economic policy and legislation at large. The labor organizations may form a political party and aim at sweeping changes, such as rapid and wide extension of government ownership, socialism as an immediate or early goal. The most striking case of such organization for far-reaching legislation was that of the Social Democrats in Germany—openly a separate political party—for the period 1880–1930. In the United States and Great Britain experience seems to show that the closer are the connections with current political movements of all kinds, the wider and more ambitious the aims, the less successful is a labor organization in keeping the undivided support of its members. Confederations of craft unions, however large their total membership and however tempted to enter the political arena, are more likely to stick to their immediate job; while those of industrial unions are more likely to go far afield and then to disintegrate.

On this aspect of the movement for labor organization, as on all the various movements for economic and social change, one's sympathy or aversion, approval or disapproval, cannot but be influenced by one's general attitude. Those who believe that the existing structure is doomed once for all and that its end is not far off will welcome the industrial union because it is not only more inclusive but because its aims seem likely to go farther. And if it happens that such a union is led by unseasoned officials, if it easily gets out of hand and so brings violence, bloodshed, a complete disregard of law—then this will be regarded by the radicals as but one step in the inevitable course of events, the march toward a different social system. The evils will be condoned, the general purpose and trend welcomed. For the visible future—a couple of generations—no such plunges toward full socialism seem to me impending in the English-speaking countries; and industrial disputes, even with the industrial union, are not likely to lead to anything like civil war. So far as they do bring violence, the underlying steadiness of the community will put a stop to dire lawlessness before the situation gets out of hand. Only those who have a tinge of fanaticism will feel that the industrial union is to be welcomed, not on the simple ground that it improves the social body as that now functions but because it hastens the eventual great clash.

§ 8. A recognition of the social gains which the independent militant labor organizations bring is not inconsistent with a recognition of the good which may be brought by other forms of organization. European experience, and especially English experience, brings abundant proof that the independent union itself can take its part in the development of other things than mere bargaining strength and aggressive negotiation. There are significant cases in which the unions have taken the lead in constructive measures, and in which the able and far-sighted manager has welcomed their overtures and systematically enlisted the good will of his men. It is necessarily implied in all joint action of this kind that the employer shall not proclaim, as he has so often done of old, that no outsider is to be permitted to come between him and his men. So long as the men feel—and on many matters of vital import they cannot but feel—that their own organization and their own independent spokesmen are essential, these cannot be brushed aside. Conference by business men with the business agents of the unions and negotiations with them are not inconsistent with conference and negotiation within each several concern. The initiative toward a combination of the two kinds of contact may come from one side or the other; the impelling motive may be the memory of bitter experience by one party or the other. The cynics sometimes say that it is always the weaker side that wants peace: that the initiative to arbitration, or friendly conference, or a new kind of relation, always comes from the side that sees defeat staring it in the face. Not quite so. Behind it all is, I do believe, something better than weariness or despair. And something better there must be if lasting good is to be achieved. From whichever side the initiative comes, and whatever the original impelling motive, no betterment can come and endure unless there be on both sides a genuine spirit of good will.

As I see the modern industrial situation, it is of cardinal importance that *all* who work in a given establishment or concern should have some sense of a common aim and common interest. That they do have a common interest is trite. We are told *ad nauseam* that the employers and employed, the owners and managers and workmen, are in the same boat, are all dependent on the outcome of the joint doings, share necessarily in prosperity and adversity. In this sort of talk there is usually an absurd glozing of the inescapable conflict on the terms for dividing the joint product. None the less it remains true that each participant is more likely to prosper when all prosper. What is overlooked is the importance of something more than joint prosperity. There must also be joint feeling, friendly association. Happiness, as the moralists have told us so often, is a matter not so much of what we get out of life as of how we get it. All men, rich or poor, alert or dull, are on a better plane of living if their working hours are pervaded in their daily contacts by some sense of fellowship, if they are not left neutral by indifference or embittered by suspicion and ill will.

Obviously this attitude bears on the question of the type of relation between employer and employee that we wish to foster. It may seem to imply the company union, not the trade union or industrial union; to turn the scale in favor of vertical, not horizontal, organization. All who are in the individual factory or establishment should get together—workmen, foremen, managers, owners. They should have an inspiriting feeling that they are members of one body.

But the company union is dead. This sort of organization, once regarded in semi-conservative quarters as the key to industrial peace, has been sadly discredited in the United States by the way in which the ultra-conservatives among the business leaders tried to use it as a means of displacing the independent union. It arouses a snort of disdain. Yet something of the kind, designed and accepted as not displacing the men's own organization but as working side by side with it, might still have life and might be of help toward improving the existing social structure.

What form and procedure of dealings between employer and employees in the individual concern might prove best seems to me quite uncertain. These are mainly human problems, not mere matters of technology and efficiency; and there is no royal road to the one perfect solution. All the various plans and schemes are worth trying—personnel departments, employee representation, works councils, Whitley councils, profit sharing of one kind or another; not least the trade unions in alliance with the individual concern or with the whole of an industry; even compulsory negotiation, compulsory arbitration with prohibition of strikes. He would be a bold man who predicted which of them, or which combination of them, is the more likely to develop in the future. The only thing quite clear is that all depends on the spirit in which they are carried out. Not that the method, the machinery, the details of organization are quite immaterial. The details do need to be planned with care, adapted to the characteristics of the different kinds of industry, modified in the light of experience. But mainly they must take account of the prejudices, prepossessions, disappointments, suspicions, which have been aroused by the experiences of the past or are imbedded in the situation as it stands. Patience and tact are required no less than judgment.

The general line of approach which seems most promising is that of an organization within each concern in the way of well-defined employee representation or works council; and combined with this a friendly or at least quite neutral attitude toward the independent union which the men maintain for themselves. The essential thing, to repeat, is how employers and employed feel about it and what is the spirit underlying it all. Here the responsibility lies most of all with the employers. They are the leaders and must accept their obligations for industrial peace no less than for industrial progress. It is the sincerity, the genuineness, of their attitude which is crucial. On their sincerity depends that of the men. While the plan of the organization does count, the essential thing is a real desire for betterment, a disposition to meet the men half way, tolerance and forbearance with persons whose lives are dominated by cares and fears quite unlike those of the employing class.

Most business men will read passages like this with a shrug of the shoulder. Such discourses are the utterances of the benevolently minded professor. They have little pertinence in the cold world of affairs. The hard-boiled employer and the hard-boiled labor leader will be equally unwilling to admit that there is anything that endures except the underlying conflict. To this attitude the only answer is that we are creatures with mixed motives. We are not just good or bad, hard-boiled or soft-boiled. Even the worst of us, the hardest, responds sometimes, somewhere, to the call of what is borne in on him as right. No doubt the mixture of good with bad is different in different individuals; and in the same individuals it shows itself differently at different times. What shall be the quality of the mixture, which way a man's thoughts and actions shall turn, depends enormously on the environment. It is not impossible that the same emulation for a foremost place among one's associates, the same love of distinction which underlies the race for profits, can be turned toward ways of higher and wider usefulness.

CHAPTER 60

LABOR LEGISLATION AND LABOR HOURS

§ 1. Labor legislation like labor organization aims to standardize conditions of employment. Legislation on the hours of labor for women and children the typical case. Other sorts of restriction. Situation in the United States. —§ 2. Why legislation must supplement and support the laborer's own efforts. A great moving force behind it is the growth of altruism.—§ 3. Limitation of hours for men. Are there grounds on principle for confining such legislation to women and children? Constitutional questions in the United States.—§ 4. A shorter work day introduced suddenly and universally might mean a decline in product and in wages; introduced gradually, and *pari passu* with improvements in production, it brings unmixed gain.—§ 5. The efforts of the Labor Office of the League of Nations to bring about a general eight-hour day. Some principles of international trade involved.—§ 6. The radical steps taken in the United States in 1938 for regulating not only maximum hours but minimum wages. The law on hours of labor.—§ 7. The direct legislative determination of minimum wages for all workers, men as well as women and children, introduced a policy radically new, even tho resting on no new principle. A persistent unsolved question remained: how deal with the unemployable?—§ 8. Essentially new in principle was the National Labor Relations Act of 1938. It rested on the principle of compelling collective bargaining between employer and employee. Difficulties of administering such a law. Uncertainty as to its eventual working and outcome.

§ 1. Any established rate of wages or other part of the labor contract is in constant danger of being cut down by grasping or hard-pressed employers; for the bargaining weakness of the laborers makes it easiest to turn to this way of saving expenses. Hence arises the constant effort of trade unions to secure the standardization of the conditions of employment—minimum wages, fixed hours, settled rules. The same sort of standardization is aimed at in labor legislation. The plane of competition is made by law the same for all. Not only is it made the same but it is intentionally raised. The enlarging moral sense of the community insists that all employers shall carry on their competitive operations on a more humane level.

The typical phase of labor legislation is that for the restriction of the employment of women and children. The perfecting of machinery and of automatic devices has made it possible to employ persons of slender physical strength in the most varied sorts of industries. All that needs to be done is to pull a lever, stop or start a machine, tie a thread. Wherever there are employers who see a profit in the conduct of machine operations with cheap labor, and a laboring class whose members are willing that their women and children should work in the factories, shocking conditions will develop. Children of tender age—but 10, 9, 8 years old—were put to work in the mills, for stretches of 11, 12, sometimes 13 or 14, hours a day and employed on night shifts as well as day shifts. Women have been employed not only for the same long hours and for night work but on coarse and heavy work that brutalizes as well as exhausts them. Lamentable conditions of this sort appeared in Great Britain in the early years of the nineteenth century as the machine processes made their way; and they appeared in most countries with the spread of those processes—in Germany, Austria, France, Italy, Russia. Where a self-respecting population has refused to submit its women and children to such degradation the processes and the methods of employment have been more or less modified, as in the United States in our earlier days; or the industries using them have failed to take root, as in the Scandinavian countries. The great inflow of immigrants to the United States, during the second half of the nineteenth century and the first decade of the twentieth, from countries of low standards so altered social conditions that the evils of children's and women's labor began to appear here also, with little mitigation, in textile mills, in mines, in glass works and in some agricultural work.

The machine process and the factory system are not the main causes of these evils; rather they simply take advantage of conditions which they find. The fundamental causes are poverty, pressure for employment, and a low standard of living. In Great Britain the factory system in its early days found ready for its use a mass of people demoralized by a bad poor law, weakened by a long period of food scarcity, cut off from the land by a feudal system of land ownership. In most countries of continental Europe there were similar low-lying human strata. Among these the factory planted itself. But the modern system of production, tho it did not create the evils, concentrated them and made them more serious. The very fact of concentration, on the other hand, makes it more easy to bring remedial forces to bear, such as factory legislation, compulsory schooling, labor organization. It is probable that even in its first stages the factory system often made things no worse for the employees; while in the end it made possible a betterment.

It is not within the scope of this book to consider the details of labor legislation. The first Factory Act came in England in 1802; the conditions which it still permitted show how bad were those which it aimed to bring to an end. It forbade the employment of children under nine years of age as "apprentices" in cotton factories, restricted their time of labor to twelve actual working hours per day and prohibited night work. This was the beginning of a long series of enactments extending to our own day. The Ten-Hour Act of 1847 was perhaps the most important, restricting the hours of labor for women and young persons (13 to 18 years old) to 10 hours a day or, as it was afterward arranged, to 10½ hours on week days, and 5 hours on Saturdays. The Half-Time Act of 1844 was perhaps not less important; it provided that children (under 13 years—by later legislation defined as under 14) should work but half the time, either full time on alternate days or half time on each day, and that the remaining half should be given to school attendance. In the United States, where legislation on this subject was long outside the constitutional powers of the federal government, the most important single state act of earlier date—because of its influence as an example and a model—was that of Massachusetts in 1874, limiting the hours of work to ten for women and children. Both in Great Britain and in the United States the limitation of hours for women and children served in effect to limit those for men also; directly in those industries where the men are employed with the women and children and indirectly thru the influence of comparison and tradition.

Restriction of hours has been by no means the only form of legislation dealing with the terms on which labor may be employed or the mode in which industry may be conducted. Gradually a complete code has grown up in the advanced countries, regulating conditions of employment in all sorts of ways. Dangerous machinery must be fenced; mines must be ventilated, lighted, provided with appropriate safeguards; sanitation and ventilation must be provided in factories. Industries threatening to health are specially regulated. Thus the manufacture, importation, or sale of matches made with white phosphorus (which renders the workers liable to a kind of necrosis) is now prohibited in all civilized countries. As Great Britain was historically the first country to enter on labor legislation, so she has remained foremost in extending and enforcing it. The Factory and Workshop Act of 1901, a typical and in many ways a model code, not only affects such matters as have been referred to but many others also—the hours when work is to begin and cease, pauses and rests, overtime, the dates and places of wages payment (the payment of wages in dramshops, for example, is forbidden), the employer's power to impose fines for negligence or damage, the mode in which piecework shall be computed (rates in writing must be posted) and so on thru a great mass of detail. In the United States the laws of the several states vary greatly; many of them are lax; often they are ill-enforced, whether lax or stringent. The backwardness of this country in labor legislation and in its administration is ascribable to various causes. One is the persistence of the *laissez-faire* traditions of former days. Another is the particularistic jealousy between the states; the fear in each that its industries will be hampered in the competition with other states. Not least, the evils are of comparatively recent origin. They began to be unmistakable only after the Civil War and became worse with the feverish industrial growth and the enormous immigration of the period 1870–1914.

For the effectiveness of a system of labor legislation stringent enforcement is indispensable. There must be a staff of inspectors, well trained and well supervised, and there must be ample provision for prompt penalties on delinquents. Every movement for social and industrial reform depends for its success on good public officials, and the prospects for success in any country are gauged by the extent to which it provides such officials. In this respect also our government is backward. The new and complicated problems of modern industry came upon the country suddenly and political traditions and political machinery had not been adjusted for dealing with them.

§ 2. The question presents itself: why legislate on all these matters? Why cannot the same results be reached thru the efforts of the laborers themselves? Why do *they* not refuse to allow women and children to work, stipulate for fencing machinery, for ventilating mines, and what not?

The answer to such questioning is in part obvious. The workmen simply cannot make stipulations as to the mode in which their work shall be carried on. This is one of the most serious consequences of their weakness in bargaining. The only way in which pressure could be brought on employers toward improving factory conditions would be thru the process of the men's quitting the dangerous and unsanitary establishments and seeking employment in those better equipped—a process of no avail where all are equally bad. Almost universally the laborer takes conditions as he finds them. The one effective way in which this part of the plane of competition can be raised is by the rigid imposition of the same conditions on all employers.

But it is not merely helplessness that prevents the workmen from bestirring themselves. The need of legislation is ascribable in large part to their own ignorance and short-sightedness and unfortunately their indifference also. Ignorance and short-sightedness play the chief part in preventing them from concern about the dangers of an occupation. It was not the miners who made the effort for compulsory use of the safety lamp but the men of science and the social reformers. The rank and file of men are singularly indifferent to danger or at least singularly slow in taking precautions against danger. Whether it be from bravado, or recklessness, or simply lack of intelligence, the fact is that measures for preventing accidents must commonly be forced upon them. So it is with the unhealthy trades. Those engaged in them seldom protest, risking their health with apparent inability to visualize the inevitable future. The initiative in legislation on all these matters has come mainly from social reformers, men of science, physicians.

It is social reformers again who have been chiefly instrumental in bringing about legislation restricting the employment of women and children. The laboring men (the women and children themselves rarely are able to make their misery known or their wishes heard) have been indifferent or stolid from simple habituation to bad conditions. Long hours, unrestricted employment of women and children, foul air and filth, are concomitants of a low standard of living. They go with low wages and low intelligence, a high birth rate and a high death rate. To lift a population from these conditions calls for strong compulsion from the outside, not only on the employers but on the laborers also. The parents are themselves often the first to evade restrictions on the employment of children. Legislation on labor conditions must therefore be accompanied by other measures, above all by education. Nothing is so effective toward cleansing and purifying such a social miasma as the bracing atmosphere of democracy—a sense of equal rights and free opportunity and a stir of social ambition.

The main moving force in bringing about all the mass of labor regulation and restriction has been the great wave of human sympathy which has come over the civilized world during the last century and a half and has so profoundly (often unconsciously) influenced the attitude of all men on social and political problems. Altruism has widened in its scope; the suffering of fellow-men and of women and children distresses as it never did before. Wretchedness that was accepted as a matter of course a few centuries ago is now not to be endured. We hear much, it is true, of the preservation of the race. Child labor legislation is likened to the conservation of mines and forests. If the growth of children is stunted by premature labor will not the stuff of the nation deteriorate? This appeal to a half-selfish motive, to the pride of race and nationality, no doubt has its effect. But the main force is that religion of humanity which aims to make life happier for all. It needs but to be made known that there is abject squalor and misery or joyless children's lives and an eager effort is aroused for betterment. The civilized world is not worse than it has been; it is much better; and better most of all in this regard, that all human suffering hurts to the quick and more and more of public and private effort is given to lessening it.

§ 3. Limitation of hours of labor for men long stood in all countries on a different footing from limitation for women and children. In England and in the United States the men were left in the main to make their bargains in this regard as best they could. The same was true of Germany. In some other countries of the Continent a maximum working day for adults was fixed by law for all manufactures, as in France and Switzerland. But the limit permitted (12 hours in France for example, 11 in Switzerland) was so wide as to make the general legislation of slight consequence. Particular industries, it is true, were subjected in one country or another to more stringent restrictions as to men's hours of work; being selected for special treatment sometimes because unusually bad conditions came to light, sometimes because the laborers in them succeeded in bringing effective pressure to bear on legislators. The hours in bakeries were regulated in Germany and in some American states. In France and Great Britain the hours of labor for men in coal mines were limited by 1920 to seven; and in some of our western states (Arizona, Colorado, Nevada, Missouri) there was legislation limiting the hours in all mines to eight. But these were exceptions; for most industries there was no direct limitation on the number of hours men might work. By far the most important restriction affecting men was a by-product of the legislation as to women and children. So far as men are employed in the same establishments, the hours fixed for the women and children are in effect fixed for the men also; sometimes (as in France) they are made applicable by law to the men in mixed establishments.

In the United States the provisions of the federal constitution by which no person is to be "deprived of life, liberty, or property without due process of law," [1] and similar provisions in many state constitutions, have been construed to limit the powers of legislatures as regards the regulation of men's hours of labor. "Liberty" has been construed to include, among other things, the right to work on any terms acceptable to the individual adult male. Some degree of regulation is indeed permitted under a

[1] This prohibition is put on Congress by the Fifth Amendment and (what is much more important) on the states by the Fourteenth Amendment.

vaguely defined "police power," whose exercise is not deemed inconsistent with liberty. But laws forbidding the employment of men for more than ten or twelve hours (and no such law can be effective if the workmen are allowed to contract out) are held to deprive them of liberty to work as they may please. Laws restricting women's and children's labor have not been held invalid, because these classes are supposed to be amenable to control under the police power. Even as regards men some laws restricting hours in particular trades, where grounds of health are supposed to justify an application of this power (as in bakeries and mines), were held valid. The general doctrine, under which men may not be deprived of their "liberty" to work long hours, results from an interpretation of the term which is easily open to criticism. The judges who thus construed it were affected more or less consciously by a general prejudice against the laborer's demands. In any case the exact definition of so vague a principle could not but be difficult. The questions of constitutional law are not within the scope of a book like the present. But the situation brings into relief a point of principle: are there grounds, apart from constitutional interpretation, for distinguishing sharply between legislation for men and legislation for women and children?

The only ground for such a distinction seems to be that it may be better for the men to get shorter hours by their own efforts than by legislation. There are no tenable objections of an abstract or general sort. The same social sympathy which leads to interference in behalf of the women and children may lead consistently to interference in behalf of the men. If it be thought intolerable that women should work more than 10 hours it may be thought no less intolerable that men should work more than 12, or 11, or 10. The question is one of degree and of balance of gain or loss: how far the altruistic impulse can be given sway without ultimate offsetting disadvantage.[1]

§ 4. The demand for shorter hours—for a general eight-hour day in the late nineteenth century and the early twentieth, and for a forty-hour week as the twentieth century wore on—is the most important item in the legislative program of labor organiza-

[1] Compare what has already been said, in Chapter 1.

tions. The same obvious reason which makes one sympathize with the demand for higher wages makes one sympathize also with that for shorter hours. It means improvement in the condition of the mass of mankind and improvement at a most important point. Specialized machinery and the division of labor tend to make labor more monotonous and irksome, less attractive. The best alleviation is by shortening hours and increasing the period of leisure—leisure for rest, for play, for domestic companionship, for the development of higher faculties and pleasures. The cynical objectors sometimes say that leisure is used by the mass of laborers for drunkenness and demoralizing idleness. But in fact drunkenness is an accompaniment not so much of short hours as of long hours and of the things that go with long hours—low wages, bad workshops, degradation. It is true that with shorter hours there should be other agencies for better living: improved education, libraries, playgrounds and healthy amusements, substitutes for the dramshop. Shorter hours—shorter than were so long traditional—can be made to bring without fail an overwhelming balance of gain in welfare.

The debatable question concerns the effect of shorter hours on wages. The demand for them is invariably combined with a demand for the same wages; less work, or at least less hours, but not less pay. Are these combined demands reconcilable? Will not shorter hours lessen the product—the source from which wages must come—and so bring inevitably a lowering of wages?

Shorter hours do not necessarily lessen the output. Where work is done by the piece, men may often accomplish as much in 8 hours as in 10. Even where work is done not by the piece but by the day or hour it is sometimes feasible to reach the same result without overdriving; tho the outcome is not so probable in the absence of the stimulus which piecework gives, since the rooted tradition toward making employment then operates without check. Even where machinery sets the pace a reduction in hours may be offset by a gain in efficiency. Machinery never fixes the pace quite without regard to the intelligence and watchfulness of those who set it in motion. An alert and wide-awake laboring force may turn out as much in 8 hours as a weary one in 10 or 12.

But all this holds good only within comparatively narrow limits. Pieceworkers and skilled mechanics can usually do as much in 8 hours as in 10; but they cannot do as much in 6. Factory operatives can often do as much in 10 hours as in 12, and not infrequently they can do as much in 8 as in 10. It is not easy to say whether a universal limitation to 8 hours a day in manufacturing, mechanical and mercantile occupations would lessen the national dividend. But—other things being unchanged—a reduction to (say) 4 or 6 could not fail to bring that result.

Other things unchanged: but other things may change. Above all the progress of invention and of the arts may increase the general efficiency of labor and so enable hours to be reduced without lessening the output. This is what has happened in the civilized world during the last half century; this is what we may confidently expect in the years to come. The tendency in all civilized countries has been to reduce working time. Factory hours in England and in the United States were 11 or 12 (more commonly 12) until the middle of the nineteenth century; they are now usually 8 in both countries, with a half holiday on Saturdays. Unfortunately there are many industries in the United States in which the hours were more than 10, as in the textile mills of the South and the iron and steel industries of Pennsylvania; a result due to the same cause which has led to the abuses of women's and children's labor in these regions—a laboring class with a low standard of living. In Germany the usual hours were 12, 13, 14, even 15, until after the middle of the nineteenth century. By the close of the century they were for the majority of workmen as low as 10, and in few cases more than 11. This general reduction in hours, *pari passu* with a general advance in wages, was made possible by the general increase of productive capacity.

John Stuart Mill, in a much-quoted passage written in the middle of the nineteenth century, declared that it was doubtful whether all the inventions had diminished the toil of a single human being. That doubt can no longer be entertained; happily it is clear that for multitudes of men and women toil has been diminished. And it will be diminished more and ought to be diminished more. With the general increase in the productivity of labor the working people have a choice between several alternatives: higher wages with the same hours; lower wages with less hours; or a middle course—somewhat higher wages and yet somewhat lower hours. This middle course is the one which has been chosen. "Chosen" is a misleading word; for obviously there has rarely been conscious or deliberate choice. There has been simply a vaguely guided steady pressure for the better conditions—for both higher wages and shorter hours. The successful attainment of both has come thru continued struggle and continued compromise and at bottom from those very labor-saving devices which the laborers themselves commonly view with apprehension. No one of the successive steps seemed at the moment to be of great importance—first in one trade, then another, first in one country, then another. The skilled mechanics get short hours first for the same reason that they get higher wages first—because the demand of the rest of the community for this sort of labor has come to be high as compared with the available supply of it. The fact that one group of laborers thus favorably situated can secure both short hours and high wages does not prove that all can do the same; but none the less it is true that this aristocracy among the laborers has been able to wrest its advantages because there have been improvements not only in the ways of doing their special work but also in those of doing the work of the other laborers.

When once the general level of wages has got well above the minimum for mere subsistence and physical efficiency some diminution of the hours of labor is the best form of higher income. It makes not only for some leisure and some enjoyment of life but for better intelligence and better character. The eight-hour day and forty-hour week constitute a goal which the laborers are right in keeping ever before them and in pressing for whenever favorable conditions exist. No doubt here, as in so many cases, they that already have find it easiest to secure still more. The skilled mechanics whose wages are already high get the shorter day soonest and without any reduction in pay. Those industries in which operations are continuous night and day—as iron and steel works—and in which the twenty-four hours have often been divided between two shifts working twelve hours each, need the shorter work period most of all. The least that can be here regarded as decent is a system of three shifts, each working eight hours.

The people of advancing countries have their choice: more material goods or more playtime? The choice is not often consciously made. Only in rare cases is the question of preference directly presented; as when there is a movement by a given group of workmen to secure higher pay *and* shorter hours. The employer may then say it is impossible to grant both: which do you want? Or if you want something of both, do you want more of one than of the other?

§ 5. The movement for shorter hours was much strengthened after the war of 1914–18 by the Labor Office of the League of Nations. The office aimed at treaty arrangements under which the several nations, parties to the League, should agree to a general restriction of all labor hours to eight a day (more or less, according as one day was made a half-holiday) or forty-eight hours a week. The step was most praiseworthy, resting as it did on an endeavor to prevent the bugaboo of international competition from standing in the way of a great social advance. The economic ideas underlying it were, to be sure, not impeccable. It was assumed, or seemed to be, that short hours were a cause of high cost and an obstacle to exportation. The familiar mercantilistic attitude had to be placated. The truth is that long hours are in general the result of the very conditions that bring high cost—poor tools and machinery, bad organization and management, inefficient labor, and a pressure of numbers from a low standard of living. In the industries in which these elements of ineffectiveness tell most a country has a comparative disadvantage; in those where they tell least the country has a less disadvantage, likely to have consequences the same as those of a comparative advantage. The general reasoning of the principle of comparative advantage has already been stated; its application here is the same as that to differences of wages in the several trading countries.[1] It bears on the long-run course of things, as indeed does most of the reasoning in the pres-

[1] Compare Chapter 34.

ent treatise—precisely the sort of reasoning which is most apt to be ignored in the discussion of social problems. Legislation and treaties cannot set aside the effects of the underlying and abiding forces.

§ 6. The next important step in the regulation of hours of labor, after the League of Nations' move, was in the legislation of the United States—the so-called Fair Labor Standards Act of 1938, often referred to as the Wages and Hours Act. As regards hours, it established as the goal a maximum of 40 hours of labor a week. That goal was to be reached by gradual stages: a maximum of 44 hours for the first year after enactment (1939), 42 hours for the second year, thereafter 40 hours. There were provisions for extra pay for overtime. These figures on the permissible working time carry restriction much beyond the point which had been in people's minds a very short period before. It was the 8-hour day which had been the goal of reformers in the nineteenth century. The 40-hour week went much beyond. Its advocacy and acceptance was based in some part on a feeling that the world had a dangerous excess of productive capacity. The more tenable grounds have been indicated in the preceding pages: the turning of man's increasing power over natural resources not only toward a greater abundance of what we usually think of as "economic" goods but also toward greater leisure.

Legislation that makes so sharp a change from an accustomed situation cannot be easy to administer; this law will doubtless be amended in one detail or another as time passes, as has been done with other parts of the Roosevelt program. But it may be safely predicted that its main features will remain: federal legislation covering the entire area of the country and a great change in the working and living habits for the entire mass of the working people. And it may be predicted also that other countries will be stirred to take steps in the same direction and in the end will probably go as far.

§ 7. Where there are very low earnings and the conditions that usually accompany low earnings, such as long hours, bad workrooms, harsh bargaining with the weak, the question arises whether there may not be a regulation of the plane of competition by regulating wages (say by fixing minimum rates) as well as by regulating hours of labor.

The demand for this further form of labor legislation was first pressed more especially for the so-called "sweated" trades. That term is loosely used and has come of late to have a wider meaning than in earlier days. Originally it described a system of subcontract and domestic industry, work being parcelled out on piece terms and done at the home of the workers. Often it is now applied to any operations in which work is done merely at very low piece rates; and gradually still further to any and all in which the wages, in whatever way paid, are very low. The making of clothing was long the typical industry. Machinery and large-scale production in great establishments, which have so completely revolutionized the making of textile fabrics, were not easily applied to the cutting and sewing of garments. The wholesale dealers and the tailors parcelled out these tasks, especially that of sewing, to subcontractors and these in turn parcelled them among men, women, and children who did the work at their homes. The most striking instance in the United States was in the East Side of the city of New York, where hundreds of thousands of newly arrived immigrants—largely Russian Jews—were engaged by subcontractors in sewing vast quantities of clothing for the American people. The contest between the factory and the handicraft, between the machine and the tool, did not set in here until the twentieth century.

Wretched conditions often appear in this organization of industry; but they do not arise from it by necessity. The earnings of the so-called sweated are by no means universally low. They are so when very many compete for the work and can turn to no other sort of work. Such is the situation in some parts (tho not in all) of the New York clothing trade; since the hordes of newly arrived immigrants are ignorant of the language and of the country's possibilities, find their compatriots doing this thing, easily join them at it, and can turn to nothing else. The subcontractor may then be what is pictured in popular imagination—a prosperous and unscrupulous person who takes advantage of the helplessness of the sweated and grinds them to long hours and pitiful wages. But quite as often he is himself a poor devil, competing with others no less poor, and unable to extricate himself or his employees (if such they can be called) from the system.

As regards legislation fixing minimum wages, a further radical step was taken in the United States in 1938 by that same Fair Labor Standards Act which went so far in fixing maximum hours. It established minimum wages also, proceeding (as was the case for hours) by stages: at least 25 cents an hour during the first year, 30 cents an hour during the following six years, 40 cents an hour after seven years. These rates, moreover, are subject to modification at the hands of "industry committees"; and it is possible, nay probable, that they will be modified further by amendatory legislation. The mere fact that the level of prices and of money wages may change as time goes on renders it unwise to fix any such figures for years in advance.

The principle of fixing by law minimum wages applicable thru all industries and for all classes of workers was a new one. As carried out in the legislation of 1938 it was not likely to bring far-reaching changes in the existing situation; since most wages were clearly up to the minimum rates prescribed. But as time goes on questions cannot fail to arise about the persons who prove to be not employable at these rates. It is more than likely, too, that the minima will be raised, and then the difficulty may arise which the conservative opponents emphasize—and doubtless over-emphasize—that there will be not only unemployment but a continuing and inescapable pressure on profits and so a dampening on vigor and progress in management.

This demand for legislation establishing a minimum rate of remuneration does not necessarily involve questions of principle different from those considered in the preceding sections; and yet if pushed to its farthest consequences might easily raise questions radically new.

As with legislation on hours, factory conditions and the like, a compulsory minimum wages rate may serve simply to regulate the plane of competition. All employers are affected alike; no one could undersell the others by cutting below the established rate. There would be obvious difficulties of administration—attempts at evasion, to be met only by a staff of inspectors, by publicity, by support from public opinion. Such difficulties, serious anywhere, would be especially serious in a country like the United States, whose methods of legislation and administration are still crude. But they involve no new questions of principle.

A more fundamental question, yet still not of an essentially novel sort, would be how to deal with the unemployable. There would unfailingly be a certain number not capable of earning the minimum—the aged, feeble, maimed, the dissolute or half dissolute. It would be impossible to compel employers to pay the minimum to those whose services were not worth it. It is a fair question whether it is not a merit in the proposal rather than a defect that the community would be compelled to face squarely the problems of decrepitude and degeneration. Among those who are incapable of work or but half capable of it two classes may be distinguished: those who are helpless from causes irremediable for the individual yet not cumulative as regards society, such as old age, infirmity, disabling accident; and those helpless from causes that tend to be cumulative, such as congenital feebleness of body and character, alcoholism, dissolute living. The first class may be dealt with charitably or provided for by some system of insurance. The second class should be simply stamped out. Neither the feeble minded, nor those saturated with alcohol or tainted by hereditary disease, nor the irretrievable criminals and tramps, should be allowed at large, still less should be allowed to breed. We have not reached the stage where we can proceed to chloroform them once for all; but at least they can be segregated—shut up in refuges and asylums—and prevented from propagating their kind. The opinion of civilized mankind is rapidly moving to the conclusion that so far at least we may apply the principle of eugenics and thus dispose of what is a most tragic phase, perhaps *the* most tragic, of the problem of the unemployable.

Another question which also involves a new principle is this: what are the possibilities of employing at the prescribed wages all the healthy able-bodied who apply? The persons affected by such legislation would be those in the lowest economic group. The wages at which they can find employment depend on the prices at which the product will sell in the market; or in the language of modern economics on the marginal utility of their services.[1] All those whose additional product would so depress prices that the minimum could no longer be paid by employers would have to go without employment. It might be practicable to prevent employers from paying anyone less than the minimum; tho the power of the law must be very strong indeed and very rigidly exercised in order to prevent the making of bargains which are welcome to both bargainers. In any case it would be quite impracticable to compel payment of the minimum to all who applied, irrespective of their numbers.

Back of this movement, in other words, is the specter of Malthusianism. The danger of pressure from uncontrolled increase of numbers exists for modern societies chiefly in the lowest stratum; in the United States the newly arrived immigrants and their first descendants. No legal minimum of wages can avail if numbers increase so as to bring an ever-growing competition for employment. How far this obstacle would really stand in the way of minimum wage schemes would depend, as we have seen, mainly on the extent to which the stir of ambition reached all classes, low as well as high. Freedom, education, broadening of opportunity, the vulgar as well as the refined forms of the love of distinction—all the influences of democracy—make it probable that increase of numbers will not destroy the possibilities of permanent uplift. But this is a long-time probability which can be put aside when attention is confined (as it usually and perhaps rightly is) to the things that loom up for the next decade or two.

§ 8. Another law of the same period was that regulating "Labor Relations." This did rest clearly on a new principle: that of *compulsory* collective bargaining between employers and the chosen representatives of his employees. Collective bargaining is not in itself a new practice or principle. It has long been a chief goal of the militant labor union. It has become the accepted method of arranging wages in many trades in the United States. In Great Britain it has been for decades the almost universal procedure. But the British government, tho encouraging it in various ways,

[1] Compare Chapter 53.

has not made it compulsory. Direct compulsion by law is a new thing, introduced into the economic world by this enactment of the United States.

There has been much misconception of the purpose and of the content of the Labor Relations Act. It is often supposed to be a measure for dealing with labor questions in general—with strikes and the right to strike; with arbitration or mediation; and even with pressure for adherence to agreements once made. No such broad powers or duties are conferred on the board which is established for carrying out the legislation. The fundamental provision on which all else rests is that employers must meet the chosen representatives of the employees and bargain with them.

True it is that the scope of the legislation, limited tho it be at the start, can hardly fail to enlarge beyond what is expressly stated; and this by mere administration as well as by subsequent statutory enactment. The very first stage in administration may come to lead far. The employer must bargain with chosen representatives; how are they to be chosen? The board must establish and supervise some sort of election within a given plant, and in doing so may influence greatly the kind of labor organization which becomes dominant—whether an industrial or a trade union, whether one or more trade unions. It is supposed to be neutral in these matters, yet must handle them with a firm hand. It must not only act as a neutral but must maintain its repute as such. Most troublesome of all is the question which arises when collective bargaining, once established and on the go, leads to no settlement. If the bargainers cannot agree, will the board serve as mediator and arbitrator, of its own initiative or at the request of the parties? Collective bargaining is no panacea; it does not necessarily lead to peaceful settlements or to the maintenance of agreements when reached.

The working and eventual outcome of all such legislation, whether on hours or wages or labor relations, is as difficult to predict as that of legislation in the field of money and the mechanism of exchange. On these matters, to repeat, no simple economic principles can be invoked. The only guiding rule is that the course of action to be followed is that which under the conditions of the time and place leads to the maximum of welfare; with the further principle, almost as simple and obvious, that inequality in general tends to lessen maximum welfare and lessens it the more if there be not merely inequality of "real" income but also inequality of power and position.

CHAPTER 61

SOCIAL SECURITY

§ 1. Insecurity of earnings comes thru accidents, sickness, old age, unemployment.—§ 2. "Workmen's insurance" against accident. The systems of Germany, Great Britain and France.—§ 3. Health insurance in the European countries.—§ 4. Old age provision in Europe by insurance.—§ 5. In the United States provision for insurance against accident was the first adopted by state legislation. Enormous extension of security legislation during the Roosevelt administrations by federal law. The provision for old age benefits.—§ 6. For unemployment the first great-scale system was that of Great Britain, 1911. In the United States unemployment was dealt with in 1935 by the same act as that for old age.—§ 7. Suddenness of the several steps in the United States.—§ 8. Unemployment insurance the most difficult to plan and administer. The unexpected tendencies toward making it part of a system of all-round relief, and the difficulties of such a system.—§ 9. Other ways of dealing with unemployment. Construction of public works. Systems of labor exchanges.—§ 10. The dangers of malingering exist but can be held in check. The economic burden; the political machinery.

§ 1. Irregularity of earnings is a much more frequent cause of distress than are earnings absolutely small. Men accommodate themselves to almost any income not below the bare minimum but few provide adequately for vicissitudes. Where the margin between receipts and necessary expenditures is slight any interruption of income means suffering. Even when the earnings are such as to make possible a provision thru savings or insurance, adequate provision is not often made. How to mitigate the consequent suffering among the great mass of the population is one of the most urgent of social problems. It is a problem, moreover, to which more and more attention has been given in recent times. This increase of attention has not been brought about by greater irregularity in earnings or greater need of provision for contingencies. I know of no satisfactory evidence to show whether the chances of illness uncared for, of disabling accident, penniless old age, were greater in the nineteenth century than in earlier times. But the modern world is more sensitive to the evils. Here as elsewhere conditions accepted in former days as matters of course are now regarded as intolerable.

Accident, sickness, old age, unemployment—these are the main causes of irregularity in earnings. I shall take these up in turn.

§ 2. Provision against accident should be arranged thru insurance. By far the most important class of accidents, tho not the only important one, is that of accidents to workmen occurring in the course of their employment. Such will infallibly occur; and it is equally certain that no effective provision will be made against them by the workmen themselves. It is even doubtful whether that sort of rough provision is made which would appear in a higher rate of pay for hazardous employments. The risks of injury in an employment are accepted by almost all workmen with virtually no attention or allowance; and when sooner or later a disaster occurs they or their dependents are left helpless. The only question can be as to the best way of making the insurance widespread and effective.

The chance of accident varies in different occupations. It is sufficiently well ascertained in most occupations to be susceptible of insurance, both for accidents having a fatal result and for those bringing permanent or temporary disability. When once the possibility of dealing with them on actuarial principles is clear; when it is certain that the workmen themselves will not insure; and when the sense of social sympathy and duty becomes so strong that provision of some sort is insisted on—the only solution is to make the employers responsible. Let them do the insuring, paying premiums from time to time which will enable a death benefit or pension to be paid to the widows and orphans, or a pension to the disabled workmen themselves. The premiums required, if paid uniformly by all employers of a given trade, will enter into the expenses of production of all and will affect in corresponding degrees the prices of the commodities sold. Such a plan will have far-reaching effect only if it is made of compulsory and universal application and if the mere fact of employment fixes the obligation of the employer, irrespective of any agreement between him and the employee.

The desired result of assured provision can be secured either by requiring the employers to organize directly in insurance associations of their own or by simply imposing on them a liability against which they can insure in companies existing for this purpose. Of the former type of procedure, Germany supplied the earliest and most conspicuous example; of the latter, Great Britain. The German system, established (1883) as the first part of the empire's elaborate system of workmen's insurance, compels the employers in each trade to form a sort of insurance company, carefully supervised by the government, to contribute premiums adjusted to the risk of accident, and thereby to enable the payment of benefits, such as pensions to disabled workmen (at the rate of two thirds their former wages for those completely disabled) and corresponding pensions to widows and minor children. The British Workmen's Compensation Act (1897), on the other hand, simply provides that the employer must pay a pension (ot one half the former wages) in case of complete disability and in case of death a lump sum amounting to three years' wages, with stated minima and maxima. In what manner he shall make the provision is left to his own discretion. In practice he almost always insures in an employers' liability company; very few employers carry on their operations on so large a scale and with such continuity as to make it safe to insure themselves. Substantially on the same principle is the French system (established 1898), where the pension in case of total disability is two thirds of the wages rate, and where also the design and the effect is to compel employers to carry insurance against their unqualified liability. The German method is natural in a country where the public administrative system is developed to high efficiency and where detailed supervision by government authority is helpful and not unwelcome. The English and French methods are adapted to communities whose traditions and habits are against such far-reaching government regulation. All make provision, tho not in the same way nor to quite the same extent, against accidents occurring in the course of employment.

Employers whose operations are on a great scale accommodate themselves most easily to a compulsory insurance system. They have large resources, allow a good margin for contingencies of all sorts, commonly lay their plans with reference to considerable periods. Smaller employers are less able to adjust themselves to additional expenses. The rigorous application of any form of labor legislation, whether in the way of restriction or of compulsory expense, tends to hasten the development of large-scale production; a result which is in accord with the general trend of modern industry yet is not welcome to most persons who have at heart plans of this kind for social reform.

A considerable proportion of mishaps is not provided for by insurance *via* the employers. Accidents to independent artisans, to those in the service of petty employers exempted from the general system, most of all accidents not occurring in the course of working operations, are not included. It is possible and desirable to give an opportunity in some of these cases (to independent artisans, for example) to join of their own volition the insurance system; unfortunately this opportunity is likely to be availed of only by a small proportion of the men concerned. A large place is still left for private and public charity.

§ 3. Health insurance[1] (insurance against sickness) is as feasible as insurance against accident. It is even more feasible, since longer observation has supplied more adequate data on the frequency of illness in modern communities and on its greater frequency with advancing age; while the progressive gain in ways of healthful living has introduced a factor of safety which is not found in accident insurance.

Saving against a rainy day—a rough sort of insurance against illness as well as other mishaps—is common among the well-to-do and the lower middle class. In the latter class and among the skilled artisans there has been considerable development of insurance proper. During the nineteenth century the Friendly Societies of Great Britain—the Odd Fellows, the Foresters, and other important associations—carried on insurance against illness

[1] The term "health insurance" is now commonly used to designate what is here considered—public provision, virtually all-inclusive, for treatment in case of illness. The term is also used in a more limited sense, that of insurance proper, with stipulated premiums and benefits; arranged either with private insurance companies or under some coöperative plan; sometimes of wide scope, sometimes only for hospital aid. The widespread public provision is obviously more closely connected with the general problem of social security.

(and other ill fortune also) on a large scale. Branches or outgrowths from them and imitations of them have done the same thing in the United States; and there are some associations of this type in most countries. They provide commonly against disability of all sorts, whether the result of illness or of accident. The same is done by the British trade unions, among whom the benefit system has an established and important part, including sick pay as well as trade benefits (strike pay and the like). It is true that the premiums or dues of all these organizations have commonly been inadequate. They promise more for a given weekly premium than they are able in the long run to furnish. Like the "fraternal" life insurance organizations which have had and still have such a vogue in the United States, they undertake to pay amounts greater than their dues warrant on sound actuarial principles. None the less, and notwithstanding frequent collapses, they have done service in mitigating the hardships from illness and consequent loss of earnings. Their serious and irremediable defect is that they reach only a class comparatively prosperous—tradesmen, persons on steady salaries, skilled artisans.

It is this failure to reach the great mass of the people that led the German statesmen to adopt the compulsory (and therefore universal) system for health insurance as well as for other forms. No other method will bring relief with certainty to those needing it most. The German law of 1883, the first in all this great series of measures for social security, established associations, commonly organized by locality (one for each town or district), in which all workmen are insured against sickness. Contributions are payable by employers, whose obligation to pay is fixed by the act of employment; but they may deduct two thirds of the amounts from the stipulated wages (the remaining third being a charge on the employer himself). The workman gets, while ill, one half his usual wages and in addition free medical treatment; in case of need, hospital treatment.[1] The ramifications and details of the

[1] Cases of injury from accident are treated in the German system of *Krankheitsversicherung* as cases of illness during the first thirteen weeks (one fourth of a year). Only if disability from accident endures beyond thirteen weeks—that is, in case of long-continued and presumably permanent disability—does the machinery of accident insurance begin to apply.

system are carefully worked out; they call for an enormous and skillfully developed organization; they secure for practically every person employed at wages a provision in case of illness.

§ 4. Old age is a contingency in this sense: no one knows whether he will reach it. Provision for old age can be made by insurance, and is so made to some considerable extent by the well-to-do thru insurance companies. Even among the well-to-do it is not often made systematically. In the social tier below that of the well-to-do, friendly societies and trade unions sometimes had a system of superannuation benefits; but it was effective only for an insignificant proportion of their constituency. Among the masses of the population there is commonly no set provision of any sort for old age; and when infirmity comes the aged are dependent on the younger generation or on charity. There is nothing more pathetic than the position of the workman, skilled or unskilled, who has passed the age of efficiency, has no resources, and is a burden, often borne grudgingly, on a household with slender resources.

Old age pensions are now provided by public authority in most countries of the western world. The German system (1889) includes them and applies to them rigorously the principle of insurance. Employers there pay the premiums, with the same arrangement as in health insurance for deducting from wages part of what they advance. One half of the premiums can be so deducted, the other half remaining as a charge on the employers; while a fixed sum is contributed toward each pension by the nation—that is, by the taxpayers. The amount of the premiums due for each workman and the pension payable to him vary according to his wages. This system requires an enormous amount of bookkeeping, an enormous investment of accumulating funds, and very expensive administration. Probably it is unnecessarily cumbrous; yet the French insurance system, established in 1910, reproduced its characteristic provisions. Much simpler is the plan of giving to every workman or to every needy workman once for all, from the public funds, a pension on reaching a given age limit. This is what is done in the countries of the British Commonwealth which have established old age pensions: in Great Britain and in Australia and New Zealand. In all of these, to be sure, the pension is subject to reduction according to the applicant's need. Only those having no other income or but a slender income are pensionable; and in the Australian states there is a restriction also for those who have some accumulated means.

§ 5. In almost all this a great change came in the United States during the administrations of President Franklin Roosevelt. I say "almost" all, because the one field which was first covered in other countries—health insurance—was not touched at all. Accident insurance (Workmen's Compensation) had already been provided in most parts of the country by laws of the several states, more or less adequate. It was not until the Roosevelt administration that old age benefits and insurance against unemployment were taken in hand. Health insurance was still left outside the pale. It requires little gift of prophecy to foretell that before long this will also be included.

So far as provision for accident goes, our case long was wretched. There was supposed to be a liability on the employers for injuries occurring to workmen in the course of their employment. But the liability (varying according to the judicial decisions and the statutes of the several states) was so hedged in by sundry legal limitations and so beset with uncertainties that it brought a provision only in a small minority of cases. Most cases were settled out of court by a compromise between the parties, with outcomes varying according to the helplessness of the victim and the astuteness of the employers' counsel. Where cases got into court the question whether the workman should get compensation depended on the lottery (such it virtually was) of a suit at law and a trial by jury.

This situation was so obviously bad, and the example of other countries pointed so clearly to the remedy, that a great change set in during the second decade of the twentieth century. State after state in rapid succession enacted workmen's compensation laws. Constitutional provisions in some jurisdictions imposed limitations and obstacles and in particular stood in the way of an absolute and unconditional requirement of compensation. Among the forces that stood in the way of uniform and unconditional provision there was also the clinging by the workmen themselves to the option for suing their employers for damages, with its delusive possibility of a heavy jury award. Different systems were adopted in different states; and not infrequently the compensation was inadequate as well as lacking in certainty. Usually the same method was followed as in Great Britain and France: the burden of compensating the workmen was put on the employer once for all but some freedom was left him as regards the manner in which the provision should be made. In many jurisdictions he was given an option of insuring either in a private employers' liability company or in a coöperative ("mutual") insurance company controlled by the state and competing with the private companies.

While provision for accident had thus been established at a comparatively early date by action of the several states, that for old age was made by federal legislation thru the act of 1935 (the Social Security Act). Something of the kind had indeed been undertaken already by a few states, but usually on a limited scale and for special cases. The United States act ignored these sporadic efforts—the states could do as they pleased in the way of changing or dropping their plans—and proceeded at once to an all-embracing system.

Between the two procedures already tried in other countries—that of a simple uniform pension for the aged as in the British Commonwealth and that of a pension varying according to the beneficiary's previous earnings as on the continent of Europe—the second was followed. And it was followed on a huge scale. Practically everyone who could show evidence of having worked at all was assured of an old age benefit. The minimum was to be $15 a month, the maximum $85 a month. The sum for each "qualified individual" was based on the total wages received by him over a series of years (the term "qualified individual" being very liberally defined).

The enormous financial measures and obligations which the act of 1935 undertook I shall not consider, not only because they are complicated and difficult but because they are likely to be altered by legislation, perhaps even before the start is made on the payment of the benefits. Yet one vital part of the financial aspects of the scheme deserves attention here—the provisions for building up the funds which are to be accumulated. An excise tax was imposed on employers, based on the wages paid out by them, beginning with 1937, at a rate of 1 per cent on the wages paid, and rising until it finally reached in 1948 the definitive rate of 3 per cent. In addition, the same rate of tax was "levied" on the employees; which in practice means that the employer is called on to pay this tax also into the public treasury, then deducting the amount from the stipulated wages when these are paid to the employee. The total "pay roll tax" which the employer must meet thus would start at 2 per cent in 1937 and become 6 per cent in 1948. What the incidence of such a total charge will be is an economic problem not only difficult of analysis (i.e. of stating on what factors the incidence will depend) but quite impossible of any accurate quantitative prediction. To the man on the street and to the average legislator it seems simple: the employer pays out of his own pocket the first 3 per cent, will include it in his costs, and will sooner or later add so much to his prices. On this reasoning, all prices will then go up; since virtually all employers producing vendible goods or services are affected. The question, of course, then arises whether or how far the price level as a whole can be made to go up as a consequence of tax legislation. And as regards the second 3 per cent (that deductible from wages), it is again a question whether the nominal rates of wages will remain unaffected or will also go up by the whole or part of this amount and so add further to the employers' immediate costs; and whether they will thus lead to or become associated with a further rise in prices all around. These are questions about what will happen in the long run; and the answers depend on what one believes to be the long-run factors that will act on real wages, money wages, and the price level.

Questions of this kind are difficult enough to answer theoretically; that is, on the assumption that no other factors will enter. But it is certain that other factors will enter—changes in legislation, in the long-run forces that bear on wages, profits and interest, in the monetary situation, disruptions caused by great wars. When all is considered no one can foresee just what will happen. The only safe prediction is that the burden will be distributed widely. It will affect in greater or less degree virtually all members of the community; a consummation to be accepted with equanimity.

Essentially, to sum up, the United States old age plan is one for subsidized compulsory insurance, providing annuities proportionate (in a rough way) to the beneficiary's previous income. It is not in the nature of an eleemosynary provision, as is the case with the European plans for modest fixed payments which commonly go no further than to take the edge off the extreme of poverty and helplessness. Whether it is well to go beyond this point and proceed to the more ambitious American plan is a matter not solely, hardly even primarily, of economic analysis but one of the underlying aims and principles of state regulation in the distribution of wealth and income. It is to be said that the state, when establishing pension systems for its own officials and employees, has invariably acted on the proportionate principle. To be strictly consistent it should apply the same principle when each and every worker is to be assured of provision for old age. Yet when it comes to dealing with a huge problem of the same kind as a comparatively small one, consistency cannot always be maintained—the financial and economic problem becomes so much more serious as it becomes larger that the difference becomes one of kind rather than one of degree.

The United States system, as established in 1935, contemplated long-run factors and long-run outcome; planned to be in effect for half a century before a definitive balance of payments and benefits was reached. Yet it would be folly to predict the economic and political conditions of the second half of the century. Changes in the system will beyond doubt be made; how many and how radical, no one can say. I cannot but believe that a system more of the pay-as-you-go character, not making financial plans for fifty years in the future, would be wiser. Nor would this be incompatible with the retention of the main principles: some contribution by the beneficiaries, some adjustment of the payments to their previous earnings and standards. These essentials are likely to stand, whatever the modifications made in the course of the decades.

§ 6. Unemployment presents problems even more difficult than accident, old age, and sickness.

Socialists like Marx and Rodbertus contend that a large reserve of unemployed workmen necessarily comes into being under the capitalist system. In answer it was maintained by most economists of the earlier generation that a steady supply of unemployed laborers tends to bring its own remedies; it brings a competition for places, a bidding of laborers against laborers, a readjustment of terms between employers and employees, and the final attainment of a stage of equilibrium when all will be absorbed in industry. As a matter of abstract reasoning this is more consistent and logical than the socialist attempt to prove that continuous unemployment on a large scale is inevitable. To put an extreme case, if one half or one quarter of the total number of laborers were long unemployed it may be reasoned with confidence that readjustment would take place by lowered wages and altered industrial and technological arrangements; and before long there would be diminution of unemployment and eventually (supposing the process to work out its results without check to the end) none would be left.

But all reasoning that attempts to show how unemployment tends to bring its own remedy assumes settled conditions of industry—the absence of friction and transition and irregularity. Such conditions never exist in the actual world and never will exist, unless indeed under a rigid socialistic régime. An automatic adjustment of the supply of labor to those conditions under which all shall be employed works out in fact only as a rough approximation or tendency; like the tendency of imports to balance exports, of the price level to conform to the quantity of money, of the earnings of individuals to be proportioned to their efficiency. In the actual world there is but a loose conformity to these long-run tendencies. So far as unemployment goes, it is true that the greater its extent the stronger are the forces which tend to make it diminish; yet there are abundant causes for its being a continuing phenomenon. The steady progress of invention and improvement brings shifts in the employment of labor; at any given moment a certain proportion of men are being displaced in one industry and are not yet absorbed in another. Restlessness among the workmen themselves—probably promoted by the monotony of factory work —is another cause of shifting. The periodic maladjustments of industry and the recurrence of stages of depression are a great and calamitous cause of unemployment. Similar in effect and more continuously in operation are the seasonal oscillations. These are sometimes inevitable, as in the work of the harvests. Often they are not inevitable but the result of the mere crudeness of the organization of production and exchange. In such industries as the making of boots and shoes, clothing, straw hats, even "Christmas goods," there is no inherent reason why the work should not be evenly distributed thru the year; yet in fact busy seasons are habitually followed by slack and overtime work by unemployment. Casual and irregular labor is sometimes inevitable, as in loading and unloading freight from vessels and railways; and irregularity is frequent even where not inevitable because many employers are disposed to favor casual labor rather than take the trouble of arranging for a permanent staff. So constantly are these various causes at work that non-employment is an unceasingly recurring phenomenon and in that sense a permanent one.

Any method of insurance for equalizing the burden of the irregularities of employment presents some obvious difficulties of administration. The irregularities are of a sort which do not tend to offset each other, like the chances of death and old age. They are therefore not readily susceptible of actuarial treatment; and if so at all only with a very wide margin of "loading." That they vary from occupation to occupation is not so serious a difficulty. Insurance against unemployment could be organized, like insurance against accident, on the basis of occupations and with differences of rates according to varying risk of unemployment.

With this enormously difficult problem Great Britain grappled courageously, almost adventurously, in her insurance act of 1911. That great measure provided not only for an all-embracing system of insurance against sickness and permanent infirmity but also for a large tho not universal one against unemployment. Thereby Great Britain came to provide, like Germany, for sickness and disability as well as for accident and old age; and went beyond, taking the lead in this humane rivalry by establishing provision for unemployment also. In certain important occupations (such, for example, as building, the so-called engineering trades, shipbuilding) insurance against being out of work was made compulsory. Contributions were required in equal amounts from employers and employees, the state also adding a share. A system of labor exchanges had already been established for facilitating the mobility of labor; it soon became so extensive in its operations as to serve effectively as a test of non-employment. Like the German insurance code, the act of 1911 was a remarkable piece of legislative workmanship. Its chance of successful operation was immensely increased, as had been the case in Germany, by the existence of a trained permanent administrative staff, to which could be allowed much discretion on details, and also by the existence of a system of national public labor exchanges, set up just before the unemployment act. An extraordinary forward step was taken in this field of social reform. Gradually it was supplemented by further steps, more and more industries being included. The number of workmen reached by the system was moderate at first, less than 4,000,000; as the system was gradually extended the number came to be over 12,000,000.

In the United States insurance against unemployment was established by the same statute (of 1935) as that for old age benefits. I say established: it is more accurate to say that it was made certain of establishment. The federal government went no farther than to bring pressure to bear on the several states toward the setting up by each and every one of them of a system of unemployment "compensations." But this pressure was such that action by the states was assured. An excise tax was imposed on all employers having eight or more employees (with certain exceptions, of which the most important is for agricultural labor), amounting to 1 per cent in 1936, 2 per cent in 1937, 3 per cent for 1938 and every subsequent year. Against this tax the employer was given credit for any contributions paid by him, up to 90 per cent of the amount of the United States tax, to an unemployment fund under the state law. The pressure on the states is obvious. Its citizens (employers) must pay the pay roll tax in any case; but if they pay contributions into a state system establishing an unemployment fund the United States tax is almost entirely remitted.

In the main, each state was left to shape its unemployment compensation system according to its own judgment. Certain general regulations were laid down to which the state systems must conform; but they did not seriously hamper the states in framing their own legislation.

§ 7. It is worth while to make a digression for a moment to remark on the suddenness with which this whole system of wide-reaching social security was established in the United States. In Europe the process of incubation was commonly long; in this country it was—or at least seemed to be—short.

The explanation of this rapidity of growth is to be found, curiously enough, in a certain deep-rooted conservatism of thought and action; a trait in the American public which has its advantages and its disadvantages. In many matters of large consequence there is sluggishness of public opinion and slowness and hesitation on the part of political aspirants and leaders in detecting a growing movement of thought; then a sudden burst, as if a match were applied to a bundle of accumulated inflammatory stuff. This was already the case in the earliest phase of security legislation, that of insurance against accident. Long opposed as un-American, inconsistent with the liberty and responsibility of the individual, dangerous to the foundations of society, and what not like phrases, it was enacted by one state (Massachusetts) and then spread like wild fire thru almost all the states because of a conviction of long tho silent growth that here was an ill that should be remedied. Something of the same sort is to be said of the Roosevelt legislation of 1935. The depression that began in 1929 served to strengthen and bring into the open a feeling that had long been brewing. This sudden acceleration in tempo is perhaps unavoidable in a government resting on public opinion; but often it leads to haste in legislation and difficulties in administering laws enacted in a final scramble.

§ 8. In one respect the provisions of all the systems of unemployment insurance have proved inadequate and unsatisfactory. The benefits (relief) have failed to continue long enough and unsolved problems remain.

This is more particularly the case with unemployment arising from cyclical fluctuations. When it comes to seasonal unemployment the trouble is simpler, the remedy more adequate. Seasonal unemployment alone was dealt with in the first American act, that of the state of Wisconsin. There the machinery of contributions and benefits was adjusted on the principle that the employer who marshalled his output in such way as to minimize the slack periods was given a refund of part, possibly the whole, of what he had paid in. This plan of procedure is all to the good. But action which merely brings pressure on the individual employer to keep on an even keel thru a given period, say a year, signifies little when it comes to the prolonged cyclical disturbances. The effects of these are a matter not of months or seasons but of years. The unemployment lasts longer, often much longer, than the period for which the benefits have been assured. And as this proves to be the case the provision is never allowed to cease. Something has always continued to be paid after the funds accumulated for benefit payments have been exhausted; perhaps under a different name and without commitment for any definite period but for a much longer time than was originally contemplated. Something more than insurance has thus been attached eventually to every system of unemployment benefits that has been in operation for a considerable time. The new thing was often given a new name; sometimes it was called "extended benefit," sometimes "relief," sometimes vernacularly "dole." It was in fact a form not of insurance but of systematic relief. The widespread use of it brought many countries face to face with a situation which, while not new, yet was thrown bare more clearly than before and was a cause of anxiety as well as of amazement.

A similar discovery—such it was for most persons—was made in the United States in 1937; not in the same way or of quite the same thing, yet essentially similar. In that year there was a marked recovery from the depression that had set in after the collapse of 1929. During the years of depression the federal government had expended billions of dollars for those in need; partly by providing employment on a great series of public works, partly by direct relief in the form of money payments to those in dire need. In the main these measures were palliatives or stop-gaps, meant to meet an immediate exigency and not to be continued indefinitely. When industrial activity began to revive in 1937 they were gradually withdrawn, in the expectation that the recipients of the relief would find employment in private industry—most of them, if not quite all. Revival set in and private employment enlarged. But by no means all who had been supported by the public found jobs; not even a very considerable fraction. The whole situation was a perturbed one and significant in many other directions than we are following here. As regards the present path of inquiry, the important thing that was seen—more than suspected before by the observant but of a volume surprising to them also—was the existence of a great number of persons who are either unemployable or such as to find employment only in times of unusually strong demand for labor; and that there was another great motley swarm made up of the sick, aged or aging, incapables, persons morally or intellectually troublesome or impossible. How far their sad lot is the result of congenital defect, how far that of unpropitious environment and poor training, is most difficult to say; but there they are.[1]

[1] Dr. William Haber, a careful and well-informed observer, remarked in 1937: "The relief population of the United States does not represent a mass of like individuals. They fall into three general groups. The first are those who, as the statisticians have so often stated, are "able and willing" to work. They will find jobs with continued recovery and better organization of the labor market. . . . They represent . . . approximately one-third of the relief population in the United States, both work and relief.

"The second group also characterize themselves as able and willing to work. There can be no question that they are "willing" but it is very doubtful if they can also be called "able" in the competitive sense. They are, at best, second-rate people. They are persons who have been left behind by technical advances, men whose carefully acquired skills are no longer needed, whose skills have been supplanted by machinery technique, men who are somewhat old, men who are comparatively less alert, men who are excluded by the hiring limits of industrial concerns, men who have some physical incapacity. . . . This group comprises 25 to 30 per cent of the relief population.

"The third group represents the irreducible minimum: the aged, the sick, the incapacitated. This group represents another third of the total relief population." The Needed Link Between Unemployment Insurance and Relief, *Social Security*, 1937.

The response to the questions thus raised is different according as one is (to use William James's phrase) tender-minded or tough-minded. Here I go no farther than point to the need of facing the plain fact that in all our advanced communities there is a great low-lying stratum which is not effectively reached by any system of unemployment insurance and probably little reached by health insurance; and only in the last stages is it reached by old age insurance or pensions.

The situation was squarely faced in the "poor laws" of the nineteenth century. That term "poor laws" has gone out of fashion; it is common nowadays to use euphemistic language such as "welfare" laws.

The English poor law investigators of 1832–34, after surveying the experience of their country prior to the great reform of that date, came to the conclusion that the only safe way to administer poor relief for the able-bodied as well as for the aged, disabled and defective, was to concentrate it in workhouses or almshouses. Outdoor relief (that is, relief outside the almshouse) was to be abolished. The principle was tough-minded: let relief be made effective but not attractive. For generations the abolition of outdoor aid was regarded by the English as the only feasible method of carrying out the principle. It was thought the *sine qua non* of successful poor law administration. Yet outdoor relief in fact never disappeared in England, even for the able-bodied. Further experience and reflection and the general change of attitude on social problems gradually led to different views. An almshouse, like a prison for criminals, is often a school of demoralization; and relief in it, expected to be unattractive, ceases with habituation to be so. The keynote of modern charity administration is differentiation in the treatment of the various kinds of needy persons. Outdoor relief is admitted to be a dangerous remedy, better discarded entirely than used freely. Yet with caution, and especially as a means of tiding over temporary straits, it serves better than an inflexible almshouse test. Again, indoor relief, i.e. institutional care, should be of various kinds, different for the young and old, the sick and the well, the habitual vagrant and the workman temporarily in need. The complex problems of charity administration, themselves the subject of a large literature, prove to be after all not fundamentally different from those of workmen's insurance and the other measures for social security. They show the widening influence of altruism and at the same time the search for intelligent and discriminating methods. Thru all runs the same fundamental principle: aid the weak in such a way as to strengthen them.

The distinction between the cases where there is no ground for hesitating in charitable effort and those in which there is, is readily seen when we consider two cases: pensions to the aged and direct money payments to the able-bodied. Old age pensions, restricted to persons in need, are virtually a form of relief to the poor. But they are comparatively easy to administer. Old age cannot be shammed. Doubtless there are cases of pretense of being older than the claimant really is, but there are no very serious difficulties in this direction. Relief to needy of every kind, the ill and the well, the able-bodied and the disabled, paid in cash, has its obvious dangers. The needs can be pretended or exaggerated, the endeavor to be self-supporting is blunted. There are plenty in the low substratum for whom half pay with no work is more attractive than full pay with steady work; and there are not a few among the quite able-bodied of whom the same is true. To say this is not to imply that all these are morally weak, or are demoralized by their own fault. It is merely a tough-minded facing of a sad fact. Outdoor relief to them as a rule is merely a palliative, resort to which becomes habitual. Experiences of this kind beyond question came on a great scale in the enormous relief expenditures of the United States (federal, state, local) during the depression of 1932–37. The danger of demoralization is less when the relief is given in kind—food enough and assured shelter but no cash; and when it is administered by trained social workers. But at best it remains a palliative and one dangerous when continued for a long time.

§ 9. Public relief works are a better device. Yet they have proved of service chiefly as safeguards against imposture; and for the latter purpose they are of uncertain effect—they sometimes cause imposture. In the United States, during the long depression after 1929, much was done by public authority in the way of controlling inland waterways—to lessen damage from floods, to improve navigation, to store water for irrigation and urban use, and to create electric power. The numerous projects were carried out with engineering skill and efficiency and on the whole with economic effects of lasting value; and indeed were more successful toward achieving these long-period gains than they were as immediate palliatives for unemployment. Yet it remains a remarkable testimony to the general effectiveness of the régime of private industry and to the extreme difficulty of finding a substitute for the spur of pecuniary interest that public relief works have rarely been successful in putting any considerable number of deserving unemployed at work on something really worth while, and have never been successful in achieving this result for all the deserving unemployed. It is easy to declare that, at a given juncture, there are both unemployed laborers and needs to be satisfied for the community by the labor of somebody. To bring these two together and set men to work on things they can do and on which their labor tells to full advantage is the most difficult task a public official can be confronted with. Both the public employer and the aided employee almost always feel it to be perfunctory. Only where the simplest and most monotonous of tasks can be assigned—as wood sawing or stone breaking—is it possible to provide work for the unemployed and hold them to a fixed stint. Very little work of real utility can be laid out in this mechanical way. Most things worth doing are more complex. It is difficult at best to find work that is thoroly worth doing; it is even more difficult to get it efficiently done by relief operations. For one thing, the power of discharge is lacking; and it must be sorrowfully admitted that this power, heartless tho it seems and subject to abuse as it is, remains essential for keeping the ordinary laborer steadily at his task.

None the less there are public works of a kind that are certainly worth carrying out sooner or later and they may best be set going in times when there is unusual lack of employment. Some palliation for the recurring stages of depression may be found by massing in such periods long-range public expenditures. In a country like Great Britain, for example, the great industry of shipbuilding is especially subject to those fluctuations which, as we have seen, are marked in the industries that make plant and machinery. If the government must build men-of-war let it put the shipyards to work on them in those times of depression when the demand for merchant shipping is at a standstill. Similarly in a country where railways are not yet adequate to the country's needs, new construction and extension may be taken in hand or subsidized at times when private investment is halting. This calls for a firm hand in checking the public expenditure as soon as private undertakings revive. Many people, employers and employees, will be certain to clamor for indefinite continuance. Even when prudently managed this is an uncertain device, subject to the dangers of perfunctory public works. Nevertheless it is better than the common procedure of letting the rush of speculative activity affect public operations also, thus exaggerating both the upward swing and the subsequent recoil.

Another palliative, one that comes nearer to being a cure, is a system of labor exchanges—wide-reaching and permanent arrangements for spreading information and increasing the mobility of laborers.

Much more can probably be done in this way by public authority than has yet been accomplished. Private agencies are subject to great abuses. They take the laborer when he is least capable of holding out and bargaining and when it is most easy to take advantage of his weakness and ignorance. Something, too, can probably be done in systematizing the distribution of seasonal and casual labor—dock and railway labor, harvest hands, men engaged in construction work. Here, again, the social ferment is at work and the problem is grappled with as never before.

§ 10. One aspect of the relief or poor law question which was much talked of in earlier days has been relegated to the background. It is the danger of malingering—pretense, imposture, demoralization. Ill effects of this kind have not proved so great and so hard to overcome as was long feared. They can exist for unemployment compensation only if there is rank corruption in the administration. In Europe they have proved to be negligible as regards health insurance. Old age pensions being on a flat basis are subject to them little, if at all. The chances of manipulation and imposture are greater when there are graduated pensions. All in all, difficulties of this character are not of great magnitude if there be a trained, permanent administrative staff—a *sine qua non* for all the regulatory activities which are accumulating in these modern times. The dangers are greatest and the need of capable and experienced government officials is greatest for the large relief problems which remain after every kind of insurance has been provided.

On the other hand, the question of the cost of it all is looming up more than before. The cost tends to become larger and larger. Benefits, at first small or moderate, are raised. New kinds of benefits are provided; on a modest scale at the outset, then gradually raised. More and more of services are provided, as for example in health insurance, and expenses go up in accord. Taxes of one and another kind are increased or newly imposed. In whatever way the taxes are levied, whether on incomes or by way of excise, they mean that a part of the income of those not receiving benefits is taken from them and turned over to the beneficiaries. This cannot go on crescendo indefinitely. The public purse seems inexhaustible when any single dip into it is undertaken. Every politician, every representative of a particular class, every ardent reformer, feels that the expense of the particular project he favors can make no vital difference in the whole of the public budget. It is so with regard to that form of public activity which is on all hands admitted to be good and not to be stinted: the education of the people. It may be we cannot have too much education; certainly we cannot have too much freedom of opportunity. But there are limits to what can be taken in hand now and here. If all the good things for which good people clamor were to be provided at once, the burden on those who in the end must carry it would prove beyond capacity. Enlargement of the sphere in which the state provides necessities, comforts, conveniences, services, can continue only if the others who take care of the beneficiaries as well as themselves become more effective producers. The apparatus of production must not only remain intact and in good order but must be improved and enlarged; and those who work must learn how to handle it better and better, to labor more intelligently and effectively. In schemes for utopias and collectivism this simple *sine qua non* is forgotten or slurred over; and so it is in the accumulating schemes of reform of the existing order.

No doubt the general effect of a system of social security is to improve the tone of the productive mechanism. It is by no means all a matter of outgo; not only is there the obvious return in welfare and human happiness but there is some gain in the material output, because people work more effectively when they are healthy and cheerful. But that gain comes slowly and inconspicuously. How great it is and how far it offsets the unmistakable cost, no one can say. At best its attainment is a matter of the very long run.

Still another aspect of these matters is again one which touches political problems as well as economic. In the United States, the movement for better government—for simplified elections, for a trained public service, for elimination of "politics" and corruption —has, to be sure, grown steadily for half a century. But the need for reform of this kind obviously becomes the greater when the functions of government are enlarged, as they have been and will continue to be. I hope and believe that a succession of measures will come for the training and selection of a competent public staff, all the way from permanent heads of large departments to country postmasters. The passage of laws may be a quick matter. But the details for good administration may take much time to learn.

CHAPTER 62

COÖPERATION

§ 1. Coöperation attempts to dispense with the business man. Its various forms. —§ 2. Coöperation in retail trading, when done by the well-to-do, of little general significance. When done by workingmen, as in Great Britain, it has larger effects. Methods of the workingmen's stores and causes of their success. The movement elsewhere.—§ 3. Credit coöperation in Germany; its methods and results. Other sorts of societies, and development in other countries.—§ 4. Coöperation in production would most affect the social structure but has had the least development. Causes of failure; the rarity of managing capacity and the limitations of workingmen. The future of coöperation.

§ 1. Coöperation among manual laborers was long regarded as the most promising means of reaching better social conditions. The prospects of far-reaching change by this method seem less good now than they did to the economists of the nineteenth century. The coöperative movement, none the less, remains an important one, not only because of its extent and its substantial results but also because experience with coöperation is instructive concerning the place of the business man and of business profits in modern industry.

The essence of coöperation is getting rid of the managing employer. Laborers, or indeed any set of persons whether laborers or not, do for themselves that work of planning and direction which is ordinarily done by the business man. They not only do his work; they also assume his risks. There must be in any case superintendence and administration; these are delegated partly to salaried agents, in part are undertaken by committees or officers serving gratuitously. The coöperators as a body settle the general policy and assume the risks of the undertaking, just as the stockholders do in a joint stock company. In this last-named way they aim to supplant the business man in his most important and characteristic function.

Coöperation has been tried in retail trade, in credit and banking operations, in some phases of agricultural work, and finally in "production." This enumeration proceeds roughly in the order of success: coöperation has been most successful in retail trade, least so in production. What has been the degree of success in these several directions and what the explanation of the differences?

§ 2. Coöperation in retail trade, or distributive coöperation, is the simplest form. A number of persons—workmen or others—get together, subscribe a fund, buy their commodities at wholesale, and distribute these among themselves. Simple as this is in outline, the business of retailing has its complexities. Goods must be on hand in convenient quantities, with due variety, easily found for the customer; those that become obsolete or shopworn must not be allowed to accumulate; the preferences and whims of purchasers must be humored. The coöperative stores have found that if they are to get beyond the most primitive form they must assume the outward appearance of the ordinary retail shop, with its show windows and placards, decorations and temptations. At one time in the history of distributive coöperation in England it was thought possible to save rent by taking premises on a back street. But as growth took place it was found advisable to do as the private trader does—take conspicuous premises on the main thorofares. Thus only can the purchasers be effectively reached and shopkeeping conducted on a large scale and with real economy. Site rent, in other words, has been found to be not a cause of high price but a result of efficient operation; and low rent has not been found to bring a net saving.

Where this sort of thing is done by persons of the well-to-do or middle class it has no considerable social interest. As regards the larger questions of social reform, it makes little difference whether a shopkeeper gets his profits or a body of coöperators saves a bit by substituting for him salaried agents. This is all that is meant by such great coöperative stores as the London Army and Navy Stores, the Civil Service Supply Association, and others. These excellent institutions owe their success in large degree to their requirement of cash payments. The traditional relations between the ordinary English tradesman and his well-to-do customers had long been, and indeed still are, those of servility combined with high charges on the tradesman's side, and of delayed and irregular payment on the customer's side combined with affected indifference to the prices. Long credits, bad debts, high prices, and large "spread" (advance of retailer's selling price over his buying price) had been the natural consequences of this pseudo-aristocratic régime. The coöperators, by agreeing to pay cash, made possible much more businesslike methods and considerable economies as to bad debts and interest.

In the workingmen's stores, however, coöperation has meant something more. These stores had a remarkable growth in the half century which elapsed since the first small start about 1850. They now number thousands, their members number hundreds of thousands, their transactions run into hundreds of millions of dollars. Their influence reaches the daily lives of a very large portion—perhaps one half—of the working population of Great Britain, especially in the manufacturing regions of the north of England and Scotland. Their example has been followed on a large scale on the Continent, and has not been without its influence in the United States.

A type of the workingmen's store is the Rochdale Equitable Pioneers' Society, the earliest and the most famous of them. The Rochdale stores, as the workingmen's stores of this type have come to be called, sell at ordinary or current retail prices. They make no attempt to effect a saving at this first step. Periodically, say at the end of each quarter, they divide profits among their members in proportion to purchases made by these. The system necessarily involves keeping account of the purchases; a somewhat troublesome process, in which the British stores enlist the aid of the members themselves. Tin tags (or, in very recent times, paper or cardboard slips) are given to members for the amount of every purchase, and these memoranda are turned in by them at the close of the quarter in order to make up a record of each individual's purchases.

This practice of postponing and lumping the savings has two advantages. It has a clear financial advantage: the gains are not divided before they are made. Where the attempt is made to sell at once at lowered prices the mark may be overshot thru failure to make enough allowance for expenses, depreciation, and the like. Then, as has happened with many coöperative experiments, the enterprise eventually goes to pieces. But the Rochdale plan has a much more important advantage than this financial safeguard. The rills of gain on the several purchases, swollen at the end of the quarter to an appreciable volume, are not so likely to be dissipated. The chance is greater that they will be put by and saved. And the stores themselves offer an opportunity and even temptation for saving. The dividends, as the accumulated profits are called, may be left at the store as capital and when so left are entitled to interest. At the very outset the store needs some capital, which is subscribed by the members (usually in modest sums, the share for each member being £1). The dividends, largely left at the store, add to the capital. It is in this way that the capital of the workingmen's stores, small at the start, has been brought to great dimensions. The stores not only make savings; they act also as savings banks.

This insinuating arrangement for thrift is intentional. The Rochdale stores have always regarded themselves as something more than storekeepers and penny savers. The early promoters and spokesmen of the movement were men of noble spirit and looked on the coöperative store as the first stage in a great workingmen's movement. The expectations which they and their contemporaries cherished have somewhat abated in later days; but there is still an atmosphere of high-minded endeavor. Thus the stores almost invariably refuse to sell liquor, even tho this might be a source of larger profit. They make it easy for non-members to join. Strictly, members alone are entitled to share in the dividends; but non-members are often allowed half dividends on their purchases, the amounts so allowed being credited as installments of subscriptions to shares until the full share is paid for and complete membership so secured. Substantial sums from their profits are sometimes allotted for educational purposes and the like. At the annual meetings, especially those of the general coöperative congress, the cause of coöperation and workmen's independence gets encouragement and laudation; sometimes, no doubt, in empty phrases yet in the main with a real spirit of social sympathy.

The causes of the remarkable success of this form of coöperation in Great Britain are several. Not least among them are the general influences which brought about the great progress of the British working classes, and especially the upper tier of skilled workmen, during the second half of the nineteenth century. In this progress the trade unions, the friendly societies, the coöperative stores played their several parts; while the march of industrial improvement under capitalist leadership sustained it all. The requirement of cash payments has been an important advantage to the stores; another has been the essential weakness of their former competitors, the petty retail shops. No part of the mechanism of the division of labor is so inefficient as that of ordinary retail trading on a small scale. At the same time ignorance, gullibility and shiftlessness enable this sort of wasteful business to hold its own with singular persistence. The coöperative store means a resolute effort to eliminate as much as possible of the waste. As with so many improvements, the initiation of this one in Great Britain was due to the energy and ability of a few individuals—picked men among the working classes—who devised and perfected the system. That system once in working order, it was comparatively easy for others to imitate; just as there are always plenty of business men who can follow the new paths opened by the real leaders of industry.

The success of the British coöperative store illustrates, too, the difficulty of getting rid of accustomed industrial ways, bad tho they may be. Abstractly considered, it might be supposed that an enterprising set of retail traders could have pushed out the wasteful petty shop by doing business on a large scale on a cash basis and at lowered prices. Some displacement of this sort has in fact occurred in the United States, where the bonds of custom are more easily shaken off. In Great Britain and on the continent of Europe habits change less easily. It required the entirely new method of coöperation, with its appeal not only to the purse of the workingmen but to their sense of solidarity, to bring about a more rational and economical organization of retail trade.

For many years the coöperative store movement in Great Britain has been so strong as to go on largely by its own impetus, yet possibly with something of artificial stimulation. The traditional rate of dividend on purchases (something like 10 per cent—on the average, 2*s* on the pound) has probably been maintained in part by keeping prices high and not solely by continued saving as compared with current retail practices and prices. The coöperators seem willing to pay a little more in order to get their accustomed dividend. However this may be, the coöperative stores are an established and important element in the industrial system of Great Britain. They have done much to promote the material welfare of the workingmen and something to train them in ways of common action.

On the continent of Europe there has also been a considerable development of distributive coöperation. As in Great Britain, it has been partly middle class and so uninteresting, partly working class and so more significant. The greatest growth of the workingmen's stores has been in Germany and Belgium, where the movement has been closely allied with that for socialism; altho the coöperative and socialistic ideals differ in essential points. The opportunity for displacing wasteful retail trading seems no less on the Continent than in England. If as yet it has on the whole been much less availed of, the explanation probably is that the workingmen of the Continent have felt only in very recent years the stir which roused the English half a century earlier. The progress of this labor movement, as of others, has of late been rapid.

In the United States distributive coöperation has never had the same sort of growth or importance. There have been many attempts and some successful experiments; but nothing of any large consequence. The lack of growth in this country is the result of various causes. Greater mobility of population, both within cities and between separate regions, is an obstacle. The comparative ease with which capable persons rise in the social and industrial scale often deprives coöperators, as it does trade unionists, of possible leaders. Greater prosperity and larger earnings cause indifference to small savings. And finally, retail shopkeeping is usually conducted with fair efficiency. The occupation is not under a ban of social depreciation, as it has so long been in older countries, and therefore it attracts more readily men of ambition and capacity. In the urban centers much of it is carried on with more than fair efficiency. The large shop and the department store have nowhere been carried to so high a pitch as in the United States. None the less a great deal of petty and wasteful shopkeeping remains. For the working classes the small retail trader often is half a friend in need, half a swindler and parasite. There is opportunity for a declaration of independence. Let the ways and habits of the people seem not to favor independence by the method of coöperation. It is striking that the really successful workingmen's stores in the United States (not many in any case) usually have a membership made up of the newly arrived and still clannish immigrants.

§ 3. In some other fields there has been a development of coöperation not less striking than that in retail trading.

In coöperation for securing better credit facilities the Germans have taken the lead. The name of Schulze-Delitzsch is associated with this movement in Germany as the name of the Rochdale Pioneers is with the stores in England. Schulze, a native of the town of Delitzsch, conceived the plan of uniting groups of tradesmen and artisans for getting small loans on better terms and led the way with signal ability in the development of the plan. In essentials it is simple enough. A knot of persons—tradesmen, artisans, and the like—form a credit society, beginning by subscribing a small initial capital. On the strength of this and of their own individual liability they borrow more—two or three times more. Schulze always maintained that for these outside borrowings unlimited liability by each member (as in a partnership) was essential; not only because the person lending to the society thus had the security of being able in case of default to levy on any and every member individually but because this very liability made the members and managers unfailingly watchful in their dealings among themselves. The total sums got together, their own and borrowed, are then lent out to the members in modest amounts at a moderate rate of interest; this rate of interest being higher than that at which the loans from outside are secured. Even tho higher in this way, the rate to members is commonly less than they would have to pay otherwise. And this is the precise object aimed at—to enable small producers to get the advances they need without paying the high rates of interest which as individuals they would almost always have to face. By combining their resources and their credit and by managing the loans among themselves they are able to borrow at moderate rates. Knowledge of each other's ability and probity is important and enables the credit society to make advances and take apparent risks which no outsider would assume except on burdensome terms. As with the British stores, the system, once established and perfected, proved capable of wide development. The societies numbered many hundreds and played an important part in Germany. Some among them are large financial institutions, with members (i.e. borrowers) who do business on a considerable scale as tradesmen, merchants, manufacturers.

Tho sometimes used for considerable transactions, credit cooperation of this sort is essentially for the small man. Its spread and success in Germany are largely ascribable to the fact that so much of small-scale production still persists in that country. More or less of it persists in any country. Large-scale operations, far spread and growing tho they are, have nowhere swept the field entirely. In Germany, perhaps more than in any other advanced country, the artisans and small producers held their own, not only thru inertia but thru an adaptation to modern methods of production that has given them real vitality. The Schulze-Delitzsch societies have done much to maintain them. The unflagging industry of these Germans and their content with sparse gains have in turn provided a favorable soil for credit cooperation.

Another phase of the same general movement in Germany is associated with the name of Raiffeisen, who also was a leader in developing an effective scheme. Raiffeisen societies are chiefly agricultural and serve the needs of the great class of peasant proprietors in southern and western Germany. Their organization is similar to that of the Schulze-Delitzsch societies, which are commonly urban or semi-urban. Some capital is subscribed by members; more is got outside (sometimes with government aid). The loans to members are for longer periods than in the urban societies, as is necessary if they are to be of real service to agricultural producers. Their spread has been extraordinary; there are thousands of societies and probably one half the smaller agricultural proprietors of Germany are enrolled as members. Each society has comparatively few members and covers a limited region; the essence of success is neighborly knowledge and supervision.

Other sorts of societies flourished in Germany—societies for the purchase of materials, for the sale of products, for the purchase and use of machinery too expensive for any one member. The credit societies, as well as these, have spread into other countries. Credit coöperation has had a large development in Italy, where also it has proved to meet the needs of the class of small tradesmen and artisans; and it has spread similarly among the agricultural classes of northern Italy. It is odd, and not readily to be explained, that in France no one of these forms of coöperation—whether in retail trade for credit or for other analogous ends—has had any considerable growth.

A striking advance has been made in Denmark and to some extent in other Scandinavian countries—coöperation among agricultural producers in collecting milk and making butter, curing bacon, packing and shipping eggs. A large export trade, especially to England, was built up on a basis of coöperative effort. The English naturally looked on this achievement with envy and wished that their own agricultural producers might adopt the same methods with the same success. But for success of this sort a system of land ownership in small parcels is necessary, or at least one of long-term tenancy with assured compensation for improvements; and not only such an assured position but habituation of the cultivators to it. The English system of landowning and land tenure constitutes the great obstacle to the spread of this sort of coöperation in England. When England gave up her policy of free trade in 1932 she imposed heavy protective duties on these products and so brought about an increase of her domestic output and a lessening of the Danish imports. A sad blow was dealt to a sturdy agricultural population which had grown and prospered under a customs régime of such long standing that there was every reason to expect its maintenance. Germany did much the same but had at least the excuse that protection was no new policy. These damages to international trade and international good feeling were among the least defensible among the many of the period.

§ 4. All the schemes outlined in the preceding sections are for what may be described as partial coöperation. They leave the members independent in their main industrial activities. Very different is the case with coöperation in production. Here the endeavor is made to get rid of the business man at the vital place. Workmen get together and procure in some way (by saving, borrowing, public aid) an initial capital. They possess their own tools and plant, buy their materials, sell the output, and divide among themselves the proceeds. They are their own managers and their own employers; and if successful they can secure business profits as well as ordinary wages and, not least, can emancipate themselves from the dependent position of the hired employee.

Evidently if this were done on a large scale social conditions and the organization of industry would be profoundly affected. The employing capitalist would disappear. The consequent changes would be vastly greater than those from the spread of the other forms of coöperation. Distributive coöperation, if carried to its utmost conceivable development (and it is far from being carried to that stage or likely to be), would mean simply the displacement of the retail shopkeepers by a set of salaried agents. Coöperation in credit touches only some fringes and loose ends of the modern industrial system. The various phases of coöperation in agriculture are designed to aid the independent farmer and strengthen his position, not to supersede him. Productive coöperation, however, if carried out to the full, would modify social and industrial organization at a crucial point. Even if applied not universally but on a scale comparable to that of the other forms—if it could show hundreds of societies, with members by the tens of thousands or hundreds of thousands—its spread would mean something of high import for the present and future.

Unfortunately coöperation in production hardly exists; or, if it exists, only to such an extent that the thing cannot be said to be unknown or untried. A considerable number of experiments in it have been made in various countries. There have been sporadic cases of sustained success. But the record on the whole is one of failure.

This is true even in France, where some societies aided by the state have had a long and successful career. The same is true of a few societies that have grown out of profit-sharing experiments. The striking thing is that whether aided by the state or not, whether started from the beginning as productive societies or the outgrowth of profit sharing, they are so few. There has been no lack of propaganda, of opportunity, of support. The net result is as nothing compared to industry in general, even compared to the growth of other forms of coöperation.

In other countries there is the same insignificance of the productive societies. In Great Britain a very few have held their own. In recent years these have been bolstered up by the great distributive stores, which have bought by preference some products from the producing coöperators. This sort of patronage is not necessarily enfeebling, any more than is public aid. But that it is welcomed or even resorted to shows that the prospects of independent success are not good. Unless the coöperators can do so well in quality and price of their goods and in the earnings which they secure for themselves that they call for no favors, simply competing with capitalists on even terms, there is no chance of any large development.

It is striking that in Great Britain the coöperative stores have themselves entered in another way on the field of production. The great wholesale societies and some of the individual retail societies have established factories and workshops of their own for making shoes, clothing, hardware, biscuits, jams, and pickles; they have even tried tea planting in Ceylon and (with doubtful success) farming on their own account in Great Britain and Ireland. All these establishments are managed by superintendents sent down from the coöperative stores. The workmen in them are hired in the same way and substantially on the same terms as in ordinary private establishments. Obviously this is a very different thing from true coöperation in production, where the workmen choose the managers from among their own numbers. The success of the stores in their subsidiary establishments rests largely on the fact that they have an assured market and confine themselves to making staple goods by staple methods. None the less it is remarkable that the associated workmen should have achieved success in management by this route when they have failed of it by the more direct route.

The essential difficulty in the way of coöperation in production is that it attempts to supersede the business man where he is most needed. Its failure is at once a result and a proof of the rarity and the importance of business leadership. Coöperation on any large scale cannot dispense with these leaders; it would have to enlist them. No spur to the full application of their powers has been found comparable to that of individual ownership and individual gain. Individuals of high capacity are sometimes found at the head of coöperative enterprises, working unselfishly for the cause and for their fellows. Such apparently has been the case in some of the great British stores. Such, too, has been the case in some of the great profit-sharing enterprises. But these are exceptions. Most men exercise their faculties to the highest pitch when working for themselves and their families. Possibly a substitute for the driving force of self-interest may be found in an entirely different organization of society; of this more will be said elsewhere. Coöperation put on trial in the midst of an individualistic and capitalistic organization has failed to enlist the needed leadership.

The conclusion, both from experience and from general reasoning, is that coöperation is not likely to bring any radical change in the social order. It may grow considerably in some of the ancillary operations already carried on with success. But the hope entertained a half century ago by many economists—that it was only in the first stages of a far-reaching development—is now cherished by few. Other ways of mitigating inequality and widening opportunity have come to enlist the enthusiasm of social reformers—labor organization, labor legislation, extension of public management and control, socialism half way or all the way. To these the future seems to belong, not to coöperative methods.

REFERENCES ON BOOK VI

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BOOK VII

ECONOMIC ORGANIZATION

CHAPTER 63

RAILWAYS (I)

§ 1. Introductory; grounds for a separate treatment of railways.—§ 2. Railways as freight carriers further the geographical division of labor; hence do not promote the public welfare unless they pay.—§ 3. Economic characteristics of railways; first, the great plant. A tendency, especially in the earlier stages, to decreasing cost. In those stages, moreover, rapid transitions from financial embarrassment to financial success.—§ 4. The element of joint cost; its significance for freight and for passenger service.—§ 5. The principle of joint cost largely explains the practice of charging "what the traffic will bear"; the justification of the practice is that it maximizes the services.—§ 6. Other consequences of the principle: the flexibility of rates; the difficulty of applying supposed principles of justice or reasonableness to individual rates; the apparent and sometimes real capriciousness of the rate system; the great power over industries which it put in the hands of railway executives; corrupt and semi-corrupt management.—§ 7. Rate agreements, pools, combinations.—§ 8. Both joint cost and monopoly are factors in railway rates. The applicability of the joint cost principle rests on the existence of capacity not fully used; hence was of special importance in the early state of railways in the United States, and became of less importance as construction ahead of traffic ceased.

§ 1. THE present Book is concerned with the same fundamental problems as the preceding Book—inequality and the ways of mitigating it. But it considers the relation of the state not so much to the laborer as to the capitalist and employer. What need is there, what are the ways, of controlling private business management or of supplanting it?

The railway is a striking example of the great-scale industries with which this treatise is chiefly concerned. Its development is typical of the changes that have come since the middle of the nineteenth century, both as regards the internal growth of railways and their relation to the production and distribution of wealth. More than any other single factor the railway brought about the industrial revolution of the second half of that century. Its cheapening of transportation immensely promoted far-reaching geographical division of labor, large-scale production, impending monopoly, great fortunes. While its position in the twentieth century was not so commanding as it was in the nineteenth it remained an agglomeration of vast enterprises, with a tendency to monopoly conditions in its inherent workings; it presented conspicuously the problems of public control and public ownership. True, in the course of the twentieth century it came to be less before the public eye and less conspicuously the occasion of heated controversy. On the other hand, as it reached a comparatively settled stage and its special characteristics became more clear, economists have been disposed to treat it as a somewhat special case among the big businesses. So it is; yet in the last analysis different in degree rather than in kind. It will be considered in this chapter and the next with regard both to the problems peculiar to it and to those which illustrate the general problems raised by the growth of the huge monopolized and monopolistic industries.

§ 2. First, one characteristic of its own and one which, while in its essentials simple, has been and often still is lost sight of. As a freight carrier a railway is simply an instrument by which things are made cheaper because transported from a place where they are made cheaply to another place where the conditions of production are less good. People commonly forget that all agencies of transportation are but means of furthering the geographical division of labor. An enormous amount of effort is given to activities which are simply ancillary—which serve only to facilitate the more effective apportionment of the community's labor. The railways of the United States in 1900 employed one person for every twenty-nine who were gainfully occupied.[1] This figure takes account only of those employed in the current operation of the roads, not of those who had worked on their construction; and we shall see presently that the amount of such previous work, as indicated by the capital investment, is exceptionally large. In estimating the total of the ancillary activities we should have to reckon also the millions of teamsters, truck drivers, merchants, salesmen, clerks, and so on—an enormous host, all engaged in the transfer of things from places where they can be produced cheaply to other places

[1] The total number of persons gainfully occupied was, in round numbers, 29,000,000; the steam railways employed a trifle more than 1,000,000.

where their expenses of production would have been greater. A comparatively slight advantage in production, which in former days would have been offset by the expense of transportation beyond a short distance, now suffices to concentrate industry in one region and to induce exchange on a great scale between it and other regions.

It follows from this obvious but often forgotten fact that a railway is not economically advantageous to the community unless it pays its way. This is the familiar test applicable under the régime of private property to all industries: unless an industry supplies things in such quantities and at such prices as will make it worth while to the owners, the case *prima facie* is that it is not worth while to the community at large. But as regards an avenue of transportation it is often said it may bring gains to the public even tho not profitable to its owners. Similarly it is often argued that a government in operating a railway may accept with composure a financial loss because the people as a whole have gained something that offsets that loss. The contrary view is the just one. No economic gain comes from carrying a thing from one place to another unless it can be produced at the first place so much more cheaply that it can afford the cost of carriage to the second. Ability to stand the transportation charge is the test of the utility of the carriage.

Needless to say, particular sections and particular individuals may be benefited by transportation which is supplied at less than cost. Early in the twentieth century the state of New York engaged in a great enlargement of the Erie Canal, at an expenditure of one hundred millions or more; and it was enacted (by the hard and fast method of constitutional provision) that no tolls should be charged for the use of the canal. With the completion of the canal, it was as if nature had made a navigable river. Doubtless more traffic may go to and thru the city of New York; the rent of landowners there may swell still further; some consumers may gain in having goods cheaper. But it must remain an open question whether the labor which built the canal yields its full result to the community. The test of its having been worth while must be whether canal tolls could have been collected in amounts sufficient to pay for the labor (and waiting). It would be desirable, obviously, to have all transportation free and to have every commodity produced once for all where it could be most cheaply produced. But so long as transportation involves labor and the use of capital a real advantage is got only if at the point of consumption the total cost can be met, including that of transportation.

It may sometimes be of advantage to open up a new country or a new region by railways (and the argument applies equally to highways, canals, steamship lines) which do not pay at the outset. This case is analogous to that of protection for young industries. But eventually the railway should pay; if the losses of the early stage are not recouped they are definitive losses. It follows that where subsidies are given to encourage railway construction they should be in the nature of loans, to be reimbursed when the stage of profitable operation has been reached.

The case, in other words, is different from that of industries which yield utilities more directly. Some industries there are in which financial loss is consistent with public gain. A water supply may be managed by a municipality on terms and methods which, while involving a deficit, none the less bring a real advantage to the public. A superabundant supply of good water brings hygienic gains not measured by the price people are willing to pay. The post office also may be administered with good reason on non-commercial principles; for the diffusion of intelligence is a boon not measured by its market value. The deficit which the United States incurs from its cheap carriage of letters, books, periodicals and newspapers is not necessarily a public loss, tho a similar deficit on the parcel post for merchandise would be.

Passenger traffic presents a somewhat different case from freight traffic. Some passenger traffic is much nearer the stage of utility and satisfaction than freight traffic. Most of it to be sure, like freight traffic, is only a phase of the division of labor; such as the constant movement of people to and from their places of employment. Pleasure traveling alone is a consumer's utility. The only serious ground for managing passenger traffic on non-commercial principles is to be found where there is marked immobility of labor or crowding of population. Cheap fares under congested conditions may bring a real social gain not measured by what the individuals are willing to pay.

These remarks on passenger traffic obviously pass into the realm of "welfare economics" as distinguished from that of the national dividend. It is worth while to call attention to the distinction here because it is particularly pertinent for industries of transportation like the railway. As regards welfare in the wider sense—in which might be included such an intangible thing as the unity and solidarity of a political entity—a railway may be worth while even if it fails to pay. But as regards the main objective of economic inquiry, the national dividend, it is not worth while unless profitable to the builders and operators, whether they be states or private persons.

§ 3. Railways have two marked economic characteristics—not such as to make them in the last analysis different in kind from other industries but so great in degree as to bring railway problems into a class almost of their own. These characteristics are, first, the great size of the plant; and second, the fact that the operations are conducted largely at joint cost. Both have important consequences for the problems of public regulation.

A railway's plant is large relatively to that in most industrial units; but it is more important for the present argument that the plant is large relatively to the railway's current output. As compared with the capital invested in plant, the annual gross receipts (the money measure of the output) are but a small fraction—one fifth or one tenth. A manufacturing plant in which the plant merely equaled in value the annual output would be regarded as having a relatively large fixed investment; how much more the railway, in which the plant is five or ten times as great in value as the annual turnover.

Connected with the large plant is a great flexibility in its use for long periods and a tendency to decreasing cost per unit of traffic. When a railway is once built, its roadbed and other fixed equipment will serve equally well, within wide limits, whether the traffic be large or small. An increase of traffic, tho it means some increase in operating expenses (probably even here not a proportionate increase), ordinarily calls for no increase of the permanent plant. Hence for the traffic as a whole it means decreased expense per unit. This is true, of course, only so long as the fixed equipment does continue to suffice for enlarging traffic. With continuing enlargement the stage is reached where the plant no longer suffices. A single-track road eventually may need to be double-tracked or a double-tracked road four-tracked; the stations, sidings, and terminal facilities enlarged and so on. Then there often ensues an uneasy period for the railway manager. A great and probably quick enlargement of the plant is called for, while the traffic, tho too heavy to be handled with the existing roadbed, is not growing rapidly enough to insure at once full employment and satisfactory earnings for the enlarged plant. The railway after having been overworked with its former outfit has for a while not enough business for its new outfit. This sort of trying transition stage is most noticeable when a railway passes from a single track to double track, yet shows itself almost as much in the enormous new terminal facilities needed in regions of dense population and traffic.

Thru all these changes and with all the irregularities which ensue from the gradual growth of traffic and the occasional abrupt increase of plant there runs a tendency to decreasing cost per unit of traffic; that is, a tendency to increasing internal economies. A double-track road with a sufficient density of traffic carries freight and passengers more cheaply than a single-track road; a four-track road more cheaply than a double-track one. It follows that two single-track roads over the same route are a wasteful application of the community's resources as compared with one double-track road; and so on. And it follows further that concentration and monopoly promote the most effective ways of laying out the railway net.

One important consequence of a railway's large plant is the frequency of sudden transition from financial failure to financial success. This is especially the case in rapidly growing communities. When a road is first built the traffic may not be large enough to make operation profitable. Gradually the traffic grows; and as it grows the road is able to carry it with the existing plant and also with operating expenses largely unchanged. A stage is thus reached where the traffic and the revenue from it are such that a profit is earned; while just before, with a traffic but little smaller, the capital invested had secured little or nothing. An abrupt change in financial outcome takes place and with it a sharp change in the market price of the railway's securities. For the same reason fluctuations in general business activity are of special effect on railways. In times of depression and slackened traffic they cannot lessen their heavy capital charges at all and can lessen their operating expenses but little. In times of revival and growing traffic their receipts increase without an increase in their expenses at all corresponding. Hence in new countries, or in countries subject to great fluctuations in business conditions, railways and railway securities offer peculiar opportunity for speculation and speculative investment and for large gains by the shrewd and far-sighted. These conditions long existed in the United States more markedly than in any other country and had much to do with the great fortunes made from railways in this country. Sometimes the first investors—the "builders" of railways—reaped large gains by waiting thru thick and thin until the growth of traffic made the enterprises profitable. Quite as often it was the persons who bought control of railways in the intermediate period of uncertainty that made fortunes by the rapid transition from loss to profit.

§ 4. A second peculiarity, no less important in its consequences, is the element of joint cost in railway expenses. The same roadbed is used for passengers and freight and for the different kinds of passengers and freight. If the outlay for plant were the only expense incurred in rendering the service the case would be one completely of joint cost. There are, of course, the operating expenses in addition. But the expense of the plant (represented chiefly by interest on the investment) forms an unusually large part of the total cost of transportation. In other words, return on capital is an unusually large part of the expenses which must be recouped if roads are to be built. In so far, the principle of joint cost is applicable to the two kinds of service—passenger and freight.

But the operating expenses also represent in large part joint cost. Many of them are incurred for the traffic as a whole and must go on whether or not individual items of traffic are undertaken. Such is most obviously the case with the large expenditure for maintenance of way. The roadbed must be patrolled, kept in order, and repaired from the wear of exposure and use; and this whether there be much or little traffic, one or another kind of traffic. Safety appliances must be there in any case. Much station expense, especially at small places, is the same whether business be large or small. So it is as to general office and administrative expenses. All such expenses serve, for example, equally for passengers and freight and cannot be said to be incurred specifically for either, or to be separable as expense for one or the other. Probably one half of the total operating expenses of a railway is impossible of apportionment to any class or items of traffic and thus stands for joint cost.

Even as to the items of expense which are not common for the traffic as a whole, there is often an element of joint cost for a considerable block of traffic. Those operating expenses which are not wholly joint vary in the main according to the number of trains run and the distances run by them; that is, according to train miles. Every train mile means so much separate outgo for wages, fuel, wear and tear of rolling stock and of track. But a train may have ten cars or eighty, and the cars may be full or empty. Train miles, and consequently the immediate expenses, will be substantially the same whether the train be long or short, full or empty; but the tonnage carried will be very different. It is a cardinal maxim in railway operation that every train ought to have as many cars as the engine can haul and that every car ought to be loaded to its full capacity. But this ideal maximum utilization of the rolling stock —this ideal fitting of ton miles to train miles—is impossible of attainment. There are inevitably some short trains (especially as to local freights) and some cars empty or half full. For each train by itself much the larger part of the cost for freight is joint for all it carries.

The same situation is even more obviously present in passenger service. Passenger trains must run on their schedule time. Their expense is substantially the same whether the seats be occupied in whole or in part, whether they have the maximum number of cars an engine can haul or only half or a third of that number. A great increase in traffic entails, it is true, an increase in passenger train miles. But a very considerable increase in passengers and in revenue may come without any additional train miles; that is, without any appreciable difference in expense. A mail car, excursion car, sleeping car, private car, attached to a regular passenger train involves little additional expense; the whole train is operated at one joint cost. On European railways first-class, second-class, and third-class carriages commonly form part of the same train and are operated at one joint expense for the train as a whole. The apportionment of charges among the different classes of passengers proceeds (in a rough way) on that basis of utility or demand which, as has been shown, dominates where cost is joint.[1]

The principle of joint cost underlies the much misconceived practice of "charging what the traffic will bear." That phrase, it is true, describes also another and very different aspect of railway rates—their monopolistic character—of which more will be said in the next chapter. As commonly used, however, the phrase refers to the apparent failure of railway rates to conform to cost of production; and it calls for a word of further explanation.

No one item of traffic, it is obvious, will be carried at a charge less than the separate expense involved for it. But above the small separate expense is the mass of joint expense; and that joint expense must be got back somehow or else railways will not be built. Some items of traffic will "stand" a heavier charge than others; that is, they will continue to be offered for transportation even tho the charge be high. Other items will "stand" only a low charge; that is, they will not come unless the charge be low. The joint expense will be got back from the former group much more than from the latter. This is the main explanation of the classification of freight; that is, the arrangement of articles in classes, with a higher rate per unit of weight on some than on others. Railways in all countries, whether under public or under private management, habitually charge less per ton mile on cheap bulky articles than on articles having high value per unit of weight. Thus coal, ores, lumber, are "low-class" articles, on which rates are relatively low; textiles and groceries are "high-class" articles, and on them rates

[1] See above, Chapter 15.

are high. The coal, ores, lumber, will not be offered for transportation unless rates be low; the traffic will bear no more. The textiles and groceries will be offered even tho the charge be relatively high; the traffic will bear it. The textiles and groceries, therefore, will contribute much more to the general (joint) expenses than the coal and lumber. In ordinary business parlance the "profit" on the one is greater than on the other; which means that there is a greater excess of receipts over separable expenses. Where both kinds of commodities are carried on one and the same train there are virtually no separable expenses for either. Barring such items as loading and unloading, all the expense is joint and the principle of joint cost has full play.

§ 5. To explain an economic phenomenon is by no means the same thing as to justify it. People constantly confound these two proceedings and suppose that because an economist shows how a given result comes to pass he therefore implies that it is a right result. That the principle of joint cost explains in good part the practice of charging what the traffic will bear does not prove the practice to be just.

As to the question of propriety or justice, there is much hazy talk among persons who have had to give attention to railway matters but have not been versed in general economics—such as railway managers, and judges and public officials concerned with the enforcement of rate regulation. These often speak as if it were obviously and intrinsically "just" that a commodity having higher value should be charged higher freight rates. It must be confessed that some trained economists have spoken in the same loose way. Yet no one would apply such a notion to transportation by pack mule or wagon; the charge here is the same (aside from insurance and the like) whether the articles be silks and groceries or coal and brick. Being habituated to a different mode of fixing railway rates, people think of it as righteous; they commonly regard the wonted order of things as just.

The justification of charging what the traffic will bear must rest on more solid ground: namely, that it conduces to the fullest utilization of the railway. More service is got by the community on this plan than would be got on a plan of uniform rates. If all rates were on a uniform toll plan, being the same per ton mile on each and every kind of freight—a so-called system of "natural" rates—bulky articles would have to pay more than now and compact and expensive articles would have to pay less. Of the expensive freight, however, little more would be offered because of the lowered rates; whereas the amount of the bulky articles offered for transportation would be greatly diminished by the higher rates. The only way in which the bulky articles can be made to move in great quantities is by carrying them at low rates; just as—to resort again to a familiar comparison—the only way in which cotton seed can be disposed of is by offering it at a price which is low as compared with the price of cotton fiber. Most of the expense involved in carrying the bulky articles is incurred anyhow; it is involved in the general or joint expense of building and operating the railway. The only way to get the full utilization of all this labor and expense is to fix the rates in such manner that the transportation shall come.

The geographical division of labor has been most profoundly affected by railways in the production of the very articles which have great bulk and weight relatively to their value—coal, ores, lumber, and the like. The vast development of modern industry could hardly have taken place without their transportation on a great scale at low rates. Thru the general practice of charging what the traffic will bear the railway plant has been made to produce its most far-reaching results.

§ 6. Some other consequences of the principle of joint cost have been and are of large social significance.

Railway rates are necessarily flexible. Even tho rates as a whole be so fixed as to cover the total cost, there is no clear relation between a specific rate and the specific cost of carriage. The absence of any precise measure of cost of service makes it plausible to adjust the charge, apparently arbitrary as it must be in any case, according to all sorts of real or supposed benefits. Where governments manage railways it leads easily to the determination of rates on other grounds than those directly related to transportation. It may be supposed, for example, that imports are bad and should be discouraged, while exports are advantageous and should be promoted; and this familiar protectionist notion leads naturally to high rates on things imported and low rates on things exported. If it were perfectly clear that a financial loss is entailed by carrying at low rates the goods destined for export, governments would hesitate as long before conceding specially low rates as they do in granting direct money subsidies on exports. The question of money loss or gain is obscured when no specific railway rate can be shown to involve a direct loss. Again, low rates which favor a particular set of constituents or a given locality will be similarly easy to bring about and may be similarly in apparent accord with the general ways of rate making. To arrange railway charges on a "just" basis, as is the aim of a government in managing a railway, is a task of peculiar difficulty and complexity.

The same difficulty exists of course when a government, tho it does not itself operate the railways, regulates the rates of private corporations. This is what the government of the United States sets out to do as to the interstate traffic under its control. The Interstate Commerce Act of 1887 says that rates shall be "reasonable." What is the standard or measure of reasonableness in rates? It is not difficult to answer this question as regards the general range. Rates as a whole should not be higher than will suffice to yield a normal return on the capital invested in railways, a "normal" return being understood to include not only interest but something in addition by way of compensation for risk and judgment. Even tho no absolutely precise settlement of such a rate of return be feasible, an approximation to it can be reached—6 per cent or something of the sort. But this helps very little as regards any individual rate. Whether an individual rate is "reasonable" is a question of its right adjustment to the traffic demand and to the best utilization of plant and equipment. It happens that this question of principle has not often been deliberately considered, either in the United States or in other countries. The general methods of railway rates as they developed under the tentative and profit-seeking ways of privately managed railways were accepted once for all. That rates should be lower on bulky goods is thought to be obviously "right." Similarly, existing geographical adjustments of rates, bringing wide variations in different regions and between different places, were left in the main undisturbed. Probably this rule-of-thumb policy worked as well as any that could have been devised. Any scheme of symmetrical rates based on supposed principles of justice or naturalness would have fettered the fullest development of traffic by railways.

Still another consequence of the element of joint cost, in the United States especially, was a perfect chaos in the rate system. This was unmistakably the situation before the enactment of the Interstate Commerce Act in 1887; and tho matters mended thereafter, much confusion still remained. In this country, as in others, railway rates were developed tentatively. The possibilities of carrying bulky goods at low rates over long distances and of the other adjustments of rates on different articles and to different regions were discovered gradually. No settled tariffs of rates existed in the early days; if any existed, they were disregarded. Almost all rates were "special" rates; that is, were reached in each case by higgling between shipper and carrier. This method, or lack of method, no doubt promoted flexibility in rates, high utilization of the railway plant, and economy in its operation; but it caused also grave evils.

One great evil was the power in the hands of railway managers. With the widening of the market due to cheap transportation the price of this very transportation became of crucial importance. Success in business was possible only to the man who got as low rates as his competitors. Favors in rates might mean a fortune. The railway traffic manager could make or unmake this man or that town. Such power over the fortunes of others can be intrusted to very few men without being abused. It constituted perhaps the strongest reason for public control, whether directly by government management or indirectly by government regulation.

In the United States the power was sometimes used corruptly. Those in control of railways—managers and directors—arranged for themselves, as traders and shippers, lower rates than other shippers got. This sort of practice is corrupt in that it violates the fiduciary obligations of directors and managers—their most obvious legal and moral duty is to manage the railway with a single mind to the advantage of the shareholders; but it is also inconsistent with the fundamental principle that competition should be on even terms. Here the game was played with loaded dice.

More commonly, however, favors in rates were given not in arbitrary or corrupt ways but under the stress of railway competition. That competition, as has already been noted, is made peculiarly severe because of the conditions of joint cost. Rather than let any particular item of traffic go elsewhere the railway manager will accept any rate which yields something over the expense (comparatively slight) entailed by that specific item. A large shipper in dealing with competing railways could play off one against another and secure for himself special rates. In the old days corruption or semi-corruption of the traffic manager—say by offering him shares in the large shipper's corporation—played its part. But competition between railways and their inevitable eagerness to "get the tonnage" were the main causes of the favors to large shippers.

These extraordinary effects of railway competition showed the modern business system at its worst. They unexpectedly and artificially accentuated the trend toward large-scale operations; they placed a premium on untruthfulness, intrigue, bullying, spying. Yet it must be said also that this same factor of railway competition immensely promoted efficiency in operation. Every railway manager was put on his mettle to carry the tonnage at a profit, even with low rates. Freight rates on American railways became remarkably low, and especially low on that long-distance traffic which was most subject to competition.

§ 7. The natural step for competing railways is to put an end to competition by combining to fix rates once for all. Hence railway pools and combinations appeared at an early date as a means of putting an end to "ruinous" or "cutthroat" competition. Such pools were hard to maintain, at least under the English and American law, which makes them void and non-enforceable; [1] but they checked the tendency to special rates for favored shippers. They were thus a means of furthering equality of treatment and equality of industrial opportunity. None the less the Interstate Commerce Act prohibited combination of any sort; the prohibition was made even more drastic by the general anti-monopoly act of 1890, known

[1] Compare Chapter 65.

as the Sherman Law. The Interstate Commerce Commission repeatedly recommended the repeal of this sort of legislation and the authorization of pools and rate agreements. The anxious fear among our public men of being supposed to favor monopolies has prevented any relaxation of the stringent restriction; and this even tho the recommendation was coupled with the proviso that the rates fixed after pooling or agreement should be subject to public approval (say that of the Interstate Commerce Commission). In the absence of any available means of escaping the stress of competition, railways were impelled to combine once for all, rival roads being absorbed under single control. The consolidation of the railway net into great systems which went on so rapidly during the twenty years after the passage of the act of 1887, tho by no means due solely or even chiefly to this cause, was promoted by the fact that railways were deprived of their best means of self-defense against competition. Our legislation on railways was in this regard inconsistent with itself. It prohibited discrimination, yet also prohibited one of the means of checking discrimination. It prohibited combinations and pools, yet promoted the rapid march of complete consolidation.

The great and flagrant inequalities in rates, by rebates and otherwise, were largely brought to an end by the activity of the Interstate Commerce Commission. An aroused public opinion contributed to this betterment; the elimination of competition thru the consolidation of the railways contributed even more. So long as railway competition persists it will always be difficult for traffic managers to resist the temptation of securing larger tonnage by favors to this or that shipper; and ingenious devices will be sought—in the way of allowances for switching or for damages, manipulations of one sort or another—for "defeating" the nominal rate. The prohibitions and penalties of legislation would be made much more effective if railways were allowed to make rate agreements openly. Here as elsewhere our public policy was ruled by a panic fear of monopoly and an unwillingness to face the essential problem, how to regulate monopoly successfully.[1]

[1] This anomaly was removed by the Transportation Act of 1920, which authorized the pooling of freight traffic by railways under the supervision of the Interstate Commerce Commission.

§ 8. The principle of joint cost, to which so much attention has been given in this chapter, is not of the same significance in all stages of railway development. Its importance is less in thickly populated countries with well-established industries than in countries with thin population and industries rapidly shifting. It bears most on the special problems of pioneer regions; and as these regions advance beyond the frontier stage it ceases to be all-pervading. The general reasoning has more application to the United States of 1870 than to the United States of 1940; and more to the United States in general than to the older European countries such as England, France, and Germany.

The applicability of the principle of joint cost to railway problems depends in the last analysis on the existence of capacity not fully utilized. There must be either a plant, indispensable in order that a given kind of traffic (e.g. passenger) shall be carried at all, which yet is not utilized to the full for that traffic; or else operating expenses (such as signalling, station, terminal expenses) which are in the same way indispensable for a given traffic but would suffice for the handling of further traffic if it could be secured. The most striking illustration is that of "back-loading." Where there is back-loading, just so many train miles or car miles of railroad service are available when the equipment makes the round trip. From this extreme case railroad conditions shade off into those at the other extreme, where we have not capacity knocking at the doors for utilization but the ordinary case of a large plant with a high proportion of fixed charges and an adjustment of the plant and the entire organization to a specific range of products—an adjustment which can indeed be changed but not quickly or easily. As railways and the regions they serve emerge from the pioneer stage; as traffic becomes denser and more regular; as the different regions served become industrially more homogeneous; as the railway becomes able to utilize its entire plant and its whole operating force continuously and systematically—the special characteristics pointed out in this chapter become less dominant. But tho less dominant, they do not cease to be important. It will always be difficult to say with precision what is the cost of a particular item or class of traffic. It will remain, for example, impracticable to allocate with exactness the cost of passenger as compared with freight traffic or to say that a charge of two cents or three cents a mile is in any exact or even approximate accordance with the specific cost of conveying passengers. If indeed a road were used for passenger traffic only and were utilized to the full for that; if no occasion arose for turning its roadbed and facilities to freight also—then a sufficiently close determination of passenger cost per mile could be made and a proper or just charge fixed accordingly. The converse case arises when a road can be utilized (as with a coal road or a logging road) for freight only. But where there is a jumble of diversified traffic—and traffic not merely diversified but attracted to the railway only thru adjustment of rates to the demand for transportation—then railway charges are most flexible, least reducible to a plain and simple rule.

To repeat, the cardinal element—capacity not utilized to the full—becomes less vital in a country thickly populated and industrially solidified. In such a country the monopoly position of a railway becomes relatively more significant for the explanation of the special characteristics of railway rates. To this phase of the subject attention is given in the next following chapter.

CHAPTER 64

RAILWAYS (II)

§ 1. The growing profits of railways in the earlier period.—§ 2. Concentration of control in a few hands. Overcapitalization.—§ 3. Speculation, "operators," magnates.—§ 4. Inside manipulation.—§ 5. Railways have represented conspicuously the general industrial and social conditions of the United States.—§ 6. Changes in the 20th century.

§ 1. Railways have been important agents in increasing the disparities of wealth in modern times and in bringing about great fortunes. They have had this effect indirectly by promoting the general tendency to large-scale production; and they have had the same effect more directly thru the tendency to increasing gains with their growth to maturity, thru the concentration of their ownership, thru the possibilities of speculative manipulation. In all the social aspects the situation became different in the twentieth century, more particularly in the years after the close of the war in 1918. It will be convenient to consider first the earlier years, before 1914.

A railway in a growing country is largely in the same position as good land. It tends to advance in value and to secure an increment of economic rent. This tendency is combined with that other, noted in the preceding chapter—repeated rapid transitions from financial uncertainty to financial prosperity. The two combine to make the railway a frequent occasion of "conjunctural gains," as the Germans call them.

In part the railway's accretion of economic rent arises from purely physical causes. Some lines have better natural locations than others. The New York Central Road has an exceptional location in the Mohawk Valley and along the eastern bank of the Hudson—the best location for the huge volume of long-distance hauls between the seaboard and the Central West. Any railway which first secures the best route along a valley or canyon has an advantage over later competitors in economy of construction and ease of operation.

An even greater part is played by general social causes. Population clusters along the line of a railway; towns and industries attach themselves to it. Its traffic increases, while on the whole the expense of conducting the traffic becomes less. Tho other railways may be built in such way as to compete with it, the established railway has an advantage which can be lost only by very bad management or very unexpected changes in the course of industry or invention. One great source of advantage is in terminal facilities at the cities. Urban land becomes expensive and the railway which got its land cheap in the early days has an advantage over competitors who try to enter in later days. It is true that this sort of advantage, like others that rest on social causes, is subject to change and possible decline with shifts in population and with new inventions. None the less the advantages of an established railway tend in general to increase steadily with the growth of population and industry.

§ 2. More conspicuous in their social consequences are the tendencies toward unified control of railways—both toward the concentration of control in few hands and toward the emergence of monopoly thru the elimination of competition.

The concentration of control in few hands was promoted by the way in which our laws have permitted the organization of corporations and the issue of corporate securities. Loose legislation and (it must also be emphasized) looseness in the prevalent standards of business ethics here led to some of the most unwelcome consequences of private ownership.

Overcapitalization, so much condemned, is not in itself a ready road to royal profits. The mere printing of stocks and bonds is no source of riches. If securities which represent no investment, or a less investment than their face value indicates, are none the less income-yielding and profitable it must be because the enterprises which they represent are profitable. The real cause of gain in such cases is either good management or monopoly; the greatest gain comes from a combination of the two. So far as railways or other industries are monopolistic in character, successful overcapitalization—successful, that is, in the pecuniary sense—is the result of high prices. A monopoly will in any case set its prices as high as it can.

To this general statement, as to almost all general statements in economics, some qualification must be attached. It will happen at times that overcapitalization does cause at least a clinging to high prices. The managers of an overcapitalized monopoly may have to face the fact that great blocks of securities are outstanding, very likely issued by their predecessors and now held by all sorts of investors. They are then loath to let go any slice of its profits. We have seen that often the monopoly principle of maximum net profit is not applied in its full sweep, especially in industries which are potentially subject to public control. Where abnormal returns on the original investment have been secured, later concessions to public opinion, in the way of lower rates or better facilities, are more likely to come when capitalization has not been inflated.

Whether there has been in fact overcapitalization, and whether it has served to conceal profits unduly high, is often difficult to decide. The typical railway in the United States presents a perplexing case. At the outset the roads were usually overcapitalized. But at the outset and when first put into operation they were but half completed. Unlike European railways, they began with a plant and equipment adapted to a scant traffic and largely provisional. Gradually as the country grew and traffic increased they were improved by putting some share of earnings into enlargements and betterments. This process continued decade after decade and was combined with the direct and unmistakable investment of additional capital thru the issue and sale of more stocks and bonds. What the total investment finally was, and what the relation between outstanding securities and actual investment, became very difficult to say.

The case is further complicated by the question of a proper allowance for risk and for skill in management. Some railways have been financially profitable; others not so. Some have gone thru a long period of no returns and uncertain prospects; others have earned good returns from the very start, some on an inflated capitalization. The differences are partly due to general physical and economic causes, partly to varying judgment and skill. The mere fact that a railway has been unusually profitable is no more a proof of special advantage or monopoly than is the mere fact that a mercantile or manufacturing enterprise has yielded a fortune. In all such cases the quality of the management is an all-important factor.

It is not easy to say whether in the United States during the period before the war of 1914–18 railways were on the whole unduly profitable and hence whether their overcapitalization concealed a large element of monopoly profits. Successes were balanced by failures, eventually large returns by periods of no return at all; while at the same time the problems of management were such as to call for the highest ability. It may be true, as is sometimes maintained in behalf of our railways, that in view of all the risks and all the enterprise and all the skill the gains from them were not greater than those secured by the investing classes in industry at large, and in that sense were not disproportionate to the energy and sacrifice involved.

It is doubtful whether the whole mechanism of shifting and swollen capitalization was at any time necessary or wise. Why not provide once for all by law that securities shall be issued only to represent what has been invested? True it is that such a limitation must have been accompanied by a liberal margin as to permissible returns. Great risks of investment must be offset by a chance of large profits. Railways in the United States never would have been built by private capital (and public enterprise, tried at the outset, proved hopelessly incapable of the tasks of development) if no more than 6 or 8 per cent had been allowed as the maximum return. It is sometimes even said that freedom, nay recklessness, in the issue of securities was a useful device, in that it enabled the projectors to look forward to returns really tempting and at the same time conceal these returns from a grudging public. Ten per cent, for example, would not have been sanctioned; but 5 per cent on a doubled amount of stocks and bonds caused no outcry. Possibly, too, there is a seductive effect on the promoter and investor from the appearance of getting something for nothing. A more simple and straightforward way of dealing with the issue of securities might have dampened in some degree the feverish speculation and restless progress of railway development. But a slower pace would have had its advantages also and, not least, restriction of securities would have saved great complications in the later stages of established monopoly and needed regulation.

§ 3. Certain it is that the absence of restriction on the issue of securities promoted acquisition of control by the familiar class of railway magnates. The importance of the mere element of control in the great corporations has been already considered.[1] At the risk of repetition and by way of further illustration something more may be said on the control of railways.

The separation of control from investment (and so from ownership) has not usually appeared at the outset. It is often alleged that even at the start the real promoters and managers of a large enterprise made no investment of their own and assumed no real risks. They are supposed to secure all the needed funds by the sale of bonds to confiding investors, keeping for themselves the stock (issued for nothing), and so reaping profits without ever having shouldered any risks. No doubt they would like to proceed in this way and sometimes have done so. But usually the matter was not and is not so simple. The "insiders" must set an enterprise going, must put in money at the start and stretch their credit, taking securities on their own responsibility. Usually they are associated with a banking firm, which takes some securities on its own account, exacts its toll for backing and indorsing, and acts as middleman in eventually disposing of the securities. Bankers as well as promoters necessarily assume some of the risks. No doubt the purchasers of the bonds were often deceived; and often they deceived themselves, thinking that a so-called "bond" had a high degree of security even tho a rate of interest was offered which on its face tells of a risk involved. As time goes on however, with misrepresentation or without, the prior securities, which have the first claim on the profits and involve the least risks, get into the hands of the general investing public and the shares of stock remain in the hands of the projectors and bankers.

Shares of stock mean ownership and control. In the eye of the law the holders of bonds are simply creditors, entitled to their in-

[1] Chapter 50, Business Profits and Corporate Management.

terest and in due time to their principal but quite without voice in the management. The stockholders in the early stages of the American roads, great and small, were apt to be a shifting and speculative body. The stock itself in those stages commonly had little prospect of dividend and was valuable for the time being chiefly because it secured control. It was bought and sold at low figures, fluctuating sharply in value because of the abrupt fluctuations in the financial prospects of railways. It was precisely the sort of security that finds favor for speculative purposes on the stock exchanges. The original promoters sold out more or less as they found the prices tempting. Often they came to be concerned much more with current quotations of the stock than with the permanent prosecution of the enterprise. In all the great corporate concerns of modern times the original notion of a joint stock company—a set of persons associated in a common venture—quite disappears. Each holder tries to get the better of the others by buying cheap and selling dear.

These are the conditions under which the "great operators" appeared and under which the railway fortunes were made. Ownership of the stock and control of railways often got into the hands of shrewd, able, daring men. They saw the possibilities of future gain when stock quotations were low. Very likely such personages, once in secure control, see to it that the properties are efficiently managed, yield large returns to themselves, and even bring better service for the community. But they come into control by the machinery of stock speculation. Such is in great part the explanation of the riches of Vanderbilt, Gould, Harriman and their fellows. The founders of these fortunes were not the original projectors and promoters of the railways; they were the interlopers who secured control in the later stock gambling stage.

§ 4. Over and above the great fortunes and the concentrated power over industry, speculative ownership has brought some special evils, of the kind designated by the phrase "inside management."

The most striking and serious evil was the corrupt or semi-corrupt manipulation of the railways. Those in control of a road might "wreck" it; might make it in appearance or in reality a financial failure, might depress the prices of its securities and then buy up these securities at the low prices. Conversely they might manipulate the accounts so as to give false indication of financial success, raise the prices of the securities, and sell at high prices to the outsiders; buying in again later when the bubble burst. A phase of the same sort of thing appears when other railroads, or associated enterprises such as bridges, sleeping cars, terminal companies, are organized or bought by the insiders and sold to the main railroad at a handsome profit. Sometimes the persons defrauded by these performances are the investors proper; quite as often they are other stock jobbers and gamblers, ready to do the same thing if they have the wit and the opportunity. The greatest harm from it all is a demoralization of the whole class in the business community which has to do with railway administration.

Still another phase of inside management has been the manipulation of rates for the advantage of the directors and managers; promoted, as has already been said,[1] by the flexibility which attaches in any case to railroad charges. Here, as indeed in all industry, the spirit, good or ill, which animates the leaders spreads to all parts of the enterprise. Not only directors and influential stockholders but managers and submanagers secure their pickings. A whole system easily comes to be honeycombed with corruption.

These evils, all closely connected with the peculiarities of corporate organization in the United States, were so glaring and cankerous that the most ardent supporter of private industry must sometimes stop and consider whether even the greatest benefits can offset them. No doubt it is possible to exaggerate the evils; and it must be remembered that they were not peculiar to railways. They were part of a raw stage of industrial development. Nor were they all-pervading among the railways themselves. Tho hardly one has been without some touch of dishonest manipulation, many were never deeply tainted with it. And even where the worst has been experienced the community at large was mainly responsible. The whole situation was accepted as a matter of course; partly because the economic and social consequences were not perceived but in no small degree because moral standards were lax. In both

[1] See Chapter 63.

regards a great change for the better set in during the last years of the nineteenth century and the first of the twentieth. The public began to understand better what speculative corporate management entails and to apply higher standards to business operations in general. The great moral advance of the later day brought a higher sense of social responsibility and solidarity. Practices common in the previous generation were no longer tolerated.

§ 5. What benefits now came from all this sullied growth?

No doubt rapid railway building was promoted. Under the stimulus of speculative construction and operation the American community got its railways earlier and got more of them. This the community universally desired, and for this it was willing to pay handsomely. Political and industrial policy was dominated by an insensate desire for swift development, for unlocking the land and its resources, for the utmost increase in numbers and wealth. The sober observer may question whether it has all been worth while. A slower growth and a smaller present bulk might have brought a better social structure. But the ideal of the day, such as it was, was attained.

The march of improvement was hastened not least among the railways themselves. And it was hastened, paradoxical as the statement may seem, both by competition and by combination. The bitterness of railway competition keyed the managers to the highest efficiency in operation; the lessons learned under competition were applied with striking effect in the ensuing stage of combination. One of the causes of lowered cost of transportation was the growth of the great systems. That process was facilitated by the ease with which control of railways was bandied to and fro on the stock exchange. The rapidity with which the vast systems were created was extraordinary. One great advance came in 1869–73, when the so-called trunk line systems—the New York Central, Pennsylvania, Erie, Baltimore and Ohio—were formed. The depression of 1873–79 gave another opportunity, just when the stage of revival was impending, for the creation of the Southwestern system by the arch-manipulator Jay Gould. Still another opportunity came during and after the great depression of 1893–96, which led in a few years to the Hill system in the Northwest, the

Union Pacific or Harriman in the Southwest, the Morgan system in the South. The combinations, of which these are typical examples, vastly promoted railway efficiency. The most remarkable achievement of the American railways—an achievement not matched anywhere in the world—has been the cheapening of long-distance transportation; which again has profoundly affected the geographical division of labor, both within the country and in the exchanges with other countries, and has increased the sum total of the industrial output.

Historically the course of development seems to have been controlled by a fatal destiny. Given the impossibility of public ownership and management (and for the earlier stages of railway development in this country public operation was out of the question); given the eager desire of the community for ways of transportation and its willingness to encourage their construction in every way; given the looseness of corporation laws, the universal speculative temper, the laxness of business standards; given the periodic fluctuations in industry, the economic peculiarities of railways, the opportunities for large-scale ventures—and the harvest was prepared for the daring and able operator. Perhaps all the advantages from rapid construction, wide permeation of the land with railway facilities, from competition and consolidation and vigorous management, could have been got in some other way; but a train of deep-seated causes seems to have decreed that they should come in just this way and with just these checkered results.

§ 6. In the closing years of the nineteenth century the railway situation in the United States began to change. In the twentieth an even more striking change set in, not only in the United States but thruout the world. Here, as in so many directions, the war of 1914–18 and its aftermath in the crisis of 1929 had unexpected and far-reaching consequences.

The changes of the nineteenth century were twofold. In the first place public regulation by the federal government of the United States became more and more stringent and effective. In the second place the industrial position of the railroad thruout the world, and not least in the United States, was profoundly affected by the extraordinary development of the automobile.

The Interstate Commerce Act of 1887 was the first step toward the effective control of railways and of railway rates. It is not within the scope of this book to consider its details or those of the series of measures that follow and supplemented it. We must content ourselves with noting some salient features bearing on the general problem.

Control over rates by the Interstate Commerce Commission was established under the act of 1887 and became effective, and indeed more rigorous than had been expected, because of an unexpected circumstance—the upward movement of prices and money wages which took place during the first decade of the twentieth century. Tho the Commission had power both to reduce rates when deemed too high and to keep them unchanged when deemed high enough, it was the latter process which proved of substantial efficacy. Reduction could not be ordered without detailed investigation of the specific cases, followed by semi-judicial procedure. Delays in dealing with these intricate matters were inevitable; a great mass of rates were necessarily left untouched which might have been found too high if probed. Only sporadic reductions could be effected. But it was comparatively easy to exercise over a great range of rates the power of keeping them as they were—of vetoing advances. Here the inevitable delays served as a brake on the railways, not on the Commission. Precisely this proved to be the characteristic feature of the period of rising prices. The railways had to pay more and more for materials and labor; but their rates could not be raised without the sanction of the Commission.

Not only was this an unexpected turn in prices and rates but the consequences, welcome in themselves to those who believed the railways should be curbed, were allowed to drift further than intended by anyone. The margin between outlays and receipts grew less and less. A situation developed in which the country had the advantages neither of private nor of public management. Private management was almost stifled. Enlargement of the railways ceased; facilities and equipment were kept within the minimum; the future was left to take care of itself. Yet the general rate structure and the general principles of management remained those of an industry primarily directed to getting profits.

Something like an impasse had been reached even before the country entered on the war of 1914–18. When it did so in 1917, when the rise in prices and wages became suddenly accentuated and at the same time the transportation needs for war purposes were suddenly intensified, there was nothing to do except for the government to take over the operation of the railroads. Without this emergency step the railroads would have been bankrupted; and without it they could not have met the military exigencies. From the close of 1917 to the early part of 1920, a period of a little more than two years, the federal government managed the railroads.

What might have been the consequences if the war had lasted long is as difficult to say as it is for the other extraordinary events of this period—the monetary expansion, the tax changes, the widespread regulation of industry. When the war ended, in the autumn of 1918, it was inevitable that there should be a revulsion from the various emergency measures. By general consent the railroads were returned by the government to their owners. But the return took place under conditions very different from those of the preceding period; and the outcome was a situation of quite a different character from that of pre-war days. The government undertook on the one hand to control railroad management to a greater extent than before, on the other hand to safeguard the private owners more than ever before.

The Transportation Act of 1920 gave the Interstate Commerce Commission greatly increased power. Not only was its control over rates maintained; it was also given large control over organization and management. Most important in this latter regard was the authority to compel the consolidation of the railways into large competing systems, whose make-up was arranged by the Commission itself. On the other hand the Commission was directed so to fix the general range of rates as to assure to the railroads a "fair" return; a fair return being provisionally defined as 5½ per cent on the ascertained "value" of the property. But on what principles that "value" was to be ascertained Congress did not specify. An earlier act (of 1913) had directed the Commission to make a valuation of the railroads, the underlying intent then being to ascertain how far there had been overcapitalization. But no tests or principles of capitalization or of value had been set up; nothing more than some question-begging phrases. The act of 1920, tho it made a far-reaching use of a figure which was supposed to represent the fair value, left the principle on which value was to be settled as beclouded as before. This sort of question-begging is common in our legislation to a degree that sadly taxes the patience of the discerning. The original regulating act (of 1887) prescribed, for example, that rates should be "reasonable," without the remotest intimation of any principle or rule of "reasonableness." The acts of 1913 and 1920 provided that the "property value" of the several railroads should be ascertained; not only without a definition of value but with a prescription that several divergent and indeed inconsistent principles should be observed in ascertaining it. Yet the substantial intent was plain enough. The railways were to remain in private hands; competition between the newly arranged systems was to give the good results of rivalry in production; the owners were to receive a moderate return on a capital value ascertained by a hit or miss process but designed to be somehow equitable. In effect the new policy was one of delegated management: complete and all-ramifying control, a "fair" return virtually guaranteed on the railways as a whole, and "reasonable" rates prescribed in the sense that they should be such as to yield this fair return and no more.

While all this was going on the other new element entered: the motor vehicle. Thruout the world the automobile profoundly affected transportation conditions. In the United States, as elsewhere, passenger traffic for moderate distances was first taken over by the motor car; then that for longer distances. Freight traffic was taken over in the same order. All the traffic of the railroads declined, not merely in comparison with the growth of population but in absolute volume.[1] It is familiar how radically the face of the

[1] The total passenger miles per year were 42.5 millions in the quinquennium 1916–20 (the maximum) and 31.8 million miles in 1926–30. The number of car miles of freight traffic reached its maximum in 1926–30, when the annual average was 17.3 billions of miles. By the year 1935 there was a drastic fall to 11.8 billions; partly a cyclical change and likely to be followed by some revival but in good part a continuation of the general movement downward.

world has been transformed by the internal combustion engines, most of all thru the advent of the automobile. The only changes in economic history which are comparable in range and volume had been brought about by the railroads themselves during the nineteenth century. The railroads in the twentieth century protested against the intruders in their field, just as in the past when the railroads came in, canals and turnpikes had protested. No doubt some of the railroads' protests were justified as, for example, that the new carriers long had free use of highways constructed and maintained by the public whereas the railways were confined to a roadbed constructed by themselves at high expense. These inequalities or "subsidies" raised some nice questions of economic and social policy, on which both sides—the railway and the motor representatives—talked as loosely as is commonly the case in such upheavals. The real grounds of complaint which the railroads had were gradually met as regulation was extended over the entire transportation field. To some extent they were ironed out by the tax on gasoline, a rough and ready allocation among the motor carriers of the drain which they brought on the public treasury by their use of the new highways. In any case the inequalities of treatment, real or supposed, had but a minor effect on the great outstanding changes. The railways were there, with a huge plant constructed for a traffic of which a substantial share was diverted from them to the new rivals. They were faced by heavy fixed charges in the way of interest on debt, by maintenance expenses fixed within narrow limits, and by operating expenses of which a substantial part was also fixed. These difficulties were felt already in the period from 1922 to 1929, when industrial conditions in general were favorable. They were accentuated disastrously in the course of the great depression which followed the collapse of 1929. The American railways found themselves in a situation quite different from that of pre-war days. So far from being in any dominant position in industry and in public affairs, they were petitioners for aid and support—for permission not only to raise their rates but to be allotted loans by the federal government toward maintaining plant and meeting obligations.

The new position of the railways was one further illustration of the extraordinary speed and range of the technological improvements of modern times. Their rapidity and sweep compel great caution in making forecasts for the future and hence in plans of legislation for the future. I content myself with general remarks on some outstanding aspects.

The plight of the railroads has led them to make improvements in their operations. It is in accord with experience in other fields that these improvements have been of the "induced" not of the "autonomous" kind. Longer trains, up to one hundred cars to a train, and heavier engines have lowered the cost of freight traffic. Better accommodations for passengers and greater speeds for long-distance travel have done something to maintain the volume of this part of the traffic and so have added to the revenues or at least lessened their decline. All such improvements, to repeat, have come thru the adoption and extension of established practices and devices, not thru independent inventions. On the whole the railway proved to be a mature industry. So far as concerns physical structure and operation, it would seem that no far-reaching changes were likely to come in the future.

Next a new stage was reached as regards competition between different railways. When public regulation began, one of its guiding principles was that the carriers should not be permitted to combine, to pool, to stifle or eliminate competition. As time went on it became more and more questionable whether the public interest was promoted by this policy. The monopolistic position of the roads in their local traffic was never much affected by it; while for the long distance traffic there was often a wasteful duplication of facilities. The Transportation Act of 1920 authorized combinations, subject to the approval and supervision of the Interstate Commerce Commission. But the railways, curiously enough, took little advantage of the new freedom as a means of introducing arrangements which in former times they had made much of. Personal pride on the part of the managing groups apparently played a considerable part in this reluctance. Neither the benefits of effective competition nor those of unified operation were secured.

All the indications now (1939) are that a greater degree of control over this great instrument will be assumed by the government. Apparently there will be continuing pressure, more unhesitating compulsion toward combined action by the roads for unified operation. There will be rearrangements of the capitalization—the "capital structure"—of the several systems, serving to eliminate securities such as junior bonds and a considerable volume of shares which are left over from old days of optimism and have come to be encumbrances on any vigorous grappling with the new situation.

Eventually, and indeed before very long, I cannot but believe that the railroads will be completely taken over by the federal government. The owners will be compensated—how fully, no one can say. An enormous step toward the socialization of industry will be taken. Before proceeding to a further consideration of this large subject it is desirable to consider other great industries presenting similar problems.

CHAPTER 65

COMBINATIONS AND TRUSTS

§ 1. Combinations in restraint of trade and the common law rule making them void. Surprising effectiveness of this rule.—§ 2. Modern forms of combination in the United States: the "trust," the holding company, the unified corporation. The Kartell in Germany. The fact of monopoly, not the form of combination, the important thing.—§ 3. The permanency of combination as affected (1) by the economies of large-scale management; (2) the devices of "unfair" competition—railway favors, discriminations in prices, factor's agreements, advertising devices. The effective defense against "unfair" competition is not from legislation so much as from large-scale competition.—§ 4. Will large-scale competition persist? The pressure from constant accumulation of fresh capital. Potential competition, and the possible emergence of far-sighted management tinctured by a sense of public responsibility.—§ 5. Are there possible public advantages of combination from the mitigation of industrial fluctuations? Are there ruinous effects from competition to be judged from this point of view?—§ 6. The legislative problems. Federal regulation called for on publicity, capitalization, eventually on profits and prices.—§ 7. The earmarks of monopoly: size, profits, discriminating prices.—§ 8. Legislation in the United States. The act of 1890 and its enforcement. The acts of 1914. The Federal Trade Commission. Economic problems have outrun political capacity for dealing with them.

§ 1. Attempts at combination and monopoly are as old as industry. In European countries, during the earlier stages of their economic development, such attempts were subject to prohibition and penalty. During the modern period the trend, until very recent years, was to let them take care of themselves, competition being relied on to keep prices at a fair or normal level. In English-speaking countries it was long supposed sufficient simply to prevent the enforcement of agreements for combination. Under our common law, contracts in restraint of trade are void. They are not punishable; but they cannot be enforced in the courts. Just what constitutes a contract in restraint of trade, such as the courts will hold void, has been the occasion of nice legal discrimination. Some agreements which restrict competition are adjudged to be "reasonable" and the parties to them will be held to their contracts.

Others are adjudged to be "unreasonable" and will not be enforced. The line of distinction is in principle clear enough: those agreements are bad which tend to bring a range of prices higher than that ensuing under free competition.

It is astonishing how effective this simple policy of indifference long was. Combinations, pools, and price agreements among manufacturers and dealers have been among the most common phenomena of modern industry. Almost invariably (unless bolstered up by some independent cause conducive to monopoly control) they have gone to pieces of themselves. The persons forming them have been both short-sighted and covetous. It has often been the case that all would have made larger gains if all had stuck to their restrictive agreements. But each has been desirous of increasing his own particular gains and each has been suspicious of his associates. The usual result has been that price combinations are no sooner made than broken, with much lament that there is so little honor among these gentry. Even where the would-be monopolists have held together for a while competition from outside has caused their compact to crumble away. The outside competitors also have been covetous and short-sighted, failing to see that their own entrance into the field tended to destroy the very gains in which they were trying to share. The truth is that few men, in business or in other doings, look beyond the present and immediate future. Had they a more resolute and intelligent eye to ultimate results, the policy of letting people try at monopoly but refusing legal sanction to their monopolistic agreements would have proved much less effective.

In our own day the situation is changing fast, at least in many directions. Far-reaching plans and ultimate results play a greater and greater part in industry. Still more important is the fact that as large-scale production spreads the number of individual establishments diminishes and the entrance of new competitors grows increasingly difficult. The attempts at combination become more persistent and ingenious and the efficacy of a policy of non-interference becomes more uncertain.

§ 2. First among the modern endeavors in the United States to prevent the disintegration of non-enforceable agreements and so secure a tight combination was the trust device, which gave to the term "trust" the meaning now embodied in familiar usage. Large-scale operations being almost invariably conducted under corporate organization, it was arranged that the holders of stock in the several companies to be combined should all transfer their shares to a few selected persons as trustees; these trustees then holding the shares and having the rights of vote and control which belong to titular shareholders, but being under obligation to manage the property for the benefit of their *cestuis* (to use the legal phrase) and to turn over to these all dividends and profits. Thus the scattered owners and their enterprises would be tied irrevocably to the combination and the trustees as nominal stockholders would control everything in their own hands; while at the same time the summary control over trustees by courts of equity would prevent overreaching of the owners by these trustees. It was an ingenious device but, as it proved, one to which the courts refused to give the expected legal solidity. In a test case it was held that the ordinary machinery of the law could not be used to carry out a scheme in effect monopolistic; and it was held further that a corporation which practically divested itself in such fashion of its independence was subject to dissolution. This particular method of securing tight combination was accordingly given up in the industries in which it was tried. The only permanent outcome was that the word "trust" came to be attached in popular parlance to any and every sort of combination and indeed to almost any sort of large-scale operation.[1]

The holding company formed the next stage. A corporation is formed which acquires the stocks of the several combining concerns—either all of the shares or enough to give control. Its directors thus become the effective managers, just as the trustees under the trust scheme were designed to be. The original corporations retain their existence and nominally continue to do business as before; but all control is united in one board. This device,

[1] The "trust" device was first used by the Standard Oil combination. The Sugar Refiners tried it later, and it was in their case that the courts refused to apply the law in the way that had been expected by the astute lawyers who had framed the scheme. These enterprises and the others that tried the device all turned to other forms of combination.

nowadays so familiar, has the advantage for the would-be monopolists of achieving the result and at the same time concealing it. It may easily be made to appear that no combination at all has been effected. It has other tactical advantages too; there are wheels within wheels, holding corporations for the original holding corporation, and thus not only further concealment but easy possibility of manipulation by a small knot of insiders. These same results are in the main disadvantageous from the public point of view; they bring obscurity, mendacity, stock jobbing, danger of corruption. There is a strong disposition to put a check on the holding company device, which can easily be done by prohibiting a corporation from being the shareholder of another corporation.[1]

The last stage, and the one to which the others lead, is simply that of the great or giant corporation, into which all the former competing enterprises are formally and completely merged. The holding corporation tends to develop into this, its constituent (or subordinate) parts being deprived of their nominal independence and the shareholders becoming direct shareholders in the single company. For some time the indications were that the attainment of this final stage of combination would be accelerated by the very endeavors of our law to suppress combination. Under the prohibitory statute of 1890 (the so-called Sherman Act) a holding company might be unlawful and subject to dissolution on the simple ground that it obviously stifled competition between the subordinate corporations held together by it. Whether the completely unified corporation, made up *de novo* from the others that completely disappear as corporations, stifles competition and hence becomes subject to the prohibitions of the statute is a question much less easy to decide; since it involves inquiry about the relations between the consolidated company and its "outside" rivals. As will appear in the course of this chapter, it is often difficult to make out whether such a company attains a monopoly, even

[1] This power—to hold the stock of another corporation—never belongs to a corporation under English and American law unless given in express terms by the grant of its charter from the sovereign power. In the absence of express grant such holding is *ultra vires*. Our American states have been so complaisantly liberal in their laws as to incorporation, and have so frequently given the power, that most people are unaware of its being dependent on specific authorization and do not know how easy it is—given only the will—to check this form of combination.

whether it strives to attain one; and still more difficult to decide what is wise policy in dealing with such a real or would-be monopoly. Yet these problems will have to be faced before long both by the judges and by the legislators; for the holding company is likely to be succeeded by the form, less vulnerable before the law as it now stands, of complete consolidation.

In Germany, and on the continent of Europe in general, a different state of the law has caused combinations to take a different form. There contracts in restraint of trade are not void; they are enforced as between the parties; but they may lead to penalization if deemed by the courts reprehensible or inconsistent with the public interest. The interpretation of these general principles has been the subject of as much nicety in judicial construction as has been the English common law principle with regard to restraint of trade. Broadly speaking, however, their outcome has been plain. Ordinary agreements for pooling, fixing prices, and the like, which are not enforceable in the countries of English law, are enforceable on the Continent. The parties having once come to an agreement must abide by it. Hence they are not prompted to use those devices for tighter combination which play so large a part in our American development. The German Kartell is commonly an elaborate organization, public and formal, which fixes prices and prevents the members from competing with each other. In its typical form it includes a central sales agency, to which orders go and by which sales and prices are effected; and, not less important, it provides for a limitation and apportionment of output, each member being assigned a specified amount (or proportion of a total) within which he must confine his product. The Kartell leaves to the individual members a greater degree of independence than any of the American forms—the trust or the holding company or the unified corporation; since each member manages his establishment in his own way. It is disputable whether the German method does or does not lead to technical improvements more than does the American—whether the interest which each German producer still has in cheapened production outweighs the advantage from large-scale consolidated management on the American plan. Nor is it clear whether the German Kartell is a mere transitional stage, likely to be followed in time by complete consolidation. There is no such pressure from the German law toward forming an all-embracing giant monopoly; and the course of economic development has been slower and more tentative.[1]

The form which combination may take is obviously less important than the fact of combination. The essential question is whether the conditions of competition are in effect supplanted by those of monopoly. Combination does not necessarily mean monopoly; it may mean only a regulation or modification of competition. But the object of those who plan it is to stifle competition in some degree and to secure greater gains than competition will permit. In the United States a new goal of business ambition appeared in the latter part of the nineteenth century (more specifically in the decade 1880–90): business leaders began to scheme for full monopoly, not only in the industries of unified plant but in ordinary manufacturing industries. The Standard Oil enterprise was the first conspicuous instance; the Sugar Refining concern was another. Both proved financially successful to a marvelous degree. Toward the close of the nineteenth century a veritable rush for similar combination took place over a great range of industries. At the same period in Germany the Kartell of the coal mines proved stable, increased the profits of the mine owners; and served to raise in even greater degree the quotations for shares in their companies. Here, too, a conspicuously successsful case led to a rapid spread of combination. The trust problem suddenly appeared full-fledged.

§ 3. Two different questions present themselves. One relates to the permanency of the combination or trust: whether it will have advantages in operation which will enable it to hold its own and bring financial gain to its promoters. The other is concerned with its effects on the public: whether it brings advantages for the organization of industry toward the general good. These two sorts of possible advantage we may consider in order.

[1] I leave these remarks as they stood in the earlier editions, altho they refer to the economic situation of the pre-Hitler period. So far as an outside observer can judge, the Hitler régime strengthened the monopoly position of the Kartells but used them systematically as instruments for carrying out its general political and social programs.

The permanency of a combination, or its success in the business man's sense, depends partly on the real economics which it makes possible, partly on some tactical advantages or so-called "unfair" advantages.

The economies of combinations are chiefly those of large-scale production and have been already considered.[1] They vary from industry to industry and within a given industry vary from time to time with the progress of invention. No general rule can be laid down regarding them. Only the test of competition and experience can decide whether an establishment produces more and more cheaply as it grows larger and larger. The special question presented in this regard by the trust movement seems to be whether a combination of establishments, each one of which is large enough to secure the utmost mechanical efficiency, can yet be so managed as to produce more economically than the several establishments when independent; in other words, whether horizontal combination and large-scale management add something to the gains from large-scale production in the narrower sense. Here, too, it would appear at first sight that the matter may be allowed to settle itself. Let them fight it out and let that form of organization survive which does the work most cheaply.

The question arises, however, whether the "unfair" advantages of a great combination may not enable it to overcome rivals, even tho these can produce as cheaply and serve the public as well. May not the great producer secure tactical advantage from mere size, mere length of purse, mere pressure thru influence and threat and manipulation, which will enable him to destroy his smaller yet equally serviceable rival?

One tactical advantage, much referred to in the debates on this topic, arose from preferential rates in the way of rebates and the like on our American railways. The notorious special rates secured by the Standard Oil Company on its railway traffic were of great aid in enabling that combination to crush or absorb its rivals, especially in its earlier stages. Other great combinations enjoyed similar favors and, like the Standard concern, threatened to become masters of the railways. Tho one great cause which led to this evil

[1] See Chapter 4.

in former days—the peculiar pressure to which a railway is subjected when competing with rivals—has been weakened by growing consolidation among the railways themselves. Another source of similar danger has come from the widespread dominance of the persons who engineer the trusts. The concentration in the control of great industrial, banking, and transportation enterprises has threatened an interrelation of "interests" and a moneyed oligarchy over great stretches of the industrial field.

None the less the influence of this factor in promoting and maintaining trusts has probably been exaggerated. Special rates were part of the general chaos of railway rates in the earlier period. They resulted from large-scale operations and in turn promoted large-scale operations; and it was this general development, inherent in modern conditions, which led to the general movement for industrial combination. The evil of railway preferences was immensely diminished, almost wiped out, by the penalties imposed in the Interstate Commerce Act of 1887 and the later measures of the same sort; by the consolidation of the railway net; and by the growing sense of public responsibility in railway management. Yet the industrial combinations persisted, even tho like the railways themselves they turned to less intriguing and irregular methods of operation. Notwithstanding the slow and halting progress of public regulation and notwithstanding the many ways of concealing an advantage under outward forms of equal railway rates, this cause of advantage for the browbeating combination ceases to be of importance.

Other devices of combinations for getting competitors out of the way are more direct. Simplest of all is cutthroat competition—sales at prices ruinously low, designed to force the rival into bankruptcy or absorption. Mere length of purse without possession of any real advantage in efficiency may bring victory in this sort of warfare. A similar method of crushing a competitor, more insidious and effective, is thru a partial reduction of prices, designed to oust him from his particular field. Thus a combination which manufactures a variety of articles may cut the price of a single one in order to bankrupt a rival who produces that one; the combination maintaining prices on its other articles and thus offsetting in part or entirely its loss on the contested one. This result is also secured if the combination can discriminate in prices on one and the same article, lowering the price where there is competition but maintaining it elsewhere.

All such maneuvers were again and again illustrated in the history of the Standard Oil Company, the archetype of the industrial trust. In its sales of illuminating oil—which long was the main product—its method, carried out with remarkable skill, was to sell to retail dealers only. In the phrase of the mercantile community, it did its own jobbing. In the regions where there was competition from other refiners it cut prices ruthlessly. But in other regions where there was no competition it kept prices up and so maintained its own profits. This policy would have been difficult to carry out had it sold to jobbing wholesalers, since these not only compete with each other over widely extended markets but know of each other's doings and buy and sell among themselves. Each retailer, on the other hand, covers a limited region only; he does not compete with distant retailers or concern himself about the prices at which they buy and sell. Obviously some geographical limitation on its competitors was also essential to the successful working of this device; the competitors must have been kept from reaching the retail market at all points either by transportation rates higher than those granted to the Standard or by the isolated location of their refineries.

Still another device is the factor's agreement, so called—a contract with a dealer (wholesale or retail) by which he agrees to sell only goods produced by the combination. If the combination has a "line" of goods which are established in public favor the dealer feels that he must have them. If many dealers are coerced or cajoled into buying these and these only, a rival producer on a smaller scale finds great difficulty in marketing his more limited set of goods.

A possible influence of the same sort appears in advertising. Mere effrontery in puffing your wares is an important factor in modern trade. No doubt it introduces new contrivances, promotes variety in production and consumption; and it is often a means of useful competition. But sometimes it is a weapon of destructive competition. Among articles equally good, that which is systematically paraded is likely to be most readily sold. People are led to buy Jones's wares rather than Smith's. One might suppose that if Smith's wares were equally good and were sold at a lower price (made possible by eliminating the advertising expense) he would hold his own in spite of Jones's preposterous puffing. But, in fact, Jones's wares are preferred; some vague impression of superiority is produced by the incessant boasting. Plentiful cash is the *sine qua non* of an effective advertising campaign. The large producer or would-be monopolist has here again a tactical advantage.[1]

The same is true of other means for popularizing your goods—prizes, premiums, gifts, pictures, what not. These delude the purchaser into the belief that he is getting something for nothing. Like mendacious advertising, they rest on the gullibility of mankind and are effective in proportion as they are carried out on a large scale. The Tobacco combination in the United States has practiced the arts of advertising and of premium-giving systematically and successfully; success being promoted by the fact that for its commodity, good will and the brand are of special importance.

It has been proposed to deal with some of these tactical devices by legislation. Intentional cutthroat competition—the lowering of prices for the express purpose of driving out a rival—is to be made unlawful. It is to be made cause either for a civil action for damages by the threatened competitor or for criminal prosecution, or both. Discrimination in prices is also to be made unlawful. A producer is to be compelled, under penalty of civil or criminal law, to sell at the same prices to all applicants and in all markets. He is to be dealt with as the law now deals with common carriers, who are under obligations to do business for everybody on the same terms. Neither cutthroat competition nor discriminating prices have been under the ban of the law in English-speaking countries. They are not punishable, nor cause for civil suit, under the common law nor usually under statutes. Underlying this state of the law is the belief in the efficacy and usefulness of unfettered competition. The pub-

[1] Compare what was said in Chapter 18 on advertising and monopolistic competition.

lic good is supposed to be promoted by allowing every competitor to press every other as bitterly as he chooses. The question fairly arises whether we must not admit that here, as in other directions, competition on the plane and within the bounds hitherto traditional fails to work for the general good.

The case is strong for such changes in the law. Unless one is a convinced socialist and believes that monopoly is simply a welcome forward step toward the eventual assumption of all industrial management by the state, every measure that aids in maintaining "fair" or normal competition is good. It may be that the situation is hopeless and that over a wide and widening range of industries nothing can stay the march of combination and monopoly. At least let all be done that can be done toward checking the ominous tendency.

Not too much, however, should be expected from legislation of this kind. There are those who believe that, unless there be other causes leading to monopoly, changes in the law on competition will suffice to prevent that control of industry and that eventual rise of prices at which exterminating competition aims. But unless "fair" competition is strengthened by economic forces—by industrial conditions enabling the independent producer to hold his own—little is likely to be gained by this method of staving off the growth of monopoly.

Such legislation is, in its nature, difficult to enforce. What is cutthroat competition? Mere lowering of prices is the ordinary salutary result of competition. Intention to wipe out a competitor, the only thing which the law can make cause for action, is difficult to prove. Cost of production, fair price, deviations in market prices—these cannot be settled with the precision essential in legal procedure. They are necessarily notions of some vagueness. A prohibition of a factor's agreement, again, is easily evaded. All that needs be done is to abstain quietly from dealing with the trader who on his part persists in dealing with the would-be monopolists' competitors. A suit at law based on a remodeled law of "fair" competition would be a very uncertain defense against monopolistic aggression.

The effective defense is found only when Greek meets Greek—when the big monopoly meets with a big competitor. The main devices of "unfair" competition are devices of the large producer and the long purse. One whose purse is equally long will endure cut-throat competition equally well; will meet discrimination with discrimination, will make his own factor's agreements. Large producers will be able to compete even tho the law of competition remains unchanged. The real question is whether competition among large producers will be permanently maintained.

§ 4. With regard to the permanency of competition between large-scale producers, two conflicting forces or tendencies meet; and it is not easily foreseen which will prevail. On the one hand, the competitors are likely to cease fighting and to combine. Where the growth of large-scale operations reduces the number of individual establishments to a dozen or so they are almost sure to get together sooner or later. On the other hand, the rapid increase of savings and of surplus for investment causes an incessant search for profitable openings. At the same time the supply of managing ability is constantly enlarged and varied with the rise of fresh generations of capable business men. New capital and new ability will be turned to every industry that offers large profits; and so long as this is the case, monopoly gains will not be all-pervading or indefinitely persisting.

There can be no question of the possibility, nay the probability, of some sort of agreement among the large-scale producers. These things go very much by tradition and habit, and the former individualistic traditions are broken among the capitalists themselves as well as among the social philosophers. The notion of getting together and ceasing from competition is becoming a familiar one and is thrusting aside the older feeling of pride in independent management. It is extraordinary how far the experiments in combination have been carried; not only to those industries where but a few large establishments—a dozen or so—are left in the field but to those where the number is thirty, fifty, even a hundred. It is true that the larger the number, the more difficult it is to form an effective trust and the more probable it is that competitors will remain or will reappear. It would be difficult to say within what limits the movement is confined by the technical conditions themselves.

One special obstacle in the way of getting capital to embark on a large scale in competition with the great combinations has arisen from the consolidation of banking operations and the concatenation of these with the trusts. New investments on a large scale are hardly possible without being "financed." The financial leaders are often in a tacit understanding not to get in each other's way. In the Germany of pre-war days, where the consolidation of banking had proceeded farther than in the other countries, each one of the great banking institutions had under its wing a set of industrial ventures. A newcomer found it difficult to get the opening wedge of a banker's backing. Something of the same sort is true in the United States also. It is not probable, however, that this obstacle to newly competing enterprises will be permanent. The constantly accumulating savings must find an outlet somewhere and no combination can prevent new banking firms from arising, with new financial and industrial leaders who will try to break into the jealously guarded preserves.

Among the forces which are likely to give a new start to competition we must reckon not only the unceasing accumulation of capital and the ambition of new business men but the possibility of decay in the management of the combination itself. A successful combination is commonly brought about by uniting in one organization the largest and best-managed enterprises in a given industry; the lesser establishments being bought up or "frozen out." Initial success is due to the ability and prestige of the leaders. As time goes on new leaders must be found. But nepotism is likely to appear in the established management. Competition, which had brought the original managers to the fore, no longer acts to bring about in the combination itself the survival of the fittest. True, good will and prestige go a long way and it is easier to hold a position of command than to attain it. But the economies of large-scale management as well as the tricks of "unfair" competition can be learned by others; the stimulus of ambition is most powerful among those who have their fortunes to make; and any well-established enterprise—be it a trust, a bank, a newspaper—is in danger of dry rot.

Whether or no, as the outcome of these contending forces, combinations and trusts will prove to hold their own permanently it seems certain that in the ordinary manufacturing industries, even in those where large-scale operations prevail, nothing but a precarious and limited monopoly can result. The trust must be always on its mettle, always on the watch against interlopers. These may be browbeaten or bought up; nevertheless new ones will constantly appear if the profits are very high. The trust may become a dominant form of organization and by good management may maintain itself permanently without bringing about true monopoly prices or extraordinary profits.

There is therefore the possibility—perhaps the most hopeful for the immediate future—of a tempered sort of combination under far-seeing management and with some sense of responsibility to the public. The guiding spirits may wisely conclude that competitors must be faced and that it is good policy to keep profits within limits that will not tempt newcomers. Such is the outcome expected from "potential competition": unified control, a stable course of industry, but prices and profits not greatly different from what would result under competition. Very likely the profits of the commanding corporation would be liberal but would depend after all chiefly on sustained good management.

Such a turn for the better in the combination movement may be promoted by public regulation; of this more presently. Much will depend, also, on the state of mind of the business men and the well-to-do property owners. Tho these still worship the money maker, the pervasive movement for promoting the common interest which has so profoundly affected social legislation and economic thought is beginning to make its impression on their ambitions and ideals also. More is heard of fair profits and fair prices, legitimate methods, honest gains, a "reasonable" regard for the public—phrases used in a vague and question-begging way but none the less significant of a tempered attitude. The monopolist is not a popular person. Even tho he shelter himself in the company of those to whom money is the sole test of distinction, he feels the sting of general reprobation. This change in public feeling works in favor of that sort of management which is both moderate and far-sighted, is perhaps a matter of shrewd expediency as well as of higher spirit, at all events promotes the general interest.

§ 5. What now are the possible advantages of combinations for the community—of combinations, that is, so large and so nearly all-embracing as to portend monopoly?

One worth considering is the avoidance or mitigation of fluctuations in industry. The irregularities of production and employment are among the black features of the existing régime. The removal of chaotic competition can perhaps do something to check them. It is argued that as a great ship can hold its course regardless of wind and wave so a great combination can disregard financial disturbances and carry on its operations continuously.

The possibility exists; but much depends on the trend of development in the combination movement. It is quite conceivable that it may intensify rather than mitigate fluctuations. A gambling promoter and a patched-up combination; an attempt to raise prices and profits; plenty of watered stock, with speculation and manipulation; the rise of competitors; a sudden puncturing of the inflated enterprise and a collapse on the stock market, followed by a period of uncertainty and reorganization—these are familiar episodes of recent times. They do not make for economic steadiness. Perhaps they are but transitory and will cease as the limits of combinations are better gauged by the investing and business public. There may be a development of far-sighted management and stable combination and therewith the lessening both of speculative and of industrial irregularity. The United States Steel Corporation has attempted to moderate the fluctuations in an industry which has been peculiarly subject to them. It is true also that among the railways the process of consolidation has checked the former alternations from feverish new construction to complete standstill. Real gains for the community would come if industrial growth could be made to take place more systematically and continuously.

Another supposed gain from combinations, in some ways allied to that just considered, is the elimination of the supposed ruinous effects of competition. Under modern conditions, it is said, competition is maintained to the last ditch. When a great plant is once started it will be kept going so long as anything at all over operating expenses is earned. Railway competition best illustrates this sort of extremity (tho accentuated by the peculiar conditions of railway transportation). Any industry having large fixed capital is in a similar situation. From all of which it is concluded that unchecked competition will inevitably be carried to the point of general disaster and that combination is the sole means of salvation.

The argument has some foundation; but it cannot be carried far. No doubt there is an analogy between the capitalist producer who has a going concern with large plant and the unorganized laborer. Both have to face a tendency to competitive undercutting of standard prices. Neither can wait without loss. Just as the laborer's working power goes to waste if not used, so the capitalist's plant and overhead organization bring a definitive loss when they are idle. Hence a wholesaler or "jobber" can play off one producer against another and nibble away at "fair" prices. Hence, too, the disintegrating influence of competition on the minor conditions of the bargains. There is disguised price cutting by manipulation of discounts, by allowances for packing and freight charges, by easy interpretation of what are damaged goods. Similar disguised cutting of the standard rate takes place when laborers are overcharged for tools and materials (in the case of miners, for example), or are called on to work overtime without extra pay, or to submit to manipulation of piecework rates. The analogy must not be pressed far. The capitalists are not so likely to suffer seriously as the laborers, nor is their bargaining so much weakened by the lack of standardized definitions. Yet some analogy there is. In both cases there is a chance for the purchaser to play off one seller against the other and in both there are causes which justify permanent organization for combined action.

This is far from saying that a tight and exclusive combination is necessary to protect the sellers, whether capitalists or laborers. An organization for standardizing competition is a very different thing from one for eliminating competition. Yet many persons of the business class talk nowadays as if competition were necessarily ruinous to producers and as if there were no escape from disaster except thru the trust or Kartell. Competition does not go on automatically nor irrespective of the ultimate outcome. The troubles of capitalists from "excessive" competition will bring in time their own cure. People will not continue indefinitely to invest in industries whose profits are wiped out by cutthroat underbidding. The real source of difficulty for the capitalists, not clearly perceived by those who say that competition of necessity works disaster, is the constant pressure of new accumulations for investment and the resulting tendency to a decline of profits in known and established industries. From this pressure the business and investing public is always trying to escape, partly by the wholesome process of improvement, invention, and the opening of new fields, partly by the noxious one of combination and monopoly.[1]

The real evils to the body politic from "ruinous" competition and the real gains which combinations may bring are of the sort mentioned a moment ago; they bear on the steadiness of industry. Competition does tend to alternations between feverish activity and dull depression. Combination may conceivably mitigate fluctuations. If it does so without bringing a tyrannous monopoly —if the peace and order be not those of despotism—a gain of social import will have been achieved. To repeat, it is by no means certain that this desirable outcome will be reached; and in any case it is a very different one in its public aspects from that preservation of profits thru the elimination of competition which the business and investing classes are disposed to welcome.

§ 6. In this state of uncertainty concerning some essential elements in the problem—such as the gain in efficiency from large-scale management, the potency of unfair competition, the mitigation of cyclical fluctuations—there is inevitably a lack of agreement concerning appropriate legislation. The underlying question of all is disputed: shall there be acceptance and regulation (or at least expectation of regulation) or stern repression? Even if the latter policy be considered settled, troublesome questions arise concerning the method of applying it and the incidental practices which may be permitted or regulated. For the time being something like a Fabian policy is alone practicable.

None the less in developing a legislative policy such as the United States is committed to, resting on the suppression of mo-

[1] Compare with what was said on this topic in Chapter 43, on Overproduction and Overinvestment.

nopoly and the enforced maintenance of competition, some things are tolerably clear. Legislation may begin on certain lines, the results of experience being awaited before proceeding further.

The most obvious thing to be secured is greater publicity thru regular reports, with supervision of books and records by public accountants. Tho publicity is in great part a matter between investors on the one hand and promoters and managers on the other and so far is not of the first concern to the general public. It is none the less of much importance to the public, for there is need of information on which to base legislation. We know too little about the extent to which combination has brought monopoly conditions, and know even less about the likelihood of its bringing them in the future.

Publicity will promote that better sort of management which has just been referred to—management more honest toward investors, more far-sighted in competition, more moderate as regards prices and profits. How far a turn for the better will come in these matters, how far private industry will become tinctured with some sense of public responsibility, remains to be seen. Effective publicity will aid in turning the course of development in this better direction.

Another object of control should be capitalization. Here, too, the interest of the public is an indirect one; capitalization is primarily a matter between investors and promoters. So far as the public is concerned overcapitalization is not a source of monopoly profits but only a device for concealing them. Its regulation rests, therefore, on essentially the same grounds as the general requirement of publicity. It can perhaps be supervised with effect only by incorporation under federal law. So long as the matter is left to fifty-odd legislatures there will inevitably be some complaisant or indifferent states which will virtually nullify a watchful and restrictive procedure adopted by the majority. Federal incorporation will seem to many persons a drastic step. However unwelcome centralized control of this kind may be, it must be admitted among the possibilities of the future.

One immediate and important phase of the control of combinations is the "holding company." It may be going too far to prohibit at once any corporation from holding the shares of another. At the least, full information should be had as to these interrelated companies. The wheels within wheels are often merely devices for concealing the real situation or for easy rotation of control by a few insiders. Genuine publicity will be secured and effective regulation made possible only if the whole story is put on public record.

The various forms of "unfair" competition call for attention: perhaps mere definition, perhaps regulation, perhaps stern inhibition. This is a thorny matter, as has already been indicated. The common law on unfair competition may need to be revised; yet this part of the legal situation seems to be itself in a state of flux and uncertainty. It is not clear that amendatory legislation is called for, still less clear what shape the new enactment, if needed, should take.

Control of profits and prices is a more drastic step and one not often formally proposed. It is obvious enough that this is the thing ultimately aimed at. As in the case of the public service industries, the essential thing is the effect on the distribution of wealth. Publicity, supervision of capitalization, regulation of competition, all look to this main end. Perhaps comparatively mild measures will suffice to prevent "undue" profits and "unreasonable" prices. But if the mere suppression of overt combinations fails to achieve the desired end, control of profits and prices must be resorted to. It may be direct regulation of rates, like that of the Interstate Commerce Commission on railroads. It may take the form of regulation of profits thru taxation of excessive gains. In either form it will be difficult enough, necessarily entailing a stringent supervision of accounts. The open-minded observer of industrial changes must face it as a possible measure.

§ 7. One troublesome problem will present itself at the very beginning of any attempt at systematic legislation: how define the thing to be regulated? What, in the eye of the law, shall constitute a combination or monopoly or trust? The law cannot use rough and approximate conclusions or statements, such as often suffice for the economist. It must define in precise terms. What are the earmarks of a monopolistic combination?

Mere size is not conclusive. A concern may be of huge extent as to capital and output and yet may not control the output in such manner as to bring to itself monopoly returns. Nor is possession of the field a conclusive indication. In current discussions it is sometimes assumed that when a "trust" produces 50 or 60 or 70 per cent of the output in a given industry it is virtually in absolute control. This by no means follows. The trust may have vigorous competitors or may be under far-sighted ("conservative") management with a view to staving off such competitors.

A more certain test would seem to be found in large profits, on a scale much beyond those expected under competitive conditions. Yet here too caution is needed. Large profits, 20 and 30 per cent on capital and more, are constantly secured in industries subject to unfettered competition; sometimes under the influence of a favorable turn in the market, more often because of high managing ability. None the less long-continued high profits, on a great scale and spread over a large capital, are suspicious. Thirty per cent on a capital of a hundred thousand dollars may not be an unusual return for a man of ability; but the same rate of return on a capital of a million, still more on a capital of ten millions or a hundred millions, cannot be steadily secured under competitive conditions.

Again, discrimination in prices constitutes, as we have seen, a symptom of monopoly; yet here also only if long continued and on a considerable scale.[1] Some discriminations arise naturally from competition and the higgling of the market, from the endeavor to stave off the consequences of an oversupply, from the wish to introduce goods in a new market without "spoiling" the accustomed price in the old. It is only where one set of buyers are continuously charged prices substantially higher than are charged to others that we smell monopoly.

The strictly economic indications, however, are not easily applied in legislation. I suspect that, certainly as a first step, the law must go by the mere fact of size. All large concerns—large in terms of capital or of output—may be compelled to conform at least to the requirement for report of the simplest facts, such as

[1] Compare Chapter 17.

capital, output, and profits. Such information, continuously secured for a series of years, will serve as the basis for further inquiry and very likely for further legislation.

§ 8. The American policy of repression was long a flat failure. For some fifteen years after the passage of the Sherman Act of 1890 the effect of all the prohibition and penalizing was *nil*. Not only did the old combinations go undisturbed but in the closing years of the nineteenth century there was that extraordinary outburst of new combinations to which reference has already been made. The great combinations were not driven into hiding. The business world went on with its experiments and contests regardless of the law of the land.

Within a surprisingly short period, however, the situation changed. An unmistakable public opinion against trust "extortions"—partly such in reality, often exaggerated—and still more against the spectacular emergence of vast fortunes, not justified under any of the accepted economic canons, led the successive pre-war administrations of Roosevelt, Taft, and Wilson to vie with each other in more and more drastic applications of the law. A large number of combinations, among them conspicuously the oil and tobacco trusts, were haled into court and compelled to disband. Others took the same course rather than meet prosecution. The policy of trying to crush monopoly was resolutely put into effect.

None the less few thoughtful persons believed that this alone sufficed as a permanent policy. Not only those who held combination in some form and under some restriction to be the more advantageous organization of industry but also those who were intent on rigid suppression looked to further legislation, less vague than that of 1890 and with better administrative machinery for enforcing its provisions. Accordingly two important acts were passed in 1914. One, the so-called Anti-Trust Act, repeated the prohibitions of the act of 1890 and added further provisions designed to prevent holding companies, so-called interlocking directorates, and other devices for concealed combination. The second, more novel and more important, established a Federal Trade Commission, with large powers of investigation and supervision. Much discretion was given the Commission. For example, it might call for reports—i.e. secure what may be termed a "round-up" of the enterprises to be supervised—on any principle or to any extent it saw fit. On the vexed question of unfair competition it was also given wide discretion. No attempt was made to define what was unfair; the Commission was simply given power of quasi-judicial inquiry and of issuing orders, with appeal to the courts in case the orders should be disputed. As in the analogous case of railways, the establishment of the Commission marked the beginning of a new era: a settled policy of control but no hard and fast settlement of the precise methods by which control was to be exercised.

No problem of public policy or public regulation is solely economic. Thruout the political aspects as well as the economic must be considered. The trust problem, like the others, raises not merely the questions of supervision and regulation, of fixing prices or paring profits but also those of devising and working the needed political and administrative machinery. The right men must be found, must be given secure tenure and adequate remuneration, must be able to carry out deliberate policies undisturbed by popular impatience and partisan recrimination. How slow has been progress in the political organization of American commonwealths need not be said again. Nor need it be said again that the average of intelligence and character, the stuff of which the community is made, constitute the foundation on which must rest all political and social betterment.

In many directions, it must be confessed, economic problems have outgrown government capacity for dealing with them. Not least is this the case with the trust problem. Modern industry has marched to huge agglomerations, whose chiefs acquire power and wealth not consistent with the ideals of democracy and equality. The traditional political agencies have not proved adequate to deal with these giants. Public control is imperative; in many directions public ownership and management loom up as inevitable. But parliamentary government, representative institutions, elective officials, divided jurisdiction between central and local authority, demarcation and limitation of the powers of legislators and administrators, are not adapted to cope with the pressing tasks. Our institutions have been largely inherited from the days of simpler industry and simpler society, from a stage when power in public personages was feared and assumption of control by the state was deemed dangerous. Political traditions hark back to the days of despots; economic preconceptions to those of wagons and sailing ships and small factories. An overhauling of the methods and traditions of government is a necessary part of reform for the future.

CHAPTER 66

PUBLIC OWNERSHIP AND PUBLIC CONTROL

§ 1. What are "public service" industries? The legal conception less important than the economic; the essential earmark is monopoly.—§ 2. The spur of profit necessary for improvements in the arts; hence a preliminary stage of private ownership a concomitant of progress.—§ 3. The question of vested rights when public ownership displaces private. "Franchises" should always be for limited terms. Purchase at market value.—§ 4. Are there criteria marking some industries as suitable for public management? The tests suggested by Jevons; distrust of public officials underlies them all.—§ 5. To secure trustworthy and efficient public officials is a problem of political organization. Some difficulties of public management, as regards the employment of labor and the maintenance of progress.—§ 6. The fundamental requisite in a democracy is a generally high level of character and intelligence. In what way corruption is connected with monopoly industries.—§ 7. The future of democracy depends on its success in dealing with these industries. Experiments in ownership to be welcomed, especially in municipalities. The prejudices of the business class on this matter.—§ 8. Public regulation the only alternative to public ownership. The two types of regulating boards. The essential object is to limit prices and profits. The elevation of the standards of private management.

§ 1. How far shall public regulation be carried? To the point of ownership and management once for all? These questions, first conspicuously presented by railways, became of greater and greater moment in the modern world as large-scale operations spread and monopoly conditions impended more and more.

There are some things which in the advanced countries are by general consent no longer in private hands. Such are highways and bridges and elementary education. As the sense of the wide-spread importance of some services becomes stronger they are conceived as no longer to be dealt with on the *quid pro quo* principle; they are provided gratuitously for every individual and the means for providing them are raised by taxation.[1] They are then necessarily supplied by general levy and under public management. The doubtful questions arise as to those services which are

[1] Compare Chapter 69.

still rendered essentially on the *quid pro quo* principle, as in the case of the post office with its rates for postage, a municipal water service with its water rates, a state railway with its passenger fares and freight charges. These institutions may be in private hands or in public; if in public hands, they present problems very different from those of education and of ordinary highways. The first is, which among them are properly subjects for public management?

The doubtful industries are those commonly designated, especially in the United States, as "public service industries" or "public utilities," such as railways, the telephone and telegraph, the supply of water, gas, electricity. The phrase "public service" is a question-begging one, implying as it does that a clear and simple line of demarcation can be drawn between those operations which are appropriate for public management and control and those that are not. Such industries as have just been mentioned are "public" in two senses. The one is legal convenience and convention and is comparatively easy to define. The other is economic and more important but more difficult of precise application; it rests on the character of the industries as monopolies.

A railway cannot be built unless there is legislation for acquiring its right of way. Without the right to take land at a valuation—the right of eminent domain—it could be blackmailed or blocked by any landowner along its route. A gas company, again, needs the right to dig up the streets, an electric company similar rights to use or cross the streets. A street-car company *ipso facto* uses the public highways. Hence these are in special degree dependent on public authorization and so subjected with comparative ease to public control.

But it does not follow from this characteristic alone that they should be managed by the public or even subjected in any special degree to public control. The real reason for treating them as "public service" industries, in the sense that they call for public control, is economic, not legal; and the fundamental economic reason is that they tend to be monopolies. If competition were effective in them, as it is in the supply of boots and clothing and flour, the fact that some use of the highways was necessary would not be thought to entail public regulation; any more than the fact that the streets are used by cabs and omnibuses, hawkers and street venders, brings these within the public service class. On the other hand, even tho there be no need of specific authorization, no grant of special powers or "franchise," no obvious means of control, any industry which reaches the full-fledged monopoly stage calls for regulation and suggests at least the possibility of public ownership. If flour making or bread making were in the hands of a tight combination we should soon hear it dubbed a public service industry. It *is* a public service industry in the sense of being of vast importance for all the public. But it does not call for regulation so long as competition is sufficiently effective in it. Water supply is a public industry in every sense: legislative authority is indispensable, the industry is supremely important, it has monopoly character.

Tho the extent to which combination or monopoly will proceed among modern industries is uncertain, it is clear that it will extend far. That the industries now commonly called "public utilities" belong in the monopoly class was not at first seen in the United States. Competition was invoked in the early days as the means of regulating their charges. Rival railways, rival street railways and gas companies were welcomed, and the belief was entertained that here as in other industries competition would suffice to make charges reasonable. How many American cities have had competing street railways and gas companies and telephone companies, with promises of lower charges and better service; and how infallibly have the competitors in the end got together in a tight combination! Monopoly inevitably ensued. The need of regulation in some other way than thru competition had to be faced.

The cause of monopoly in many of these cases (tho not in all) is strictly economic: namely, that the industries are conducted under the conditions of increasing returns.[1] So with the railway; tho probably the rate of increase diminishes as the railway system enlarges. When power superseded animals in street railway traction the same became true of this industry. Electric light and power, gas and water, all are more cheaply supplied if one unified plant serves a single large area. In such cases the words prophetically used by John Stuart Mill, in the early days of the present

[1] That is, increasing returns due to "internal" economics. See Chapter 14.

industrial régime, are as true as they were a century ago: "When a business of real public importance can only be carried on advantageously upon so large a scale as to render the liberty of competition almost illusory, it is an unthrifty dispensation of the public resources that several costly sets of arrangements should be kept up for the purpose of rendering the community this one service. It is much better to treat it at once as a public function; and if it be not such as government itself could beneficially undertake, it should be made over entire to the company or association which will perform it on the best terms for the public." [1]

The post office and the telephone and telegraph are best operated under monopoly conditions, and this for several reasons. They are much more useful to the public if all-embracing and singly managed. It is conceivable that letter service should be handled by one set of companies in the cities and by another set in the country. The rates could be, and probably would be, lower in urban districts if the service for these were separate; and it may be a question whether the present uniform rate, yielding high profits in the cities, is in accord with current traditions on the equitable relation between cost and price. But the enormous convenience of being able to reach any and every correspondent once for all at a simple fixed rate outweighs any possible doubt as to the equity of the uniform rate.[2] To this, of course, must be added in the case of the post office the educational and political gains from a uniform rate and an all-inclusive service. In the case of the telephone the advantage of unified service is most conspicuous of all. The essence of effective telephone service is to be able to talk to any and every subscriber. Competing telephones, each having

[1] Mill, *Principles of Political Economy,* Book I, Chapter IX, § 4.

[2] The expense of the post office is largely for collecting, handling, sorting. These items are the same for every letter in a given district. Mere transportation costs comparatively little. Hence a uniform charge, irrespective of distance, is not so far out of accord with cost as at first it seems. This was among the main grounds on which Rowland Hill argued for his great reform (penny postage). In a comparatively small and densely settled country a uniform postage rate thus rests on an economic as well as on a social basis. In a vast country like the United States the economic reasons are less strong. Distance and cost of transportation count for more in the expenses, especially where not only letters are carried but bulky printed and miscellaneous matter. Uniformity of charge, like the extension of free delivery into sparsely settled country districts, can be justified chiefly on larger social grounds.

its own set of subscribers, are the height of absurdity. The elimination of competition is here not only inevitable but unquestionably beneficial. The only question is whether there shall be public monopoly, or private monopoly regulated by public authority.

§ 2. In virtually all of these cases, public ownership, where it has been adopted, has been preceded by private; and this for the reason that the spur of profit seems to be necessary for the initiation of advances in the arts. By initiation here I mean not merely the first stage of invention but the later stage of trial and uncertainty which has always been experienced.

We are here on disputed ground: how far do the selfish motives predominate and how far must they be appealed to for the furtherance of material progress? Men are extraordinarily unequal, and not least unequal in the degree to which they respond to altruistic impulses. Among men of genius—great painters, poets, musicians, men of science—the coarser motives are often veiled or overborne. In them the inborn instinct is strong; they work not primarily for reward but because the bent is irresistible. So it is to a large extent with inventors. But all these are highly exceptional persons. For the vast majority of men the argument from the bribe holds. The prospect of gain is immensely powerful in bringing men to exercise their faculties to the utmost pitch. This is the case in no small degree even with those of highest genius. It is more markedly the case as we descend from this very small set to the much larger class of men who are able but not brilliant. For all except a very few of extraordinary gifts the spur of gain seems to be not only powerful but indispensable. Almost all inventors and men of science are subject in some degree to the self-regarding motives which affect so profoundly the life about them. They work the more strenuously and effectively in proportion to the expected reward. This is the principle underlying the whole system of patents, copyrights, and trade-marks, nay the whole system of competitive industry and private property.

Further, for the progress of industry there must be not only inventors and managers but persons willing to venture their means in new ways. The history of all the great advances in the arts, especially the epoch-making changes of modern times, shows that the business man and venturesome capitalist have played an essential part. We are apt to think of successful inventions as made once for all at a precise date by one individual. In fact there has been almost invariably a long period of experiment by many persons—rival projects and false starts, disappointing trials, slow emergence of the finally successful device. The steam engine, the textile inventions of the Industrial Revolution, the railway, electric power and light, the motor car and truck, the flying machine, all went thru this stage of uncertainty. To select among the rival schemes and to venture boldly on new investments the business man is as necessary as the inventor. Sometimes, as in the cases of Stephenson and Siemens, the inventor is also a business man. More often—as in the typical case of Boulton and Watt—the two sorts of ability must be combined in a partnership; the inventor needs the backing and guidance of the managing capitalist.

The history of the past shows the spur of profit to have been at work and apparently indispensable in all the industries of the sort we are now considering. Private management has been invariably a long initial stage. Public management has come as a transition and a growth, not by independent start. Where indeed an industry has been developed by private activity in one country it may be transplanted to another without the preliminary stage. When the railway, after a long period of experiment, had been brought into effective working order in England it was easy to introduce it on the Continent as a state industry.[1] A generation later it was easy for the Australian colonies to undertake public management of railways by importing from England men trained in the school of private management. Electric traction for urban transportation was easily started in Europe as a public business after private enterprise in the United States had shown how the thing could be done.

The probabilities are that the same course will be followed in the future. The present state of water power transmission thru

[1] Most railways on the Continent, none the less, were built by private companies and at the outset managed by them. The first construction was usually undertaken by English contractors, among whom the Stephensons and Brassey were conspicuous. In the United States the railway grew independently and thruout by private enterprise.

electricity supplies an instructive illustration. Here are great possibilities, nay great certainties. The simple matter of building dams and impounding the water can indeed be done by the state. But the hydraulic and electric plant and the transmission and distribution of the power involve risks and call for enterprise and vigor (not to mention technical progress) such as public officials are not likely to supply. The utilization of water power thru electricity thus waits on private initiative and management. Obviously a monopoly situation exists, or at all events impends; here is just so much power, and he who controls it controls all the industrial possibilities. The public should never give away in perpetuity the ownership of this great resource. Yet during a long stage it can probably secure effective development only by allowing scope for private profit. It is at a later stage, when the ways of utilizing the power have come to be understood, that public management may take the place of private.

§ 3. When the transition from private ownership and management takes place, the question of vested rights will always arise. The terms of purchase must not be such as to deter future investment in other enterprises. But, on the other hand, only so much should be paid as is necessary to keep alive the spirit of private management and investment. The bribe should not be larger than suffices. Naturally the recipient tries to get more—unlimited franchise at the start and at the later stage purchase at the top price. The financial markets will capitalize his earnings, however high, and he will expect purchase at the capitalized value.

It is the first and simplest canon of public policy in these matters that there should be no unlimited franchises. Whether the question be of railways or street railways or gas works or telephones or water power, the right to establish and conduct the industry in private hands and the needed authorization from the law should be for a limited term. There should be, too, a reserved privilege of purchase at terms based on the cost of the plant, not on the capitalized value of its earnings. Experience shows that a period of thirty years, certainly one of fifty years, is long enough, and that a right of purchase on reasonable terms does not deter private investment.

In this respect our American communities have been reckless of posterity. They have sold their birthright for a song or have simply given it away. The explanation is obvious enough. In the pioneer days one of the main objects of the early settlers is to possess themselves of the very things that will become valuable in the future—land, urban sites, mines, forests, water power, "franchises." No one then thinks of conserving the rights of posterity; nearly everyone wishes to appropriate at once those things for which posterity may pay a large price. Only a stringent prohibition, by constitutional enactment or from an outside power (Congress as to the territories), will keep a pioneer community from such appropriation of the possibilities of the future.

When the mistake has been made of allowing the monopoly industry to get into unrestricted private ownership, and where it has been sold and bought by successive persons on the basis of such ownership, there is nothing to do, if the transition to public ownership is determined on, except to buy the owners out at the market price. The case is the same as with land and urban sites. If the community has sanctioned investment and purchase on the basis of perpetual ownership it must itself buy, as it has authorized others to do, on the basis of present value. At the most it can conserve for itself only the future increase in the earnings of the monopoly or privilege; just as it may appropriate thru taxation the future increase in the value of urban sites. Unless all private property is wiped away once for all, the lawful owners of this particular kind of property cannot be singled out for special dispossession. Hence, for example, when Prussia in 1878 resolved on the epoch-making step of buying the railways for the state, purchase proceeded frankly and even liberally on the market value of the roads. Great Britain will do the same when she buys her railways, as she may before very long. The United States will have to do the same when the time comes for that far-reaching change. France is in a comparatively favorable position for the future possibilities of this industry; since under the terms of the original legislation her railways are to pass into the state's hands by the middle of the twentieth century (1959) without any compensation at all for the permanent plant.

§ 4. The preceding discussion has proceeded as if the transition from private ownership to public were certain to come in the case of all the monopoly industries, and as if it were dependent solely on the attainment of a settled stage of technical and industrial development. But the matter is not so simple. Public ownership may be preceded by a long period of private ownership under public regulation. The conditions on which the choice of policy must depend are here not economic in the narrower sense; they are mainly social and political.

There have been, it is true, attempts to formulate certain economic characteristics by which the line between public and private industry can be drawn. A well-known older attempt was that of Jevons, who stated the earmarks of an industry adapted for public management to be the following: (1) small capital account; (2) routine operations; (3) the coördination of several services, as the post, the telegraph and the telephone; (4) the sufficiency of a single all-embracing plant, as in the case of water and gas supply. This enumeration, made at the time when the transfer of the telegraph to the state was under discussion in England, has obviously failed to fit later exigencies. The very first requirement, that of a small capital account, is not met in the case of the railway; yet here we have public management on a great scale. None the less the enumeration still deserves attention; for it points to some of the political difficulties of the problem.

Underlying the requirements of Jevons was a suspicion of public officials. This explains the very first requirement—small capital account. Where the capital account is large the financial and technical outcome of an enterprise is difficult to judge. The management may be good, yet expenditures for repairs or enlargements may result in a deficit in the year's account. Conversely, a skimping on needed repairs and on improvements for the plant may enable a good showing to be made by a poor manager. Every person who has looked into the accounts of a railway or large manufacturing concern knows how necessary it is to analyze the figures and, above all, to probe the capital account before judging whether the management has been good. To supervise public officials and to judge whether their administration has been efficient becomes the more difficult as plant is larger and more complex. The more one is disposed to entertain general doubt as to the probable quality of public officials, the more is one averse to intrusting such business to their hands.

Something of the same sort holds of a routine character of the operations. This also makes supervision easier. Where administration can be reduced to set rules it is easily seen whether these have been followed. For the same reason it is sometimes said (as it was by Jevons) that an industry is more likely to be well conducted by the state if its operations are constantly under everyone's eye. The post office fulfills all such requirements; indeed this case doubtless suggested the criterion. If we start with the premise that public officials are to be mistrusted and must be constantly under watch we end with limitations on state management such as Jevons suggested.

Now the question whether public officials need to be constantly watched depends on their character and quality; and in a democracy this again depends ultimately on the character and quality of the electorate or other body that chooses them. If we are sure of the probity and ability of the officials we may turn over to them for management a very wide range of industrial operations. We need not hesitate because the capital account is large or because the operations are irregular and complex or are concealed from the public eye. We may intrust to them the management of all the monopoly industries which have passed the formative and experimental stage and in which the technical conditions have become fairly settled.

To sum up: the strictly economic earmarks for state-managed industries are maturity and monopoly. But the state means state officials; and whether these are competent to take charge is a troublesome political and social problem.

§ 5. Two things are necessary for the securement of an efficient body of public servants: first, well-devised political institutions; and second—above all in a democracy—a sufficiently high level of intelligence in the great mass of the community.

Not a little depends on tradition and habit. The spoils system is largely a bad habit. Until it is rooted out good public management is hopeless. The bureaucracy of Germany has the support of ancient traditions, long bound up with devotion to the monarchical ideal but likely to persist whatever the form of political organization. It has proved an invaluable instrument for the successful extension of state activity. The British civil service as it developed during the second half of the nineteenth century proved an instrument not less efficient. Like the German it had a certain oligarchic flavor, utilizing a spirit of achievement and of service which had been nurtured in a select highly educated class. In Great Britain also that spirit may be expected to persist even tho political conditions may greatly alter. The reform of the British civil service during the second half of the nineteenth century is one of the most remarkable episodes in the history of government. A spoils system rooted in habit and apparently immovable was completely transformed within hardly more than a generation into one based on merit and operating with efficiency; and this without disturbance of the rest of the political system. The similar changes in the United States have proceeded at a much slower pace and with less result. Our American principles of checks and balances, of limited powers and divided responsibilities, imbedded as they are in the constitutional structure, work against efficient public management. Our traditions have been inherited from the days when there was fear of a would-be absolutist and when state officials were suspected of attacks on liberty. We are coming to recognize that the state is a great agent for social uplift and that its officials need more freedom of action, less fetters on action. In municipal government, where the situation is worst, the goal of reformers is the elimination of the wheels within wheels, concentration of responsibility, diminution of the number of elective officers and lengthening of their terms, permanent tenure for the routine staff and for the trained experts. In all these respects, habits of thought are slowly changing and the way is being prepared for at least the possibilities of better things.

The employment of manual laborers in a democracy is always a thorny problem. They strive to become a favored group within their class, with extra pay and extra privileges. As has already been said,[1] other laborers commonly support them in such endeavors from a confused notion that the process will raise wages and privileges generally. Elected officials, on the other hand, are apt to accede to their demands; for this compact body of voters needs to be conciliated. When the governmental machine is at its worst the employment of large bodies of laborers means a political machine and political corruption. Even when good on the whole, it is likely to bring place-making and easy stints; hence, inefficiency and expense.

Private industry has a quasi-automatic check to this evil. The manager looks to money making and will pay his labor no more than he can get it for; that is, no more than other labor secures. The public official, on the other hand, is not rigorously subject to the test of profits; he can dip into the apparently bottomless public purse. The state should be a model employer and should set an example of good wages, moderate hours, steady employment, humane surroundings. But the state should set also an example of requiring for its full day's pay a full day's work. The ideal of too many people is that it should be generous with the pay but easy-going with the work. A public official in our democracy always finds it difficult to exercise the power of discharge and extremely difficult to prevent conduct that is merely slack and dilatory.

The maintenance of progress in the arts is another difficult matter under public management. Technical maturity is never reached completely; further advance is always possible. True, there is a wide difference between the early stage of uncertainty and experiment and the later stage of gradual improvement on established lines. The railway, for example, is still being made more efficient; but the great lines of technical and economic procedure seem to have been definitively marked out. Nevertheless in railways as in other industries, even when they have reached a comparatively settled stage, public management, to be fully satisfactory, should not be content with doing passably well what the world has already learned to do. The continued progress which it should maintain calls for keenness, vigor, enthusiasm, single-minded devo-

[1] See Chapter 52.

tion to professional tasks on the part of trained administrators and experts. Only an intelligent and self-restrained democracy or a very capable autocracy can enlist such men and get them to do their work in the best spirit. The German Empire and the German states, in their post office, telegraph and telephone, perhaps in their railways, unmistakably in their military organization, long maintained a high spirit of ambition and emulation. But the Australian colonies seem to have secured simply humdrum management; honest, to be sure (and for this we in the United States, to our shame, must pay our tribute of respect), but devoid of life and vigor. No democratic community, with the possible exception of Switzerland, has shown in its public industry a spirit of progress comparable to that of private industry.

§ 6. In the end, all these matters of organization and efficiency go back in a democracy to the most fundamental of the requisites for successful public management—the moral and intellectual quality of the community. There must be in the community a good average of character and conduct in order to secure even honesty and faithfulness; there must be, in addition, a good average of intelligence and self-restraint in order to select and retain a body of trained and progressive experts. It is hard enough to secure the first of these things; it is very hard to secure the second.

We in the United States have still to learn how to get common honesty and faithful routine. Antiquated political institutions, excess of elected officials, lack of concentrated responsibility—all these explain a good deal, and improvement in these matters of political machinery promises a good deal. But in the end we have to rely on the stuff of the people. A good electorate will choose honest and capable officials, a debased or indifferent one will tolerate demagogs and thieves. The traditional method of committee administration and scattered responsibility has often been held accountable for the evils of municipal government in the United States. No doubt it has had its ill effects. But it is striking that a very similar system in Great Britain has not stood in the way of honest and efficient administration.[1] Reform in the machinery of

[1] See Lowell, *Government of England*, Vol. II, Chapters 39, 40, esp. p. 179; and Munro, *The Government of European Cities*, pp. 282 *seq.*, esp. p. 307.

municipal government will avail little unless the right persons are chosen to run the machinery. From this elemental requisite there is no escape.

It is often said that corruption in our municipal and state affairs is caused by private ownership of the great monopoly enterprises and that public ownership is the cure. To reason thus is to mistake the occasion for the cause. The occasion is the great fund of gain which the monopoly enterprises can yield; the cause is political demoralization. It matters little whether the initiative in corrupt ways is taken by the heads of the monopoly corporations or by the public officials—whether the first step be bribery or blackmail. In either case it is the existence of venal legislators and administrators that brings coarse and characterless persons into the management of the "public service" industries. Honorable men withdraw from the unsavory affairs and are replaced by those less squeamish. The root of the difficulty is that a bad political situation invites corruption, not that corruption makes the political situation bad.

On the other hand, this much must be admitted: there is a kindling power in public action. The sentiment of a community can be aroused toward accomplishing well the tasks which it has set for itself. It is absurd to go so far as to say that there is an automatic effect on the quality of government from giving government much to do—that the mere assumption of larger tasks will make the body politic fit for accomplishing them. But pride can be enlisted, especially local pride, and some stir may thereby be given to smoldering forces for good.

§ 7. It is not too much to say that the future of democracy will depend on its success in dealing with the problems of public ownership and regulation. To allow the great monopoly industries to remain without control in private hands is to allow an *imperium in imperio*—and the greater is the range of monopoly, the nearer is the approach to a plutocracy. To manage them as public enterprises or to regulate them effectively while still in private hands calls for restraint, abdication of the town meeting method, intelligence in choosing good leaders, steadfastness in following them. These things are not learned in a day, nor is there any certainty that the mere increase of public industrial management will evoke them. The ideal solution is that the great monopoly industries should be under efficient and progressive public management; but he is sanguine who believes that the attainment of this ideal will come easily or quickly.

To admit that a task is difficult, the outcome uncertain, is not to say that it should be given up. The experiment of public ownership and operation should be tried and every effort made to bring it to a successful issue. The most promising field would seem to be the municipality of moderate size. To put vast industries now into the charge of city governments like those of New York or Philadelphia would be dangerous. But cities of smaller size may have better possibilities. Even tho in these also the political conditions too often have been wretched, the movement for "municipalization" has better prospects and a trial is to be welcomed. If it fails, it will show that those are mistaken who would make haste in adding to the undertakings of democracy. If it succeeds, so much the better.

Success or failure in such experiments cannot be gauged in a short time, nor without reasonable discrimination. Mistakes and disappointments will be inevitable in the early stages. A considerable period must elapse before it can be known whether the needful lessons will be learned. And as regards the final outcome, it must be remembered that the question will always be one of the *balance* of gain. The opponents of public ownership are constantly pointing to its weaknesses and its dubious aspects—slowness and indecision in adopting improvements, placation of the public by concessions that make a show on the surface (e.g. low passenger rates and good passenger accommodations on railways to the neglect of the more important freight service), log-rolling, undue favors to employees. The real question is not whether these things are bad but whether they are worse than the evils of private ownership. He who compared, for example, the railways of the United States and Australia would undoubtedly find some serious defects in Australia. But he would find crying evils in the United States. There has been greater efficiency in our country but also tortuous management and ominous consequences in the greater inequality of wealth; and no unqualified verdict can be rendered against the state railways of Australia.

The business and well-to-do classes of all countries, and especially of English-speaking countries, rarely consider this subject with an open mind. They listen readily to all the evidence that tells against public ownership and are pessimistic about its prospects. The persons now in control of the money-making monopolies supply them freely with all sorts of distorted information and superficial arguments. In the United States more than anywhere else their prejudices are rank. This attitude arises from various causes. In part it is an inheritance from the older political philosophy of *laissez-faire* and non-interference. In part it is due to sad experience of misgovernment in this country. But to no small degree it arises from a lurking fear of any dispossession. Public management is "socialistic"; it is feared as the entering wedge to complete expropriation.

The relation of the problems of public ownership to socialism will be considered elsewhere.[1] But this much may be said at once: private property is more likely to maintain itself if it is coupled with an extension of public regulation. It will be more secure if its abuses are done away with and if the avoidable causes of great inequalities are removed. Public ownership of the monopoly industries, or the alternative of public regulation, may be called conservative in the sense of possibly obviating changes really revolutionary.

§ 8. The clear alternative then, and the only alternative, to public management is public regulation. Ideally regulation is less good but practically it may be much better. Reasonably successful regulation is more easy to attain than reasonably successful public management.

Some matters of political machinery need attention in this case, as in that of direct management. The success of regulation depends on the quality of the individuals who are to regulate. They should have stable tenure of office and adequate salaries. They should be chosen not by popular election but by executive appointment. These are simple requisites too often neglected in our American

[1] See Chapter 67.

states. But the problem of finding and retaining good men on regulating boards or commissions is easier than that of finding and retaining men capable of efficient management.

Two distinct types of board or commission have appeared in American experience: the commission for investigation and recommendation, relying chiefly on publicity; and that with power of command. The first type, of which the Massachusetts railroad commission was the earliest and the best-known example, was commended for a long time by the sober American observers. None the less the second type gradually came to prevail. Investigation and publicity can do a great deal but not everything that is needed. The milder form of regulation was a natural first step, when people were still timorous about state interference. As they became used to it and as the growth of monopoly appeared more clearly to call for regulation, commissions of the second and more drastic type were generally established. In Massachusetts itself the authority of the railroad commission gradually extended beyond investigation and recommendation; and the later commission of this state, with jurisdiction extended to all the "public service" industries, was also given large powers on the crucial question of the prices to be charged.

All the modes of regulation, whether by supervision, publicity, or unqualified prescription, look to the same end: control of prices and of profits. Sooner or later such control is likely to be undertaken directly as well as indirectly. People of conservative temper smell confiscation in it; yet it is all involved in those first steps of investigation and publicity which they commonly approve. Reforms of this sort proceed by stages which follow the slow growth of public opinion, the meaning and probable outcome being concealed at the outset by ambiguous phrases and mild measures.

Direct control may be of prices or of profits, or of both. Like the control of capitalization, it should have a reasonably liberal regard to the returns of investors and managers and must content itself with results satisfactory on the whole. Prices seem on the whole easier to regulate than profits. Restriction of profits, i.e. of dividends, may be evaded by extravagant salaries and bonuses. Even when not so evaded it removes the stimulus to efficiency and progress. Prices, it is true, are not so easily fixed at a "reasonable" point as is a rate of dividend on capital. Some knowledge of cost of production and of technical details is called for. The need of a trained body of permanent public officials is obvious. But the fact that their task is difficult and that only an approximation to an ideal solution is attainable is no reason why the task should not be undertaken at all. All the truths of economics are approximations and all its ideals can be attained only in the rough.

Not the least of the things which public regulation should try to accomplish is the elevation of the standards of private management. The speculative promoter, the stock jobber, the unscrupulous corrupter, should be crowded out and the business leader of the better type brought in. To this end publicity will do much; and pressure will do much, too. Let it be made a paying policy to have honest and far-sighted management, content with moderate but sustained profits, and considerate in its dealings with the community. There are able business men in plenty to whom management of this sort appeals. There is no harm in mixed motives, and some mixture of public spirit and private interest is not uncommon and not necessarily inconsistent with the general interest. The now-pervading conviction that there are industries not strictly private, and that the people in charge of them have duties to the community as well as to the investors, leads to a very different attitude from that of a generation ago. The public is no longer damned. Pressure thru publicity and thru threat of legislation or forfeiture of charters, plans for direct public ownership, demagogs' attacks, if you please—all strengthen the better attitude. Let it be made worth while to please the public.

CHAPTER 67

SOCIALISM (I): WHAT IT MEANS

§ 1. The terms communism and socialism. Changes in their meaning. Communistic societies. Changes in religion, the family, political institutions, are not essential to the socialist or communist program. Nor is violent change essential.—§ 2. A different distribution of wealth and income the essential thing. Land and capital to be in public hands; but private ownership on a small scale might be allowed. Wages the only form of income.—§ 3. Exchange and money.—§ 4. Accounting, and its problems. —§ 5. The principles of distribution.—§ 6. Three possible standards: needs, sacrifice or disutility, efficiency or productivity.—§ 7. How far public ownership, as existing in present society, is socialistic; how far labor legislation and the like are so.—§ 8. Some current objections to socialism of little weight; for example, that the huge organization is impracticable, that goods could not be valued, that capital could not be accumulated. Would freedom disappear?

§ 1. To the socialists, the conclusions of the preceding chapters will seem not only uncertain but childishly uncertain. Legislation such as is there described will seem a feeble palliative for a deep-rooted disease. The outstanding fact, they say, is the collapse of competitive industry. Combination and monopoly are the inevitable result of the machine processes and of large-scale production. Legislation cannot prevent monopoly, nor can it prevent its concomitant of ever-growing inequality. The bourgeois economist only palters with the situation when he weighs the pros and cons of competition and combination. The bourgeois legislator, whether he tries to repress or to regulate combination, is trifling with a force that is irresistible. The evolution of industry necessarily brings full-fledged monopoly. The ultimate outcome is plain: the state will expropriate the monopolists and will manage all large-scale industry for itself. Socialism is the one goal and the one gospel; it is the desirable and the inevitable end.

Socialism proposes to do away with the system of private property, and especially with that system so far as it leads to great inequalities. It proposes, above all, to do away with the leisure class and with incomes from interest or rent—to allow only incomes secured by labor.

"Communism" and "socialism" are used with different and changing shades of meaning. During the nineteenth century, while both alike implied common ownership of all real capital (barring small handicraft tools and the like) they did not imply the same principles of distribution. Communism implied complete equality, i.e. all had the same incomes, shared equally in the available social output. "Socialism" did not go so far. While neither kind of scheme allowed any income from property, the "socialist" scheme did not propose to make the remuneration of all labor the same. But in the twentieth century, and especially after the Russian revolution, the terms came to be used otherwise. Communism was associated with a violent revolution; an uprising of the masses, a sudden and complete abolition of private property, a drastic "liquidation" of the property holders. "Socialism" and "socialistic" came to be used with widely varying meanings. In the minds and in the speech of the conservatives any proposal for enlarging the function of government was likely to be dubbed socialistic and thereby condemned once for all; as for example any plan for the public ownership and management of industries like the railways or electric power works. Steps of this kind may or may not prove to be the preliminary stages in a gradual process toward universal public ownership of the community's entire outfit of real capital; but in themselves are quite consistent with the maintenance of the essentials of private property. And while the thorogoing socialists expect the process of gradual change in that direction to be carried out to the full they are not necessarily militant "communists." They may hope and expect that the final outcome will be reached by a series of peaceful steps, not to be regarded with horror by anyone. Further, they are likely to be non-committal about the precise character of the eventual society, more especially about the possible persistence and range of inequality. These they regard as matters that cannot be settled in advance; the problem must await experience and even deliberate experiment. It is in some such sense as this that it seems to me best to speak of socialism—a complete change but not necessarily an abrupt one as regards property owning and property income; some scheme of justice for the single remaining income, labor; but not inevitable violence or bloody revolution.

Socialism, then, proposes to wipe out, gradually or rapidly, the system of private property, especially so far as it leads to marked inequalities. It proposes, above all, to do away with the leisure class and with incomes from interest or rent—to allow only incomes earned by labor or provided by charity.

In the first half of the nineteenth century schemes for small-scale "communism" or "socialism" were rife. They contemplated select communities, oases in the competitive desert. In these, men who had left the selfish life should share things in common, without strife or victories or privileges. Such communities have been established in many countries, most frequently in the United States, where the spirit of freedom and non-interference, if it has led to extremes of individualism, has at least permitted men to experiment freely. Usually the societies or associations which tried these experiments were communistic in the older sense; that is, all things were shared in common and all members were on one level in respect of income. But such complete leveling is not an essential feature. It is quite conceivable and not inconsistent with the ideals of the societies that leaders should be distinguished not only by their position of leadership but in some degree by their income as well. Usually, too, the older societies had a religious basis. This also is not an essential characteristic; some have been frankly unreligious. It is true that those infused with a religious spirit have lasted longest and have been most successful both in worldly and in spiritual ways. As a rule, the experiments collapsed after a comparatively short period of trial; yet a few, under leaders of commanding personality and fervid religious spirit, had long and interesting careers. Harmony, the Shakers, the Oneida community, the Amana Society—these are some noted cases in the United States.

The history of the small communities, however, counts for little in the modern socialist movement. Socialism looks to large-scale operations, not to petty experiments. It proposes a complete transformation of all society. Machinery and huge industrial enterprises, the minute division of labor, the use of great plants, transportation and exchange on a great scale—these are to continue; but all under public management. No corner of society is to be left untouched by the process of transformation.

This transformation is to be primarily economic. It is to be accompanied by other changes only so far as they may result inevitably from those of the economic sort. True, many socialists advocate changes in other great institutions also—in religion, in the family, in political organization; and to some among them such changes seem as essential as changes strictly economic. Yet there is diversity of opinion on these matters; and the socialist ideal does not necessarily lead to any one policy regarding them. It is conceivable that the socialist state should not concern itself at all with religion, as little as does the state in our American society. Equally possible and consistent would be support to different denominations, such as that formerly given by German states. The majority among the unqualified socialists are frankly unreligious; but some deeply religious persons, devoutly attached to existing churches, are frankly socialistic. Tolerance of worship and belief would seem to be not inconsistent with the ideals of the transformed society.

Again, no great outward change seems to be necessarily implied in the family and the institution of marriage. Some socialists believe in a looser connection between the sexes than that of marriage for life; but there is no compelling reason why their society should not maintain the present relation. The responsibilities of parents to children, it is true, would inevitably be different from what they are now—of this more will be said presently. Yet marriage, the family, the home, might remain much as before. Nor is any particular form of political organization essential. Here, to be sure, there is a greater approach to unanimity among the socialists than on some other points. To most of them their economic program seems the legitimate and inevitable outcome of democracy, and democracy—at least in form—the ideal political organization. Yet one of the keenest among the early socialists, Rodbertus, looked to the permanent maintenance of a monarchical form of government; and a great philosopher, Comte, who sketched an ideal organization virtually socialistic, believed that it must have an autocratic head. Just what democracy really means and what in reality ensues when it is established in a specified form—all this is as hazy and uncertain under socialism as under non-socialism.

Lastly, socialism does not necessarily imply revolution or violence. Most well-to-do people of the half-educated sort associate it with the red flag and a reign of terror; just as most of them find no epithet of condemnation so conclusive as "socialistic." It is true that Marx, the most influential socialist thinker of all time, tho expecting and advocating in his earlier activities a gradual change, became in the end more a revolutionist, concluding that the existing régime could not be abolished without violence. Other socialist thinkers, no less ardent, look to a peaceful change; some to a rapid one, even tho peaceful; some to a slow evolution that shall lead to the transformed society by gradual and orderly steps. The most thoughtful and kindly disposed among the socialists—and brotherly love, rather than hatred or envy, underlies the movement—look not even to any hasty dispossession of the present property-holding classes. These might be pensioned in some way, assured of a sufficient income for themselves during life. It is indeed inconsistent with socialist principles that there should be indefinite continuance of a set of persons who are as mere drones; but the process of getting rid of them may be a gradual one, perhaps thru a far-reaching scheme of inheritance taxes, not necessarily entailing acute distress for any individual.

§ 2. The essential end which socialism tries to attain, then, is a change in distribution; and it is by way of attaining this and primarily in order to attain it that the machinery of production must be turned over to other hands—transferred from its present possessors to the ownership and management of the state. All land, all factories, workshops, railways, all the instruments of production, are to be public property. All the advantage which such things bring, in the way of increasing the productiveness of labor and the output of industry, is to go to the community as a whole. No part of the advantage is to be got as now by private owners.

This does not mean that absolutely all ownership of property must disappear. It is sometimes said that socialism will inevitably fail because it runs counter to a deep-rooted instinct of ownership and property, showing itself from the child's grasping of its toy to the avarice of the aged. The socialists reply that, whether or no there be such an ineradicable instinct, ownership is not to disappear. One may have one's own clothes, furniture, and books and household possessions, may save one's own money, perhaps even possess a house. Only such forms of consumer's wealth as may readily give rise to an "exploitative" income are to be kept out of private hands. The ownership of dwellings to be let at a rental by one person to others, could not be permitted; for this would spell inequality and a privileged idle class. But it would not be out of the question that a person should possess for life a house of his own bought with savings; as one might own a piano or a horse. These things might also be transmitted by inheritance to children. Only ownership of *investments* of any kind, and transactions with things as investments to yield an income, would seem necessarily outlawed—no contracts of lease allowed, no payments of rent or interest. The details of a socialist community have an attraction for many people who amuse themselves by specifying just how dwellings might be owned and inherited, how turned back to the state at a valuation if the possessor wished to make a change, how let by the state as universal landlord. So one might speculate on the extent to which sale or hire of other durable consumer's goods might be permitted—furniture or pianos. The essentials in regard to the ownership of property in the socialist state are that so far as it is in private hands at all it shall be susceptible of wide diffusion, shall not give rise to anything in the way of "funded" income, and shall not be cumulative.

§ 3. Exchange would proceed very much as it does now. Exchange is part of the machinery of production and that is not to be disarranged. There would be warehouses and shops, constant passage of goods from factory to counter, daily purchase of goods by consumers. All middlemen and all shopkeepers (virtually all—might there be exceptions for some hucksters?) would still be "business men" but they would be managers in the employ of the state and receiving wages from it. There would be money, too; very likely some metallic money, because this is clean and durable. The devisers of utopias have sometimes pictured something else—

labor tickets, a sort of paper money but different from the traditional paper money. Things for sale in the shops might be labeled with the amounts of labor which their production had involved—all the labor, remote and near, direct and indirect. Each producer on this naive application of the labor theory would receive tickets in proportion to the amount of the labor he had performed and would use these tickets as money. Such an arrangement assumes an adjustment of wages on some strict labor or sacrifice basis. Of this aspect of the case more will be said presently; certainly the determination of the prices of goods would necessarily involve some established principle of distribution among the wage receivers. So far as concerns the mechanism of exchange an essential thing would be to have stable prices and stable money incomes—no fluctuations in the value of money, no crises, no dislocation of the machinery. The quantity of the circulating medium would be adjusted to the quantities of things bought and sold, and to a given scale of prices for them, in a manner analogous to the present adjustment of the supply of subsidiary coin to the occasions for its use. Or, quite possibly, the total quantity of money would be adjusted to the established scale of money incomes; this if the object were to keep incomes stable rather than prices. In a well-functioning socialist state neither the prices of things nor the range of money incomes would be allowed to adjust themselves, as now, to the quantity of the circulating medium. That medium we may suppose to be paper, or gold and silver and copper—or any combination of them. The printing of the paper as well as the mining of the metals and the manufacture of coins would of course be government operations.

This cool-headed attitude toward money as a mere medium of exchange, to be dealt with in such way as to have no influence of its own on real income and real capital, is not easy to maintain undisturbed. The traditions so long attached to money might be turned to bad account as well as to good account. In a socialist community there would be temptation, as in an individualist one, to conceal bad economic policy or unsuccessful outcome by printing more money and so adding to the immediate financial resources of the state. In either case the consequences of error might easily be allowed to accumulate, the day of retribution for a bad handling of the economic system put off, and a final return to good order made painful.

§ 4. Questions of the same sort arise about the accounting system of the state, which could not but be a huge and complicated one. Something in the way of careful accounting is obviously necessary for the state's budget and for the state's industries. No less obviously, it must run in money terms. It would involve cross debits and credits between departments, advances and charges, opportunities for manipulation as well as for adjustment, temptations to provide "resources" and "funds" by the easy process of printing paper money. It is beyond the scope of the present book to consider in any detail this vitally important matter. I can go no further than to consider how far the socialist state must conform to economic principles which hold good for any and every kind of complicated social body.

It has been alleged that an accurate system of accounting, even a working one that is reasonably helpful, would be impossible in a socialist state. The objection has even been pressed so far as to maintain that the only way in which the state could arrange and manage a good accounting system, one which could be the basis of its budget as well as of the whole economic scheme, would be by a return to the methods of private industry and to its principles of value. I cannot believe that there are any insuperable difficulties in the way of an economic ordering quite different from the equilibrium structure which is the ideal or normal outcome under private industry. But I do believe that there are enormous difficulties and dangers in the erection and management of an accounting structure that would really serve as guide to the leaders of the great state.

The Ministry of the State (I use that term for brevity and convenience) would produce everything and sell everything.[1] Its output—*the* output—would consist of goods and service for consumers and its sales would be sales of those same consumer's goods. Both would be in pecuniary terms—so many dollars or rubles. But the sales of consumer's goods would be less than the output; because part of the output would not be of a salable kind. This

[1] Barring of course the remnants of petty private business.

discrepancy would arise in two ways: one inevitable and persistent, the other not necessarily persistent yet likely to recur.

First, the socialist state, like the state of private industry, would provide a large variety of services without direct charge to the consumers; such as public highways, sewage disposal, police and fire protection, museums, parks, playgrounds, schools, public hospitals. Some goods also might well be supplied gratis: fresh water, books for schools. In all the proposed utopias, and in the Russian utopia in its half-completed stage, the range of such consumer's income is wide; it would seem likely to become wider in the future. For all provision of this kind there is cost, an outgo of money; but there is no money income. In individualist society if the state makes such provision gratis, the difference is made up by taxation; that is, by taking from the people part of the income they have received. In the socialist state it is also taken from the people, but by a different process; that, so to speak, of stoppage at the source. Those who turn out the vendible goods, as food, clothing, fuel, the various comforts of life, ornaments and gewgaws, cannot get the whole of what they produce. They receive money enough to buy a part of their product, but a part only. Those producing the public goods —the things which are gratis to all—receive the rest. While the two classes between them produce all there is and receive all there is, the state treasury receives money income only from the things which are sold; none from the public goods. It makes a sort of "profit" from its sales, out of which come the money funds which pay for that real income which by necessity or preference is non-salable.[1]

The same kind of situation, tho not identically the same, must exist with regard to capital goods—the output in the way of plant, machinery, industrial buildings, means of transportation. To provide these goods on the great scale of modern technology means construction carried on thru periods of years and perhaps decades. For a long time something tangible and physically measurable is added in the form of producer's goods from day to day; but until

[1] Hence it is that even if remuneration were based entirely on the basis of labor (man-hours), the "wages" would not yield to each worker the full marginal product of his labor. He would then get wages in *proportion* to his man-hours; doubtless a weighted proportion.

the stage is reached where consumer's goods emerge, nothing becomes available that can be sold or can constitute a part of the community's real income. Ultimately real income—consumer's income—is expected to be enlarged; unless this is achieved the operations are worthless and the new plant must be scrapped. In any case there are the long years over which the construction is spread and during them the persons engaged in it are in essentially the same position as those at work in providing the free public services. They contribute nothing to the current money income available for the Treasury from its sales to consumers.

Resort may indeed be made to something analogous to the borrowing of the capitalistic state; resort to the printing press—increased money incomes, more money spent on consumer's goods, but of course no more real income than the existing machinery had been turning out, perhaps less. In other words, the socialist community which wishes to add to its productive equipment must submit for a time to a standstill of its real income, very possibly a diminution. Every community, socialist or other, is tempted to conceal this necessity by monetary manipulation and to go ahead exuberantly as if all were quite easy and simple. The problems do not solve themselves; they can be veiled or postponed; sooner or later they must be faced. Such was the case during the planning and execution of the huge construction operations of the Russian Soviet during the twenties and thirties of the twentieth century—operations whose final outcome was necessarily uncertain and was made the more difficult to evaluate because of the inevitable unwillingness of state leaders—not less than that of private leaders—to admit poor judgment or bad management.

§ 5. To return now to the subject of distribution. In one way the program is very simple, being merely a matter of the adjustment of wages—of income from labor. Rent and interest disappear. The continued existence in Soviet Russia of government interest-bearing securities, of public savings banks paying interest to depositors, of the payment of interest to foreigners on Soviet securities sold to them—everything of this kind can only be a phase in a transition period, to be swept away when the perfected system is achieved. At that stage there would doubtless still be pensioners and paupers but no able-bodied persons having non-labor incomes, least of all any living in comfortable idleness.

"Wages" necessarily mean a wages *system:* a settled scale of remuneration for men who are working at things which they do not themselves consume. In that sense, laborers must be hired in any community, socialist or individualist. Wages on the basis of continuing employment with terminable engagements are not indeed inevitable. Some sort of "salary" arrangement is quite conceivable. Whatever the arrangement, it is certain that men cannot live and work unless they receive at once the wherewithal for their living while engaged in the manifold earlier stages of an intricate division of labor. The question of the scale on which they shall be paid cannot possibly settle itself. Some officials must arrange the terms on which each worker is to receive his share of the consumable goods and services.

An authority then there must be. The huge machine will not run itself. Some one, some group, must be in command. Discipline there must be, a tautness of organization, obedience to the orders of superiors. Who shall select the leaders and what promise there is that those qualified for leadership shall be wisely chosen—that is another matter, to be considered presently. Certain it is that no spontaneous or self-regulating organization is possible. The notions of the eighteenth-century optimists, that the inherent goodness of men, once released from the trammels of an artificial society, will lead each to fly to his proper station and do his proper task—all this is no longer worth discussing. Leadership and direction and organization—that is, bureaucracy of some sort—are essential.

§ 6. On what basis is the pay of different sorts of workers to be fixed? There are three conceivable principles of apportionment: need, sacrifice, efficiency.

(1) Distribution according to need would be the simplest of all. It would mean in general—as the basic principle—that all should share alike. It is true that men's capacities for enjoyment are different and their needs correspondingly different. Some are sensitive by nature; to them plain fare and cheerless surroundings will always be more distressing than to the average man, while ampler

means will be a greater source of pleasure. And apart from differences in sensitiveness, he who works with his brains perhaps needs for full efficiency better surroundings and greater variety in occupation than the manual worker. But considerations like these could not seriously affect the general proposition that distribution according to needs leads to virtual equality. The seeming diversities in the keenness of desire and enjoyment—"in needs"—are chiefly the results of habituation. Those bred to comfort and refinement are sensitive chiefly because they have been made so. The socialist state could pay no attention to such differences. And tho it might logically pay attention to other differences not arising from the established habits of far-separated social classes—to differences between weak and strong, between sensitive and coarse persons—the divergences from the rule of equality could hardly be considerable. Still less could they be made acceptable to the rank and file. There is no way of measuring how far differences in capacity for pleasure are real, how far fanciful. Essentially, distribution on the basis of need would mean that all should share alike.

This is perhaps the highest ideal; perhaps it conforms to the highest pitch of altruism. It has usually been accepted in the communistic societies which have been under strong religious influence. It is more or less consciously the ideal of those who find "socialism" in the teachings of Christ. But it is not proposed, at least not overtly, by most socialists. Many persons think that leveling is an essential part of socialism. Great mitigation of existing inequalities does indeed seem to be universally demanded by socialists; and a lurking predilection for complete equality is found in the usual propaganda. Nevertheless almost all socialists have in mind, however vaguely, some degree of differentiation in the individual incomes.

(2) The second principle of distribution, that of sacrifice, means that men should be paid in proportion to the irksomeness of their labor. If all labor were equally severe and equally distasteful this would mean that men should be paid in proportion to the time (hours and days) of their labor; for, on the whole, a day's labor or an hour's labor would mean as much to one man as to another. The principle of sacrifice as measured by labor time underlies the

notion of an intrinsic value in commodities, resulting from the incorporation of labor in them. Marx had a doctrine of this sort. Value was said to be so much embodied labor, a kind of labor jelly; regarded not as a mere phenomenon of the market but as something inherent in economic goods. Quantity of labor—such quantity as is ordinarily and reasonably necessary—was supposed to settle this inherent value. The doctrine really had in mind the principle that goods *ought* to be exchanged in proportion to the labor needed for producing them; and this, again, implies that all labor *ought* to be remunerated on the same basis, that differences need to be explained and justified; hence that duration and intensity and disagreeableness of labor should alone be the occasion for differences in its remuneration. In such a mechanism of exchange as would conform to this principle, goods would be valued according to the quantity of "socially necessary" labor involved in their production and sold on that basis.

In Bellamy's *Looking Backward* (1888), a book at one time much discussed in the United States, it was proposed that all laborers should be paid at the same rate but that the hours of work in different occupations should be adjusted in such way as to make sacrifice or irksomeness the same for all. Let the pleasant sorts of labor have long hours—those of superintendence and government, for example, since "bossing" seems always to be agreeable. Let the dirty and heavy labor, such as mining and ditch digging, have short hours. Readjust the hours if it should appear, from the deficiency or excess of applications for the several employments, that this weighting by the length of working time was not accurate. The underlying idea is no more to be taken as an essential part of socialism than any other detail in the sketches of utopia. But it brings out clearly the principle of equality of sacrifice: not pay at the same rate for all but pay at such rates as to bring the same sacrifice for all.

Equality of sacrifice rests on an ideal of liberty. Sacrifice, hardship, irksomeness, are subjective feelings. They can be measured only by giving men choice of what they shall do and judging of their feelings according to that choice. Tacitly, there is an assumption that equality exists as regards the capacities of men; that all can turn at will to the several sorts of labor; or, at least, that enough persons can turn freely one way or another to make it feasible to get a full quota for each sort. If we assume that all men have the same inborn abilities, and that there are no obstacles to free choice of occupation from custom, expense of preparation, or social environment—then precisely this kind of adjustment of wages would ensue in an individualistic society. The only differences would be those that served to offset the varying disagreeableness of different sorts of labor.

(3) Very dissimilar is the third principle, that of remuneration according to efficiency or productivity. This says that each man shall be rewarded in accord with his contribution to the social income. The able, strong, and alert shall get more, the dull and weak less. The outcome would be in many cases quite the opposite of that from the principle of needs; for under that the strong and healthy get less, the weak and ailing more.

Remuneration according to efficiency seems to most persons in the individualistic societies to be obviously just. We think it right that he whose work accomplishes more shall get more pay, that an efficient man shall be paid at a higher rate than an inefficient one. The principle assumes, too—tho this assumption often is not consciously made by those who reason on it—that efficiency cannot be the same for all, some having by nature greater capacity than others. Remuneration according to sacrifice tacitly assumes perfect liberty of choice; whereas remuneration according to efficiency tacitly assumes that not all men can do all things and that not all are equally sedulous.

The ready acceptance in everyday talk of capacity as a just basis of reward is the result of its being the basis on which reward is now in fact adjusted. In existing individualist society men are paid for labor, on the whole, according to what they contribute to society; or, to be accurate, according to the marginal contribution of their kind of labor. On this matter, as on others, most persons accept as just that to which they are habituated. The substantial ground on which remuneration according to efficiency is to be justified is the utilitarian one. It spurs every man to contribute his utmost. The argument for it is the argument from the bribe. On the most altruistic ethical standard there is no reason why the strong man should get more than the weak; nay, rather, there is ground for his sharing freely with the weak. The reason why he should get more is that unless so rewarded he is not likely to exert his strength. In the end—this is the essence of the argument—all men are better off when each is induced to contribute his utmost. If indeed all men are born with equal gifts and have equal opportunities, the final result will be the same as under the second principle—all will be paid in proportion to sacrifice. Everyone will be spurred to turn his labor to the occupations which are highly rewarded; in these, numbers will increase and reward then will diminish; ultimately only those differences will remain which correspond to differences in irksomeness. But if there are inborn and persisting differences in capacity some men will always get more than others, even tho opportunities be the same for all. The resulting inequalities must be accepted as necessary in order to induce every man to exercise his own faculties and to exert himself toward improving by training and assiduity those faculties which bring about high efficiency and high reward. Such is the utilitarian argument.

Not many advocates of socialism have expressed themselves clearly on this fundamental question: what is the just or ideal apportionment of reward for labor? Often they think loosely and fail to discriminate among the possibilities. In the twentieth century the trend among them, on the whole, has come to be toward remuneration according to sacrifice; if not entirely on that basis, yet so in large degree. Strong as is the underlying protest against complete inequality, few would accept all the consequences of the principle of capacity. Often they ignore inborn differences, clinging as they do to a belief in the perfectibility of all men; and in any case the great differences which flow from reward according to capacity would not be in accord with their general striving for equality. Tho only half conscious of doing so, the sober-thinking socialists are apt to propose or imply some sort of compromise: some inequality, but not very much; some adjustment to efficiency, but not so much as to lead to marked inequality.

It is to be said that Marx himself was aware of the intricacies of this aspect of the question of principle and was keen and discriminating in his discussion of it. His view was that some concession to the principle of pay on the basis of productivity—in essentials an acceptance of it—was needful in the transitional stage which would follow immediately on the first revolutionary adoption of socialism. "These evils [inequalities] are inevitable in the communistic society in that transitional phase in which, after long pangs of birth, it emerges from the capitalistic society. . . . Justice under the law *(Recht)* can never be on a higher plane than is the economic development and the culture development of a society." [1] . . . "In a higher phase of the communistic society, when once the servile subordination of individuals under the influence of the division of labor has ceased and thereby the distinction between intellectual and manual labor has disappeared; when once labor is no longer a means toward living, but has become the very first thing desired in life; when the many-sided development of individuals has increased the powers of production, and all springs of common welfare run more fully—then, and then only, the narrow bourgeois horizon of justice can be completely done away with, and then society can inscribe upon its banners: From everyone according to his capacity, to everyone according to his needs." [2]

§ 7. Before further consideration of the meaning and possibilities of socialism, it may be pointed out wherein socialism differs from public ownership and from the humanitarian legislation which is often spoken of as socialistic.

Public ownership in itself does not mean socialism. The individualist state, when owning and operating railways, proceeds in essentials as a private company does. It pays high salaries to the managers at the head, less salaries to subordinate officials, ordinary wages to mechanics and unskilled laborers—thruout on a scale similar to that prevailing in the world outside. No doubt there is some tendency to mitigate existing inequalities. The higher offi-

[1] Quoted by Professor Lange in the *Review of Economic Studies,* Vol. IV, p. 131.

[2] Marx's *Critique of the Gotha Program of 1875,* English translation, p. 31. Kautsky, the loyal follower and voluminous propagandist of the Marxian doctrines, refers to this possible ultimate stage as "that blessed second phase of communism about which we do not know whether it will ever be more than a pious wish, similar to the Millennial Kingdom."

cials often get less than persons of the same capacity would get in private employment; tho this, again, has not infrequently had the consequence that the officials are not in fact, as they are supposed to be and ought to be, of the same capacity as those in private employ. In democratic countries the mechanics and unskilled laborers are often paid more than they would be paid by private employers. These are no more than differences in degree, howevèr, and rest on no clearly conceived principle. As a general rule, the existing differences of wages are accepted in public business management.

Again, public ownership does not do away with the leisure class. When the state turns to railway ownership and operation it buys out the private owners, who thereafter receive their income from other investments. Purchase by the government of existing plants often results simply in an exchange of public securities for corporate securities. The same consequence ensues when the state sets out to build and operate great works at the very beginning (as the Australian colonies did in building their railways). Almost invariably it then borrows the funds and pays interest to the creditors. The leisure class still gets its income. If indeed the socialist program were carried out to the full—if public ownership and management became universal—this could be no more than a transitional stage; in the final stage the leisure class would disappear.

No doubt it is true that public ownership means, at least in democratic countries, an endeavor to mitigate inequalities in distribution. Monopoly returns are to be done away with or (what comes to the same thing) are to be appropriated by the community. This is by no means inconsistent with the conduct of the great mass of industrial operations by private hands, with all the resulting phenomena of private property—inequalities in earnings, savings and accumulation, investment, a leisure class, a stratified society. There is a vast difference between some mitigation of present inequalities and the complete removal of the causes which lead to those especially unwelcome kinds of inequality which are characteristic of the existing régime.

Similarly the whole series of social reforms, from the regulation of the large-scale industries to factory regulation and old age pensions, which look also to the mitigation of inequalities and of the results of inequalities, have a limited scope. All such measures serve to determine the plane on which competition shall proceed without putting an end to competitive bargaining or competitive returns. Factory legislation, for example, workmen's insurance, even minimum wages, fix the limits within which the bargains shall be adjusted but do not attempt to settle the terms. The case would indeed be different if the state were to go to the point of actually fixing wages, say by a system of compulsory arbitration. This would involve a principle more far-reaching than the other forms of labor legislation; since, carried to its logical conclusion, it calls on the state, by fixing wages once for all, to settle the other elements of distribution as well.

True it is that all these things—public ownership, regulation of industry, labor legislation—rest on the same principles and ideals as socialism, that they look in the same direction, and that they may lead ultimately to a socialistic state. They do rest on the same or similar impulses—a wider altruism, a growing impatience with great inequalities. So far they look in the same direction. But their ultimate outcome is by no means necessarily the same. That outcome may be a purified and better society, still organized on a basis of property and of free bargaining. Oddly enough, the advocates of socialism and its extreme opponents alike have a vague and all-embracing conception of the movement. The advocates welcome every step for reform as "socialistic", and the opponents stigmatize with the same name every measure to which they object.

§ 8. Some current objections to socialism are easily met.

It is said that the scheme is too huge, the difficulty of organization insuperable, the actual operation sure to break down because of the extent and complexity of the industrial problems. The large-scale enterprises of modern times go far to dispose of this objection. The possibilities of organization have been proved immense. When we see how great industrial enterprises are successfully conducted (not always with success, yet not infrequently) on a vast scale under unified management, we cannot assert that the difficulties of management and operation which arise merely from size would be insuperable under socialism. In fact, many of the problems of production, exchange, transportation would be simplified. Fluctuations and uncertainties would largely disappear; only the inevitable irregularities of the seasons would have to be reckoned with. Overproduction of any one commodity could be set right simply by waiting until the existing supply was disposed of. There could be no ruinous underbidding by frantic competitors, each rushing to market in the fear that the others would undersell. It is true that the system, order, regularity, which the socialists may fairly claim as belonging to their society, may mean also stagnation—the cessation not only of change but of progress. This, however, amounts to saying not that administration and management are impracticable but that they would not be progressive; an aspect of the case which will be taken up in the next following chapter.

Again, there would seem to be no insuperable difficulties in the way of valuing commodities in the socialist state. The pricing of the goods on sale would involve, to be sure, not only accurate bookkeeping (of the cost account sort) but the determination of the wages of the laborers engaged in the several branches of production. In other words, it would presuppose a scheme of distribution among the laborers. As already explained, and as will presently be further shown, this is a troublesome matter. But supposing the principle or standard to be settled, the next step, that of fixing a price for the goods produced by different kinds of labor or different combinations of labor, is not more difficult than it is now for a great manufacturing establishment. Often enough in existing industrial organization figures of cost can be reached only with approximation to accuracy; and a reasonable approximation suffices.

Nor would the accumulation of capital be a matter of crucial difficulty. It would simply proceed by a different process from that of present society; not by savings and investments of individuals but by the deliberate setting aside of part of the community's resources for new construction. It would depend as at present on the existence of a surplus, an excess over what is used for satisfying current wants. In this sense there would be "waiting" and saving in the socialistic state. It would be waiting, however, not by a comparatively few but by all. Each and every individual would have his present real income curtailed somewhat, in order that provision might be made for adding to the outfit of the community. Success in making such a provision would depend, of course, on the possession of a fairly high level of income; that is, on an existing high productivity of labor. Given a sufficient present income, there would be no difficulty in setting aside something for addition to the community's capital. The serious problem, once more, would be whether there would be continued progress and invention, not whether there would be the means for carrying out new projects.

It is often said that socialism would be destructive of liberty. Yet for the great majority of mankind freedom might be no less than it now is. Most men now find the nature of their occupations fixed for them. Their daily round is settled virtually without choice of their own. Change from one occupation to another of a similar grade would seem to be no more difficult of arrangement in the socialist state than in our own. If the dreams of the socialists come true there would be shorter hours and more leisure for all. But greater freedom in this sense is not unattainable in existing society. If the dreams of the non-socialists come true toil will be less all-absorbing, free time more plentiful. For the mass of men it is not clear that on the score of liberty there is a preponderance of gain under either system.

Whether persons of unusual gifts would have greater freedom is again not easy to say. Unless real freedom could be secured for them, real opportunity for development, no dreams of the socialists could come true. A stiff and bureaucratic socialism—and danger there is of crass bureaucracy—would stifle individuality. This is a matter of the kindling of ambition and emulation, the selection of leaders, the maintenance of progress—difficulties which I conceive to be the crucial ones and shall consider presently.

Obviously loss of freedom there would be for many who are now privileged. The commonplace persons among the well-to-do class who now have an "independence" of their own to fall back on would have less choice of occupation, less freedom as to their mode of life. The abolition of the régime of privilege would necessarily destroy some advantages of the privileged. That elegant freedom now enjoyed by the possessors of large "unearned" incomes would disappear completely.

We are so habituated to the ways and traditions of present society that we cannot easily imagine what those of a society essentially different would be. There is no such thing as unrestrained freedom. Men live now within limits set not only by the need of earning their living but by law, by custom, by environment. In the socialist state, also, there would necessarily be restrictions, in some respects similar, in some respects different. A bureaucratic and semi-military socialism is conceivable, which would crush individuality. A regulated and refined system of private property is conceivable, with unfettered freedom of opportunity, in which there would be a completeness of liberty hardly to be attained in any socialist state. If we believe the *summum bonum* to be the full development of personality we must hesitate before saying with assurance which sort of social organization gives the promise of the best happiness.

CHAPTER 68

SOCIALISM (II): *PROS* AND *CONS*

§ 1. The family and the problem of population under socialism. The Malthusian difficulty hardly more serious than under private property.—§ 2. Vigor and efficiency among the rank and file. No inducement to "make work." The absence of the power of discharge. The irksomeness of labor; how far could it be lessened?—§ 3. Leadership and the ways of securing it. Motivation; the love of distinction. Mixture of higher and lower aspects in the love of distinction. The possible growth of altruism.—§ 4. The selection of leaders in a socialist state. Differences between the various kinds of intellectual ability. Judgment needed above all; not discerned early or easily. How leaders have come to the fore; how they have been selected.—§ 5. Material progress thru the accumulation and improvement of capital also depends on leadership. Is a change in distribution alone now needed; can advance in production be disregarded?—§ 6. Leadership and management present the crucial problems. How select the leaders.—§ 7. The intelligence and character of the people. Intellectual capacity rests on inborn qualities; behavior and moral quality rest more on environment. The possibilities of training, preaching, propaganda, greater for good and for ill in this generation than ever before.—§ 8. Will socialism be the ultimate outcome of social evolution? The materialistic interpretation of history and its prophecies.—§ 9. The future. The confident predictions by socialists of the nineteenth century not verified; no confident prediction warranted for the twentieth century. What may be expected for the next generation or two.

§ 1. WE turn now to problems in a socialistic organization about which one must speak with caution. They reach into unsettled questions of psychology, ethics, biology.

Tho socialism would not destroy the home or the family, it would bring domestic relations very different from those with which we are familiar. The socialists are justified in scoffing at the bugbear of phalansteries and barracks, with supposed gigantic nurseries, quasi-incubators, in which children would be reared without parental love or guidance. Yet inevitably the family would be in an environment very different from that of the present, its influence much diminished, the relations of parents to children greatly modified.

Formal education and training, it would seem, must be completely under state control. The training of the young and their preparation for a career in life could not be left to the discretion of parents. At the least it would be subject to minute public control. And on the other hand the responsibility of parents for the future of their children would virtually cease. Every child would not only be taught the fundamental things but properly fed and cared for. Its education would be pushed as far as the constituted authorities might deem worth while. And a corollary would seem to be that every child, when its formal education was completed, should be assured employment and as good an opportunity for earning an income as any other child of like promise.

Malthusianism was held up by the economists of a generation ago as an insuperable obstacle to any collectivist scheme. The socialists have commonly pooh-poohed it. The problem is none the less real. The decline in the birth rate and the lessening pressure of population which appear in the highly civilized countries are the consequences of individualism and the régime of property. These tendencies, salutary on the whole, arise from the stirring of social ambition more than from any other force. They rest on the present position of the family, hope for the future of one's children, desire to rise in the social scale. It has been said [1] that the natural man has only two primal passions—to get and to beget. The desire to beget is now held in check by the desire to get. That removed, what would check multiplication?

This is a thorny subject, entered on more coolly and openly by the socialists than by their opponents. Man the animal tends to multiply like other animals, and when he does so encounters essentially the same obstacles as other animals. Relaxation of the tendency to increase and even more its regulation are imperative, yet are fraught with dangers, physiological and moral as well as social. These dangers and evils are ominous in existing society. So fundamentally different would be a collectivist organization that it is rash to predict just what dangers would be avoided in it, just what would be inevitable. It is possible that some coarse and mechanical regulation of the sexual relations would be resorted to;

[1] By Dr. Osler, *Science and Immortality*, p. 10.

a formal retention of monogamy and family obligations, yet without those concomitants which now make the family a safeguard for public and private well being. The sexual relations are made safer for society not only by the marriage tie and the lawfulness of monogamy but by care and responsibility for the offspring. The domestic relations are highly unselfish within the narrow range of the family but highly selfish as regards the relation of the family to the rest of the world. In their essence they are individualistic; and it is their very individualism and selfishness which cause them to work to social advantage.

It is a sad commentary on the civilization of the twentieth century that the subject of population is rarely handled with intelligence, either by non-socialists or socialists. In great nations having widely different political, economic, social structures—France, Germany, Italy, Russia—the policy still is to increase numbers once for all. In the main the military motive remains strong—the wish or supposed need to have more fodder for cannon. It is rare in the prevailing attitudes on population to find attention to quality. A permanent uplifting of mankind depends on an elevation of the general level of intelligence and character, on enlarging the proportion of the gifted, diminishing the proportion of the dull and commonplace and defective. As regards the prospects under socialism one might conceive that a highly intelligent and strongly intrenched government would apply remorselessly the eugenic principle; breed men as it would breed horses and cattle, keeping only the better strains and allowing the poorer to die out. But the socialists are prone to brush aside differences in inborn capacity, being as reluctant as the democratic individualists to face even a plain biological fact if it seems to run counter to their doctrines.

It is not easy to say what the attitude of the socialists would prove to be if the time should come when their society had settled down and were no longer in a stage of uneasy transition and adjustment. Perhaps they would then still welcome an increase of numbers, if only as a matter of pride and prestige and as a supposed proof of progress. And it is also possible that they would begin to be concerned less with numbers and more with a permanent bettering of the quality of the people. The same questions arise in the individualistic societies. It cannot be laid down that one kind of state is likely to deal with them more wisely than the other.

§ 2. The maintenance of vigor, efficiency and progress presents problems no less troublesome, both as to the rank and file and as to the leaders.

True it is that, as regards the rank and file, some among the difficulties in the existing order of things would disappear. There would be no inducement to "make work" or oppose improvements. The fear of unemployment, which is the main cause of the disposition to adopt such policies of restriction, could not have influence in the socialist state. In that the laborers no longer needed in one occupation or in one locality would be transferred elsewhere; with no loss or suffering during the transition, even if immediate utilization proved not feasible. There would be no inducement for making the job last.

On the other hand there would also be no right of discharge; none, certainly, that could be exercised with effect, least of all in a democratic community. Criminals, ne'er-do-wells, the hopelessly defective, would indeed be comparatively easy to deal with. They could be immured, kept from breeding; nay, if beyond redemption, got out of the way painlessly. The serious problems would be presented by the rank and file of men, neither hopelessly bad nor inherently good. How deal with mere slackness, indifference, the lazy stroke? No threat of discharge could avail; for non-employment and work seeking are quite to be done away with. The men must be dealt with once for all either as workers or as delinquents.

If indeed labor were not ordinarily irksome and if work were always done cheerfully and spontaneously, no serious difficulties would arise.[1] But steady labor at monotonous tasks, such as is essential for the productiveness of industry, is unwelcome to almost all men. In an ideal state we should wish to have good work, good pay, good leisure; but will men do good work if assured in any case of good pay and good leisure? Spontaneity in labor seems inconsistent with large-scale operations. It is found when men work for themselves, or in small groups where each works for all and

[1] See Vol. I, Chapter 1.

under the eyes of all. The larger the group and the more remote the connection between each individual's labor and the final output, the less likely is it that men will work faithfully without some supervision and penalty. The problem is similar to that universally encountered in taxation.[1] The public services being gratuitously supplied to all—there being no precise *quid pro quo*—all grudge the taxes that must be levied in order that government shall be able to supply the services. Hence the mien of the tax gatherer is inevitably stern. In a socialist state all workers would be assured once for all of getting their share—on whatever principle adjusted—of the results of collective activity; and hence some sort of pressure would have to be exercised in order to induce vigorous and effective work. Must not the socialist taskmaster *seem* harsh, like our present tax gatherer?

This difficulty has not been ignored by the proponents of socialism. An interesting episode in the Russian Soviet experiments has been the endeavor to create rivalry between groups of laborers and thereby to arouse interest in the work—and also enlarge the output. Work is to be made a game; a grand score of output is to be a victory. Prizes are offered—bonuses, travel tours, banners or badges—to individuals excelling in performance; and also, what is more important and more nearly unique, to large groups in factories, in agricultural work (harvesting) and the like. How much has been accomplished it is impossible to make out. The accounts of great successes which come from the officials in charge must be taken with the same caution as all public propaganda, in peace or in war. One cannot but read with skepticism the enthusiastic reports of interest, exhilaration, imposing success. This sort of excitement wanes after a while; it cannot be kept up week after week, month after month. And the operations of modern technology must proceed at a steady pace, not with a succession of spurts.

A problem there is clearly; and the proponents of socialism do face it and try to deal with it. Better ways and traditions than are commonly found in modern industry would mean much for human happiness. The "personnel" managers who deal with the ways of handling as well as paying the rank and file of the em-

[1] Compare Chapter 69.

ployees are apt to think only in terms of pay and of output, and fail to remember that the zest of life arises in the relations of men with their fellow men and of groups with their fellow groups. The socialists at least start with a concern for the spirit in which work is done.

The socialists of the twentieth century, while entirely willing that experiments should be made toward arousing interest in daily toil, are in general hard-headed enough not to pin their faith on this sort of procedure. They are ready to adjust remuneration to capacity; not indeed once for all and to the full but with some regard to the individual's contribution to output. Higher or lower wages will be paid in some proportion to the productivity of the several kinds of labor. If the principle were applied to the full the greatest variations from the average or ordinary rate would appear, of course, for the comparatively few having great gifts: the great leaders and administrators, the men of science and the inventors, and the poets and artists likewise. Differences of the same sort, tho less in degree, would appear in the rank and file also. The interest of every private employer now leads him to make distinctions on this basis. He selects for the better-paid positions the steady, zealous and intelligent, and relegates the dull and indifferent to tasks that can be mechanically measured—or he discharges them once for all. Is it to be supposed that public officials will discriminate in such way as to stir zeal and intelligence, penalize laziness and incompetence? Will the public officials of a really democratic socialist community do so?

§ 3. We come thus to the questions about leadership and management. They are of two kinds. One, that of reward and motivation, has just been considered in its more general aspects; as regards leaders it has an importance and interest of its own. The other, even more troublesome, is that of the selection of leaders.

The variations and possibilities of reward and motivation—the range of ways for spurring men of high ability to exercise their faculties to the full—are greater than the intolerant critics are disposed to admit. The essential thing, say the socialists, is to find new and better ways of inciting emulation and satisfying the love of distinction. What men chiefly strive for in leadership is fame, place, and power. In some degree, no doubt, they are prompted by a mere impulse for the exercise of their gifts. Not the poets and painters and musicians only but the men of science and the administrators also have an inborn bent for achievement. Add to this the stimulus of emulation, of widespread appreciation, of conspicuous distinction, and the sordid rewards of present society can be dispensed with. Give free play for the exercise of genius and power and the ribbon and the laurel wreath will suffice as rewards.

Psychology of this kind is better beyond question than that older one which supposed that all men have a simple desire for wealth. Just as other things than riches and worldly success appeal to the artist and the man of science, so the leader in business also responds to other rewards and ideals. Government posts have an attraction which goes far to outweigh higher pecuniary rewards in private business. And in private business the captains of industry and fortune builders are actuated by very mixed motives. They follow the traditional paths of emulation and usually are but dimly conscious that the wealth they pursue is prized after all as a symbol of achievement and success. What stirs them more than anything else is social ambition. The essential thing is some symbol of eminence that shall put its possessors above the common herd conspicuously, as riches now do.

Admitting that emulation and imitation rather than a desire for wealth in itself underlie the doings of industrial leaders as of others, it does not follow that the particular kinds of appreciation and recognition familiar in our system of property and inequality can be entirely dispensed with. How completely will the typical person of business ability respond to other incentives? Even among persons of intellectual and spiritual gifts there is a mixture of motives. Creature comforts, command of the services of others, are not entirely despised even by poets and philosophers. It is not often that the laurel wreath alone is enough to satisfy ambition. As few men are wholly selfish and few wholly altruistic, so few are wholly moved either by the "higher" or by the "lower" forms of the love of distinction.

Much depends on the growth of altruism, and this again depends on the spirit that pervades the community. The wider feelings may be fostered or smothered in the individual by the atmosphere which surrounds him. With a better development of democracy, with a spread of education and a clearer understanding of social and economic problems, we may expect that the environment will become more favorable to emulation in mutual service. A less spectacular way of giving rewards and distinctions will prove effective in proportion as the sense of common interest is stronger in its hold on all. But it is not to be supposed that a mere change in institutions will at once overturn the deep-rooted self-regarding impulses. The familiar trappings of distinction cannot be dispensed with at once and once for all.

§4. Turn now to the problem of selection. Granted that ways can be found in the socialist state to stimulate and reward the persons fit for leadership, how pick them out?

Gradations of ability, talent, and genius are not measured with ease. Those who show promise must go thru a stage of trial. High intellectual capacity, unlike bodily dexterity, rarely appears at its full until long after adolescence. Poets, painters, scholars, look back with mingled curiosity and amusement on the work of their early years. Often those whose achievements in later life prove greatest could not be singled out in youth from their competitors. Men of affairs, especially, are bred in the hard school of experience. The more promising are indeed soon picked out from the rank and file. To what degree they are promising and how far they will ultimately advance is not evident in the early stages.

There are curious differences in this regard between the various kinds of intellectual capacity. In some subjects a very high degree of aptitude, not to say genius, shows itself unmistakably at an early age; thus in mathematics, and in the quite different subject of music. In other fields of intellectual work one cannot be sure whether a promising young man's quality is of the very first order, or what his final height of performance will prove to be; as is the case in political science, where wide information and matured judgment are essential. High ability in theoretic economics, of the mathematical type, is like that in mathematics—discernible at an early age; whereas outstanding ability in realistic economics, like that in questions of government policy, may not reach its fullness till middle age. And in the enormous task of leading and guiding the entire life of society it is high capacity in political matters and in concrete economic problems that is most needed.

Recall now the characteristics of modern industry: the intricate process of production, its extension over a long period, its enormous outfit of real capital, the intercalation and succession of its operations. The division of labor, both in the contemporaneous and successive forms, ramifies into every nook and cranny of the field. With all this goes large-scale production in a wide variety of industries; great units, each turning out a given product or set of products in huge quantities. The technological outfit which the bourgeoisie developed and brought into at least passable running order must be kept going—nay still further improved—by the hands that are to take hold in the collectivist society. The problems of management would indeed be different; in some ways less difficult, in some ways more so. But without effective management the populations that have accumulated in the countries of western civilization could not be supported—probably not at all in their present numbers, certainly not with any approach to their present real incomes. It is the rapid and revolutionary advances in industrial leadership as well as in technology that made possible the unprecedented increase in population in the course of the nineteenth century and the growing material prosperity of the fast-swelling numbers.

In the industrial field, as in all fields of human activity, leaders come to the fore by a process analogous to that of natural selection. No society has produced great poets, musicians, painters, and sculptors except by the emulation and competition of a large body of aspirants. Many try, few succeed. The case is the same with men of science, inventors, business leaders. It is said not infrequently that the most brilliant of all in every field of achievement find it hardest to make their way because they are ahead of their time; whereas those most readily gain place and appreciation who have high ability but not the originality of genius—the poets and painters who do that to which the general taste has already been educated, the leaders in science and industry who apply principles and methods already established. I suspect that this failure of success for men having genius is not so common as is supposed. And even if genius does often fail to get its full reward, the effect is rather on the time it takes for new ideas to become fruitful than on the conditions under which they make their way to acceptance. The world is full of would-be geniuses and crack-brained schemers. Persons who are now called on to take the initiative in the processes of investment, such as bankers, hardly pass a day without having new projects urged on them—some obviously absurd, many doubtful, a few promising. The exercise of good judgment is necessary before novel enterprises can be launched with promise of success; and then must follow a period of experiment to test the outcome. The same holds good as regards the selection of guiding executives, administrative officers, managers, for large enterprises already established. It is hard to make out in advance who has the particular qualities that make an effective leader; most of all, who has those that make a great path-breaking leader.

By whom is the process of selection to be carried on when there is nothing analogous to the "natural selection" of present society? The discouraged and rejected will then be no longer free to seek someone else to back their projects. They must accept once for all the decision of the officials in charge. Governments now find it hard enough to do things well in the ways already approved by experience. They do their best when they select for their work men whose qualities for leadership have already been tested in private industry. How would it be if there were no private industry? if the responsibility for selection and promotion were once for all in the hands of officials? Even those public business enterprises in which management is now reasonably efficient are apt to be a refuge for the safe and sober who cling fast to established methods. Men of new ideas and far-reaching projects do not easily find a hearing. The same reasons which lead to the generalization that in existing society government can advantageously take charge only of those industries that have reached a stage of maturity [1] tell against the control by government of all industry. It is conceivable that democracy will choose efficient leaders; even this awaits the proof of experience. It is well-nigh impossible to conceive that any gov-

[1] See Chapter 66.

ernmental organization, democratic or autocratic, will be able to pick out the men who are at once imaginative, venturesome, and clear-headed.

One qualification or correction is to be made as regards the selection of able leaders and managers and the continuance of progress in a society based on private property. Selection of this "natural" kind assumes competition. Where there is combination or monopoly the problem becomes different. One of the familiar arguments against monopoly is that it leads to decay of efficiency; while a main argument for competition is that it keys men to their best. It is not easy to say with certainty how far competition has been displaced by monopoly or will be displaced in the future. Tho complete permanent monopoly is rare, there is plenty of horizontal combination, more or less effective, and plenty also of incomplete monopoly always on the defensive against real or potential competitors. Further, neither the efficacy of competition in promoting industrial advance nor that of monopoly in laming it is so clear as was thought in the nineteenth century. Businesses which are highly competitive have proved inefficient generation after generation; as in the case of retail trade. On the other hand some great-scale industries—the telephone, nickel, aluminum—while virtually monopolized, have continued to be alert and progressive, maintaining research, invention, initiative. And yet, to turn to another conspicuous case, the American railroads became stagnant when they seemed to have achieved monopoly—before they were spurred to improvement by the competition of the motor car. In general the old dictum probably holds: when a monopoly is fully entrenched stagnation will come sooner or later, and this whether there be a public or private monopoly. The more there is of monopoly under private property the harder it is to justify and maintain that régime. As regards this element in the case—continued progress—a society based on private property has the advantage only so far as it is pervaded and vivified by competition.

§ 5. Considerations of a similar sort apply to the construction and improvement of capital. The mere accumulation of capital in a socialist state is perfectly feasible, as was noted in the last chapter; that is, the setting aside and "saving" of a surplus. This, however, is only the first step in the process by which real capital is added to. Tools, implements, "capital goods," are not saved; they are made. If there are to be not merely more of them but better kinds of them there must be progress in the arts. Increase of effectiveness in the community's capital can take place only thru improvement and invention.

In the sketches of utopias there is usually reference to the great mechanical improvements which will be seen in the ideal society—vast systematic plant, automatic devices, supersession of dull manual labor by ingenious machines. The schemers speak as if these things came of themselves. In fact the great mechanical advances have come in the past by slow steps, with experiments and failures and gradual achievement of success. They are dependent on the accumulation of surplus means but are not caused thereby. True, the future is likely to see tools perfected far beyond what we now possess. But all new and better devices will come, as they have come in the past, by trial, by selection, by eventual perfection. There must be not only the means for getting new capital made but organizers and inventors. The process of merely adding to the number of existing tools and machines is easy. When once the turbine engine and the dynamo and the automatic loom have been perfected, it is no difficult matter to make more of the same kind. To improve the loom or the turbine still further calls for a different procedure and a different kind of man. The betterment of capital no less than its construction and handling is closely interwoven with the selection of capable leaders. Both are essential for continued advance.

It may be said, of course, that advance in production is no longer a matter of the first consequence. Better distribution may be thought the prime requisite. If the whole income in civilized communities were equally divided now, would not all have enough? Possibly; but what is thought sufficient? It would probably be a liberal estimate of the average income of a family in the United States, the most prosperous country on the globe, if it were stated at one thousand dollars a year.[1] When we consider what this

[1] This on the basis of prices and money incomes as they stood before the war of 1914–18. The reader need hardly be reminded that in the use of illustrative figures of this kind allowance must be made for changes in monetary conditions.

means in food, shelter, clothing, education, recreation, we can hardly be content to let it stand as the last stage in material progress. It is but the beginning of what we may hope to see in the centuries to come. Those who dream of the millennium to be seen in the socialist state, of the perfected machines and the superabundant products, thereby confess that much beyond the present stage of productiveness is desirable. And the more "scientific" socialists, also, when they speak of the inevitable victory of large-scale production, of the disappearance of the small producer and the middle class, imply that there is still occasion for those advances in the arts on which the spread of large-scale production depends.

§ 6. The main questions between private property and socialism reduce themselves to questions as to men's character, motives, intelligence, ideals. They are questions, in so far, of psychology; in more familiar language, of human nature. They are not simple but highly complex; because human nature is highly complex.

What is sometimes called "strictly economic" reasoning rests on the assumption of deliberate intelligent choice of the procedure that brings the most gain to the individual. It assumes hedonism in its simplest form. Motives other than the self-regarding ones are supposed to show themselves only in matters that belong outside the "economic" sphere—in the family relations, in religion, in charity, perhaps in political action. Human nature is not so simple as this, nor so neatly divisible into separate parts. Men are not wholly selfish or wholly unselfish. True, in most of their dealings with strangers to the fold they pursue their own advantage; and it is this fact which underlies and justifies "strictly economic" doctrines. But they do not follow their advantage ruthlessly. In the future they may follow it even less ruthlessly than they do now. They may be restrained not only by the law but by a higher moral sense. Human nature varies in this regard from age to age and often varies for the same individual with his own changing years. It may change in the future so much as to make feasible plans of social reorganization which now seem utopian.

So it is with the impulses of emulation and distinction. In the past they have turned usually to some form of domination, in accord with that instinct of struggle and conquest which we have inherited from savage ancestors. Power over others has been the keynote of political and economic history. It was at the base of the feudal system. It affects enormously, tho half unconsciously, that struggle for wealth in modern society whose ways of emulation are still so much under the influence of the feudal traditions. And the love of distinction is so universal and so rooted that it cannot be eradicated. But it can conceivably be turned into directions which, while still satisfying the ineradicable impulse, lead to a wider spread of the elements of happiness. A spirit of service may replace the spirit of domination, and emulation may be for the greatest promotion of the common good, not of individual interest.

We are much better men than our savage ancestors; more altruistic on the whole as well as more intelligent. Of this general betterment the last hundred years have supplied many illustrations. Suffering will not be endured as it was in former times: the mere description and exposure of it means that an effort will be made to stop it. The abolition of cruel punishments is a phenomenon of large significance. The steady development of social legislation and the increase of charitable and educational endowments are other results of the sense of common interest, of the growing altruistic impulse.

From this point of view it may be said that all the great social movements of modern times rest on the same basis and that all tend away from individualism and in the direction of socialism. Tho important distinctions exist, as has been noted, between full-fledged socialism and public management of selected industries, it is none the less true that the movement for public management and control rests at bottom on the spread of a more altruistic spirit. And the substitution of public for private management is not only impelled by this higher social spirit but depends for its eventual success on a high level of character and intelligence. Labor legislation is both impelled by the spread of better ideals in the community at large and dependent for its ultimate good results on betterment of quality among the laborers themselves. The differences in spirit, in method, in limiting conditions, between socialism and other movements for reform may be said after all to be only a matter of degree.

Leadership and management on the one hand, the character and intelligence of the people on the other—these then are crucial problems for socialism.

How select the leaders and thru these the managers? The immediate answer is simple; it must be thru the political organization. A democratic system is the ideal of all the modern socialists: universal suffrage, elected representatives, leaders elected also, either directly or thru intermediate bodies. It is curious that the socialists of the earlier stage—till the middle of the nineteenth century—were shy of democratic institutions and usually had in mind, more or less vaguely, the selection by some process or other of a supreme ruler, a sort of demi-god. The modern socialists cling to the externals, at least, of democracy. What the realities might prove to be is as hard to say as it is for the actual working of democratic institutions in countries like the United States, England, and France. The Constitution adopted in Russia in 1936 had on the face of it a traditional democratic apparatus, something not unlike that of the United States. But there were wheels within wheels, all kinds of ambiguous phrases, which left it quite uncertain whether the virtual dictatorship of the previous years would really cease, or if it did, still uncertain what kind of political situation would follow. Nothing is clearer in modern history than that the actual working of constitutions has often proved quite different from what the founders expected. It seems to me most hazardous to try to predict what will be the actual working of the Russian Soviet Union; whether the continuance of more or less concealed dictatorships, with a succession of internal struggles, rivalries, revulsions and revolutions, or the gradual development of democratic tradition, government by compromise, guidance by elected leaders, administration by a trained bureaucracy. Whatever the outcome, the question will have to be faced: who will select and manage the managers? Even the maintenance and good working of the present huge economic organizations call for executive and administrative organization of an order rarely attained by the modern state. Adjustment to new conditions, further progress, vigor and life, are still harder to secure. The real working of the whole economic and social structure will always depend on the men at the head. *Quis ipsos custodiet custodes?*

§ 7. Turn now to the other crucial matter: the character and intelligence of the people. On this aspect of "human nature" something different is to be said. The qualities of leadership and management are mainly inborn. Education, training, environment can do no more than bring out what is already in the men. So it is as regards the intelligence of the masses; that too can be nurtured, but not implanted. But as regards character and behavior the case seems to me not quite the same. Relations with one's fellow men—behavior, moral standards—are not so fully settled by heredity but are in greater degree subject to influence from training and example. True it is that there are hereditary differences in character and disposition, "temperamental" characteristics. Some persons are by nature highly altruistic, others inordinately selfish. An inborn moral sense, some readiness to subordinate individual gain to group gain, there seems to be in all. But the standards of behavior for all are profoundly influenced by tradition and precept. The *direction* in which the moral sense impels them varies with the environment. The preacher can modify men's behavior more than the teacher can improve their intelligence.

The difference doubtless is one of degree rather than of kind. Individuals not only vary, as was just said, in the degree of response to the moral sense but the extent and the way in which they respond is affected by the less pliable trait—their intelligence. On both scores, moreover, there seem to be variations between large groups of men; between nations and between social groups within nations. The related questions of psychology, ethics, biology, anthropology, range far. For the main field of economic study, that of the social and industrial life of modern communities as we find them, it suffices to express my belief that morals can be affected by deliberate action more deeply and more quickly than intelligence.

Writing on this subject thirty years ago I expressed a different opinion. Then I remarked that "the current standards of right and wrong, the beliefs as to what constitutes right government, right relations between men and between men and women—these foundations of society are extraordinarily stable. Even when shaken by a great upheaval like the French Revolution they prove in a short time to have been little disturbed. They are maintained from generation to generation by the unseen but pervasive influence of example and imitation." In the period of a generation which has passed since this passage was written the foundations then supposed to be firm have been sadly shaken. The war of 1914–18 did much to shatter the older standards and conventions. Elementary education, almost universal, made it easier to spread new attitudes. Two great technological changes added to the possibility of reshaping men's social traditions—the cheap modern newspapers, impossible without the accompanying huge supplies of paper; and, later but even more important, the radio. Propaganda came to be addressed to enormous numbers of men with a rapidity and an effect never before known. The impact seems to be greatest on social conventions and political and social traditions; not great, even negligible, on character; and on intelligence so small as to be quite negligible. How far will the effects extend, how lasting will they be?

§ 8. In the preceding pages no far look into the future has been essayed. Only for the next generation or two would I venture on predictions. In the United States and in Great Britain we may expect that public ownership will spread, tho how far we cannot be sure. The plane of competition will be raised; the institutions of property and inheritance will be narrowed in scope. But what of the final outcome? Will the evolution of society eventually proceed to the socialist state?

The so-called materialistic interpretation of history, as worked out by Marx and adopted by others of more or less socialistic drift, tries to give an explicit answer: the future will inevitably bring the disappearance of private ownership in instruments of production and the elimination of the property-owning and income-receiving class. Stripped of inessentials, the details of prediction are simple enough. Large-scale production will spread further and further; the small producer and the middle-sized will disappear; there will remain only a few great capitalists and a propertyless proletariat; the masses will become more intelligent and conscious of their power; the capitalists will then be dispossessed (possibly but not necessarily by bloody revolution) and the fully organized socialist state will emerge.

The militant socialists usually expected the overturn to come soon. A century ago, at the time of the revolution of 1848, Marx thought that the final stage in this industrial evolution was already setting in. The first stage, long extended, had been that of the direct exploitation of the laborers thru slavery and serfdom. During the second stage, lasting from the beginning of the industrial revolution in the eighteenth century to the middle of the nineteenth century, the property-owning class had exploited the free laborer. The third and last stage, that of the emancipation of the laborer thru dispossession of the capitalist, was supposed to be ushered in by the revolution of 1848. But of this prediction as little has been fulfilled as of the confident expectation then cherished by others that an era of universal democratic government was setting in. The uprising of 1848 subsided, with few immediate changes in social or political structure. Its lasting effects, fused with those of other movements, came about by slow and gradual changes. Society was much altered in the succeeding hundred years but it was not revolutionized.

So it may prove to be with the expectations raised by the Russian revolution of 1918–19 and the establishment of the Soviet community. In its earlier period, the Russian socialist leaders themselves expected as confidently as their predecessors of 1848 an overturn of the whole world within a few years. Many of their admirers and sympathizers, even those who were critical and objective, shared with them the hope and the belief that the spread of the movement would be complete before long—within half a century or so. Now, in 1939, any confident prediction about the international spread of socialism seems as unwarranted as it was thirty years ago, when the first edition of this book was written. The possibilities of rapid and radical changes do indeed seem to be greater; but how far they will go, how long they will last, is not to be foreseen. During the next generation Russia may move from the left toward the center; and for the time being a period of quiescence may have set in.

§ 9. The question persists whether there is not some goal to be set for the development of society. One may be convinced that the full-grown socialist state is not to come in any early future; but may it not come in the end? I cannot believe that it is possible to foresee what the distant future will bring. Consider what was the state of civilized society some four hundred years ago, at the culmination of the Renaissance and the first stages of the Protestant Reformation: who could then imagine what development would take place in the coming centuries, what political, social, intellectual, industrial changes would occur? No less impossible is it for us to conceive what will be the changes in the centuries that lie before us. The system of private property, if it maintains itself, is indeed likely to be very different from what it is now; but whether it will remain unchanged in essentials, or will be gradually stripped of many features now deemed essential, or transformed at last into something like the socialist state —all this we cannot foretell. I am thus repeating what I said long ago on many aspects of this great subject: we cannot foretell.

The reader may fairly ask for something less nebulous. Tho it may be impossible to predict, may it not be possible to set a goal? I will give what answers I can.

It does not seem to me desirable that the peoples of the western world—still less so those of the Orient—should march toward the establishment of a socialist state to be reached at any time in the future about which it is worth while to speculate. All that we know about political and economic history, about human character and human intelligence, about the ineradicable differences between men, about their ambitions and ways, tells against the possibility of securing that sort of millennium which the enthusiastic proponents expect. Revolutions have come often in the course of human history. But commonly they have not changed the fundamentals of society; and when they have succeeded in doing so, the new structure has been worse than the old as often as it has been better. Those to whom the upward movement of humanity toward greater material welfare and a higher spiritual level is a religion cannot expect the advance to be sure and good if it tries to proceed by explosions. That process of modifying the institution of private property is most promising which moves step by step. The best ways in which human beings can live together in large numbers will long remain such as to keep in large measure—diminished yet still large—the régime of private property; the family; inequality but not the perpetuation of fortunes; genuine democracy; somehow or other the selection of capable leaders, somehow or other the growth of better and higher ways of emulation among men and leaders. Of this kind is the program of the liberal thinker of the twentieth century, equally removed from the extreme of socialism and the extreme of *laissez-faire*. And it sets up a program rather than a goal; a line of action to be followed as long in the future as we can see our way, without commitment about the goal that may be reached in the course of the centuries.

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BOOK VIII

TAXATION

CHAPTER 69

PRINCIPLES UNDERLYING TAXATION

§ 1. The essential characteristic of taxation: no *quid pro quo*. Taxes a sign of wider consciousness of common interest.—§ 2. Proportional or progressive taxation? This question of justice inextricably connected with the general questions of social justice and the righteousness of inequalities. "Ability" and "equality of sacrifice" are inconclusive principles.—§ 3. Should property incomes be taxed at higher rates than those from labor? —§ 4. Can taxes be made higher according to the source or nature of the income?—§ 5. Progressive taxation of interest from capital, on the principle of taxing saver's rent.

§ 1. THE essence of a tax, as distinguished from other charges by government, is the absence of a direct *quid pro quo* between the taxpayer and the public authority. It follows that a tax is necessarily a compulsory levy. The post office illustrates the payments which are different from taxes. A charge is made by it for each letter; no one is compelled to contribute toward its revenue unless he makes use of its service. The revenue from postage stamps in almost all countries roughly equals the expenses of conducting the business, and each individual user pays (again with a rough approximation) in proportion to the service which he gets. The same situation exists when a government manages the telegraph or the railway. But when it maintains streets, a fire department, a police force, it supplies the several services free to everyone. On the other hand everyone is called on to contribute. It is immaterial whether the individual citizen happens to be benefited directly or indirectly; a great deal, a little, or not at all. What he pays to the government for a postage stamp, for a railway ticket, for a supply of water, is in the nature of a price for a specific service. It is very different from a tax, which is exacted from all alike and without any regard to the individual's use of the services supplied.

This severance of payment from service is sometimes inevitable. To tell how much any individual is benefited by the maintenance of order thru a police force is impossible. The only way to support the force is to call upon everyone to contribute in some proportion deemed equitable. The same is true of a military force, whether regarded as a sort of enlarged police or as an instrument for national advancement in other ways. The benefits from the maintenance of sanitary service are also unapportionable. As regards fire-fighting apparatus, it is conceivable that division of the expense should be made among different owners of inflammable property on some well-defined principle of insurance premium. But it is obvious that the whole community is vitally interested in preventing conflagrations, and the support of this public service also takes place by the levy of taxes which disregard any question of special benefit.

In other cases, increasing in number as civilization progresses, the use of taxes instead of prices is not inevitable but is the result simply of a growing conviction of the wide usefulness of the service. Highways beyond the confines of cities or thickly settled spots were in former times often managed on the toll principle; so were bridges. Those alone paid for them who used them and paid according to the extent of the use. Their construction and maintenance were likely to be left in the hands of private persons, to be managed like any other business. As the conviction spread that freedom of movement was of general advantage, tolls were abolished on roads and bridges and these means of communication were supported by taxes. The most striking illustration of the movement of opinion in this direction is found in the modern attitude toward education. It is entirely feasible to conduct education as a private industry or to manage it, if public, on a principle of payment in proportion to the expense incurred. All civilized peoples, however, believe it to be of vital importance that education should be supplied to all and should be supplied in such way as to uplift and advance the community at large, not on any basis of proportional payment. No doubt a motive even more distinctly altruistic enters—a desire to equalize opportunities, to make the way easier for the great masses of the poor, to mitigate inequalities in possessions and income. Under the influence of these converging motives education is made free; not only elementary education but in more or less degree higher education as well. A great range of government activity illustrates the growing consciousness of common interest and the growing influence of sympathy and altruism—libraries, museums, parks, hospitals. It has been aptly said that the growth of those services which are supported by taxation measures a people's consciousness of common interest—nay its very progress toward higher civilization.

Taxation necessarily involves compulsory levy. Tho people may be unanimous in the belief that it is in the common interest for a given set of services to be undertaken gratuitously for all, the support of the services by voluntary contributions is quite out of the question. There have been occasions, in times of great national peril and of fervently aroused public spirit, when voluntary contributions have been an appreciable financial resource; but they have been rare and short-lived. Even in the most imminent danger a steady and considerable revenue can be got only by compulsion. Hence the mien of the tax gatherer is as stern under a self-governing democracy as under the most absolute despotism. Men's willingness to support public service does not grow apace with their conviction of the need of public service.

§ 2. The first question of principle in taxation has to do, therefore, with the mode of apportionment. In what manner determine how much the individual shall contribute toward defraying the various public services rendered gratuitously? Shall he pay simply in proportion to his income or more than in proportion? On this question there are two fundamentally different answers, the one more conservative, the other more radical; the one maintaining the principle of proportion, the other that of progression.

The conservative opinion, maintaining the principle of proportion, is very simple. It proposes to call upon each person to pay in proportion to his income and so to leave the relations between different incomes undisturbed. Let the rich pay more in the degree to which their incomes are larger, but in that degree only. The essential basis for this view is that the existing distribution of wealth should not be disturbed. True, some people are more prosperous than others; some are rich, others are poor. But these differences are regarded as defensible—nay, in the unqualified support of the existing social order are thought to be in accord with the maxims of ideal justice. Since taxes must be levied and since it is hopeless to measure either the cost of the public services rendered to any individual or the benefits to him of the services, let all be treated alike and let all be called on to contribute the same proportion of income. The social system thus remains undisturbed by the tax levy; it was equitable before and it remains so.

A somewhat different view but one leading to the same result is that the existing distribution of property and income should not be disturbed *by taxation*. If it is to be disturbed, let other machinery for doing so be adopted. This view implies neither approval or disapproval of the gulf between rich and poor, merely indifference or aloofness. The tax gatherer, it is said, should not be distracted by having to consider such large and difficult social questions. His task, even in its simplest form, is troublesome enough: to devise ways of securing the needed revenue without arousing discontent beyond endurance. This may be described as the pure fiscal principle of taxation, according to which taxation should concern itself solely with the problem of raising the money for public expenses. It leads, like the view first described, to proportional levy and to the rejection of progression.

Still another "fiscal" principle of taxation may be noted; one that perhaps should be called the cynical principle. According to this, the essential task for the legislator is to get the revenue in such way as to cause the minimum of vexation and opposition. Any tax is good which brings in a large net revenue without causing much protest from the payers, or at least from those payers who have political influence. If in a democratic community high progressive taxes on the rich bring in substantial returns, without trouble in administration and without causing many voters to revolt, let them be imposed. And on the other hand if taxes on an article consumed in great quantities, such as sugar or coffee, promise a large revenue and can be levied by a hoodwinking process which prevents the masses from realizing the burden, let them too be imposed. "Pluck the goose with as little squawking as possible." This cynical view is hardly ever advocated in so many words; but a great deal of legislation rests upon it. Every finance minister has constantly to face demands for additional revenue and also opposition from those whom he proposes to tax. The temptation is well-nigh irresistible to follow the path of least resistance. The very great part which indirect taxes on commodities play in the finances of all modern countries is explicable chiefly on this ground.

The question of justice in taxation is at least ostensibly kept in mind in most discussions. A consciousness of it underlies the trains of reasoning in favor of strict proportion, which have just been stated—both that which affirms the distribution of wealth to be now just, and therefore rightly to be left undisturbed by taxation, and that which simply would keep taxation disentangled from questions of social reform. Both of these opinions have the merit of facing squarely a truth which many writers on this much-debated topic have failed to face; namely, that the question of equity in taxation cannot be discussed independently of the equity of the whole existing social order.

The courageous advocates of progression base their views precisely on the ground that the existing social order is not perfect and that taxation should be one of the instruments for amending it. Even tho it be an open question whether all inequality in wealth and income be unjust, such great degrees of inequality as the modern world shows are regarded as not consonant with canons of justice. Very rich persons should be called on to pay taxes not only in proportion to their incomes but more than in proportion. This proposal has been called socialistic; and it is, if all measures looking to mitigation of inequality be so called. Those who hold it place progressive taxation in the same class with free education, factory legislation, regulation of monopolies, extension of government management—measures all of which are based on a desire to improve the social order in the direction of less inequality. The extent to which they are willing to go with progression no doubt depends on the degree of their fervor for social reform in general; nor are they themselves able to give a precise answer to the question often asked, how far is progression to go? Their opponents have urged, to use a much-quoted phrase of McCulloch's, that when once you diverge from the rule of proportion you are at sea without rudder or compass. The same difficulty might be urged against all sorts of movements for reform. Few except the rigid and extreme socialists have clear notions about their ultimate goal. It suffices for the average man to know in what direction he is moving. Most persons in the advanced countries of modern times, tho they have very hazy ideas about taxation and socialism and economics in general, will instinctively declare it "right" that the rich should contribute to the public burdens, as compared with the poor, not only in proportion to their incomes but more than in proportion. In so saying they show that influence of the spirit of the time from which none of us can escape.

Sundry phrases have been used, embodying supposed principles of taxation, which fail to face this fundamental problem. It is often said that taxation should be based on "ability" (the Germans use the word *Leistungsfähigkeit*) or on "faculty." Yet it is by no means clear either that this principle conforms to economic justice or that it leads to any certain conclusion on the crucial point—proportion or progression. No doubt the rich man's ability to pay is greater than the poor man's. Does it follow that he should pay more heavily toward public charges? His ability to pay for bread and coal is also greater; yet we accept it is a matter of course and as reasonable and just that he should pay for them at the same prices as persons of small income. It may be questioned whether this be really just—whether the strong and efficient, the fortunate and favored, should be in a position of economic advantage.[1] But such is the way of the modern world under the régime of private property. Why, under that régime, should an entirely different principle be applied in regard to taxation? Can the principle of "ability" be declared abstractly just without maintaining also that our economic system is in general unjust?

In any case the principle of ability leads to no clear conclusion on the question of progression. Granted that the rich should pay on the basis of ability, the question remains, how is that "ability" to be measured? Does their ability increase in exact proportion to their incomes or more than in proportion? Those who advocate ability or faculty as the just principle for apportioning taxes

[1] Compare Chapter 67.

usually come to a conclusion in favor of progression. Yet their principle does not necessarily lead to that conclusion. They are influenced, tho not always consciously, by an underlying belief that the rich in general are in an unduly favored position and that it is therefore equitable to apply to public charges a different rule from that which holds in other affairs.

The same sort of difficulty, and the same inevitable harking back to the fundamental questions of social justice, arise from another phrase much used in these discussions; namely, that taxes should be so levied as to bring "equality of sacrifice." Unflinchingly applied, this principle would lead to high progression in taxation. Take away half the income of a poor man and the sacrifice imposed on him is vastly greater than when you take away half the income of a millionaire. In the case of the poor man taxation at this rate would exact what is essential for life or for meager comfort; in that of the rich man only the means for luxury and ostentation. To bring about equality of sacrifice you must take away a much larger proportion from the millionaire. The fundamental question recurs: why equality of sacrifice here when in other matters no such rule is followed? Efficiency, not sacrifice, is the dominant principle in existing distribution. Problems of taxation can arise only in communities founded on individualism and private property; and to apply in these a principle of equality of sacrifice is to admit that the working of individualism is not to one's liking—that is, to undertake in this regard at least a change and a reformation.

§ 3. This same insistent question presents itself with regard to another much-debated point: whether property incomes shall be taxed at the same rate as labor incomes. In the literature on taxation the terms "funded" and "unfunded" incomes are much used.[1] Funded incomes are those derived from income-yielding property—interest or rent or established monopoly gains. Unfunded incomes are salaries, wages, business profits, professional gains. I shall speak of them as property incomes and labor incomes

[1] In Great Britain the terms "unearned" and "earned" are used; they are to be avoided because even tho usually applied in a purely technical sense they imply a judgment on the justification of the two classes of income.

respectively. The former last indefinitely; the latter cease at latest with the lives of their holders. Should they be taxed at the same rate or at different rates?

The difference in duration between the two gives no solid reason for discrimination. If it be said that the property incomes, because lasting longer, are really larger, the answer is that the tax too lasts longer. If the income lasts forever, the tax will go on forever. There is indeed, in one respect, a substantial difference in the weight of taxation; the holder of the labor income is in many instances under a moral obligation not to use the whole of his income but to save some considerable portion. What he puts aside for the future use of wife or children is virtually no part of his present income. It will become later a part of the income of the dependents. If it is taxed now and is taxed again when it reaches the beneficiaries; or if, after it has been invested, an income from it inuring later to the beneficiaries is taxed in their hands—then there is double taxation of the same income. The holder of a property income may indeed do the same thing and his savings also may become the occasion of double taxes; but he is not so likely to put aside part of his present income, since this passes on, presumably undiminished, to his heirs. On such grounds countries which levy an income tax often permit the deduction, from the amount *prima facie* taxable, of certain sums paid out for life insurance premiums. The sums so allowed to be deducted are limited and only unmistakable savings out of income (evidenced by insurance premiums) are considered; precautions of this sort being necessary to prevent the mitigation from becoming a means of evasion. But the principle of lesser taxes on labor incomes is thus recognized, and recognized on the precise ground of not taxing such sums as are no effective constituents of present income.

The common practice, however, of taxing property incomes at a higher rate hardly rests on this ground. It rests probably on the same attitude toward social problems as the common acquiescence in progressive taxes—on a half-unconscious admission that justice does not call for identical treatment. Property incomes stand for the leisure class—for those who contribute nothing directly to the community's resources but live on secure income-yielding possessions. The thick-and-thin defender of the existing order will indeed say that these incomes are as just as the incomes of those who now work. Interest and rent are as worthy and as defensible as any other sorts of income, and discrimination against them by higher rates of taxation is an illogical admission of lack of justification. The contention is as unanswerable as is the similar argument against progressive taxes on the rich. Nevertheless most persons, tho they do not formulate their conclusions with care or accuracy, feel that somehow incomes derived from labor do have a more solid justification and that the leisure class incomes do stand on less defensible ground. It may be right that some fortunate individuals, and their descendants forever, should live in leisure, without doing a stroke of work. But this does not seem right in the same degree as "earning" your living. Hence, tho complete confiscation of property incomes, thru taxation or any other machinery, would be condemned by the average man as "dishonest" or "socialistic," some concession to the critical and reforming spirit is made by approving higher taxes on such incomes. Unless there be concession of this sort and on this ground there is no logical basis for the general application of a lower rate of taxation on labor incomes.

§ 4. Any conclusion, then, in favor of progressive taxation and higher taxation of property incomes must rest, to be consistent, on a frank admission of unwelcome features in existing society and on a program of social reform. The only question will be whether this particular mode of reform, thru taxation, is likely to work well, whether it may not bring evils in its train, whether other ways toward the same end are not better. And here there are serious reasons for proceeding with great caution.

Some difficulties of administration which stand in the way of applying progressive scales will receive attention presently. They vary with different sorts of taxes, as will appear on a consideration of particular levies. Let attention be given first to some questions of principle.

Progressive taxation, so far as it aims to correct unjustified inequalities, evidently deals with results not causes. It is obviously better to go to the root of the matter and to deal with the causes.

A more effective and promising way of reform is to promote the mitigation of inequality in other ways—by equalization of opportunity thru widespread facilities for rational education, by the control of monopoly industries, by the removal of the conditions which make possible illegitimate profits. Progressive taxation, which deals with income (or property) solely according to size and not according to social desert, is less discriminating and also less effective in reaching the ultimate goal than the various ways of diffusing material welfare which have been considered in the preceding pages.

It may seem a simple matter to apply the principle of progressive taxation on the basis of the character of the income; to make the rates progressively high, not in all cases where the income is large but in those cases where income is made large in objectionable ways. The principle seems clear enough: are the inequalities such as induce activity that is advantageous to the community as a whole? Given the institution of private property, with all the motives and ambitions which are part of it, a great range of inequalities is in this sense advantageous. On the same ground interest is not to be dispensed with, nor that return for natural agents which is indistinguishably commingled with interest. Salaries, professional earnings, business profits in the strict sense, are inseparably associated with the exercise of their faculties by those who earn the incomes. The fullest activities are promoted by letting them earn all they can; and the greater the competition thus promoted between them the more likely is it that the community will be amply supplied with useful services. Tax no such incomes on the ground of their size.

But to earmark the incomes thus "legitimately" large and to distinguish them from the "illegitimate" incomes is an extremely difficult matter. The law must deal with unmistakable facts; its specific provisions cannot be based on general principles and rough approximations. On the other hand the conclusions of economic science, above all on the great social questions, are essentially in the nature of rough approximations. What, for example, are "illegitimate" profits? How define them in such manner as to make them subject to special taxation? We may be certain that there are such gains, the results of chicanery, swindling, browbeating of the weak and inexperienced. How separate them sharply from the profits secured in ways advantageous to the community and in accord with its accepted standards of right conduct? To apply any sort of discriminating taxation without bearing also on the springs of energy and enterprise is impracticable. The best course is to deal with the causes: to protect the weak, to elevate the plane of competition, to improve the law, to prosecute remorselessly the guilty.

Certain kinds of property income are marked off more sharply than others as not essential for the working of the individualistic system and therefore peculiarly fit for taxation. Such are urban site rents, or rather those accretions of future site rents which are not within the principle of vested interests.[1] Monopoly profits are in the same class. Often, it is true, they are as difficult to define with the necessary precision as are "illegitimate" profits. How separate high gains due to enterprise and good management from those arising purely from monopoly? Yet there are cases when this can be done; as where a bank is given the monopoly of note issue or a street railway or gas company the monopoly of serving a city. Then it is clearly proper to provide that profits above a given rate of return on the investment shall be divided with the state. The amount going to the state in such case may be entitled a "tax" or a "share." The name is immaterial; it is in essence a levy on a certain kind of income, justified by the principle of removing inequality which brings no offsetting social gain.

In general, however, progressive taxation is not practicable on the basis of the *kind* of income. It is susceptible of application, on a wide scale, only with reference to the amount of income. To many persons this will seem no significant distinction. To tax an income large in amount will seem to them the same thing as taxing an income objectionable in kind. Tho few would carry this sort of belief to its logical outcome and condemn all inequality once for all, there is an abiding feeling that great inequalities are bad and very large incomes peculiarly fit objects of taxation. The growth of social sympathy and all the prepossessions of

[1] Compare Chapter 44.

democracy strengthen the hold of the principle of progression in its undiscriminating form. This state of mind and the inevitable formulation of the law on sharp lines make it well-nigh certain that progressive taxation will have wider and wider application. The only question will be how far it shall go and what difficulties of administration it must encounter.

§ 5. Still another question arises with regard to differential or progressive taxes on property incomes. It is concerned with the application of progression not according to the source or kind of the property income but purely according to its amount.

The essential ground on which interest can be defended is that the return is necessary in order to induce accumulation. Saving is onerous and will not be carried on unless there is a return on investments. But we have seen that this is by no means the exact situation with regard to all savings. There are many intramarginal savers.[1] As to these, the appropriation of part of their income by the state would not lessen accumulation. The same principle is applicable as in the case of rent proper. A tax on rent falls definitively on the owner and has no further effects on the supply or the utilization of the source of rent. From this point of view there may be ground for progressive taxation of large property incomes.

Those whose means are large almost always enjoy some "saver's rent." They may secure say 4 per cent on their investments; but they would maintain the investments intact in almost all cases even tho they got only 2 per cent. The capital sum being large, a comfortable income, perhaps a large income, would still be secured at the lower rate. Rather than forego this income, accumulation would be maintained and capital would remain undiminished.

The same reasoning would apply, of course, in all cases where there is saver's rent. Those who save primarily in order to make provision for the uncertainties of the future, for old age, for wife and children, would continue to do so in large measure, even tho interest rates were much reduced, nay wiped out. The appropriation thru taxation of a part of their income from accumulations would not cause a decline in social capital. But in these cases there is not commonly the degree of inequality which gives rise

[1] Compare Chapter 39.

to the demand for differential or progressive taxation. Great inequalities, such as seem inconsistent with the democratic and equalizing spirit of our time, arise from the very large properties, which are hardly ever accumulated merely because of a desire to provide for the future. Social ambition, the love of domination, the pride of achievement, are the motives of the creators of fortunes; social ambition, again, and the love of ease are the motives which lead their descendants to maintain the fortunes. A lower rate of return would not cause impairment of their principal or a diminution of the sources on which the community's apparatus of production depends.

On grounds like these progressive taxation of large property incomes can be advocated; advocated, that is, if one frankly accepts the view that great inequalities in wealth are undesirable and should be lessened, by taxation or other means, so far as other consequences equally undesirable for the community can be avoided. In this case one possible undesirable consequence is a check to accumulation; but on the strict theory of saver's rent no check in fact is to be expected.

CHAPTER 70

INCOME AND INHERITANCE TAXES

§ 1. Income taxes present the problem of progression sharply, yet should be considered in connection with other taxes.—§ 2. Income taxes limited as a rule to the well-to-do classes. The exemption of small incomes rests partly on social grounds, partly on administrative expediency.—§ 3. The British income tax and the device of stoppage at the source. The system not consistent with progression; it has undergone steady modification.—§ 4. Progressive taxation on the entire income. Declaration necessary. Conditions for the effective administration of such a tax. Income taxes peculiarly adapted for readjustment from year to year to fit fiscal needs.—§ 5. The income tax question in the United States. The system developed since the constitutional amendment of 1913.—§ 6. Inheritance taxes are comparatively easy of enforcement and lend themselves easily to progression. The trend toward progression.—§ 7. A high rate of progression in inheritance taxation would check accumulation. If applied, new ways of ensuring the supply of capital must be sought.

§ 1. In the preceding chapter the problem of justice was treated as if all taxes were paid out of income. And this in the end is the case: ultimately all taxes are derived from income. Tho many taxes, in the first instance, are levied not with respect to income but with respect to lands or houses or commodities, these taxes fall eventually on someone's income, even if not on that of the person first charged with their payment. True, there are some taxes which may conceivably cause a diminution not of an individual's income but of his capital or his accumulated possessions. Such may be the working of taxes on inheritances. These, however, are effects not common in modern communities. There is no serious deviation from the truth in saying that taxes are derived from income.

But tho taxes are paid out of income, by no means the whole of the public revenue is secured thru direct levy on income. Some countries have no income taxes at all. Income taxes have played a larger and larger part in the budget of most countries in the 20th century; yet no country endeavors to reach in this way *all* incomes. Direct taxes on income are confined virtually to the prosperous members of society. Few of those who earn wages by manual labor are reached by them.

It follows that the problems of justice in taxation, dealt with in the last chapter, are to be considered with reference not simply to those public levies which go by the name of income taxes but with reference to all levies of whatever kind. The questions whether taxes should be progressive or are in fact progressive must be answered with reference to all the charges. It is entirely possible, for example, that income taxes should be progressive, yet the tax system as a whole not so. As will presently appear, a great many sorts of taxes in wide use are really regressive in their ultimate effects; that is, in proportion to income they bear more heavily on the poor than on the rich and the well-to-do. Under such conditions it may be maintained without hesitation that taxes levied directly on the incomes of the latter should be progressive in order to secure simple proportionality for the tax system as a whole. Whether this is in fact the case for the tax system of a given country is extremely difficult to make out; so uncertain is the ultimate effect of many of the taxes commonly resorted to. But the very existence of the question and the uncertainty of the answer show that progression as to taxes levied directly on income is only part of a much larger problem.

None the less the dispute concerning progression is especially active and often acrid concerning direct income taxes alone. It is so because here the question must be faced; whereas in the case of other taxes it is concealed and evaded.

§ 2. The limitation of income taxes to the comparatively well-to-do arises in practice from the fact that the trouble and cost of direct levy make it impracticable to reach small incomes. It costs at least as much to collect an income tax of, say, 2 or 5 per cent from a man having an income of $500 as from one having an income of $5,000; it may very possibly cost more. The revenue in the one case is ten times as great as in the other. To collect from millions of workingmen a few dollars or a few shillings each would be perhaps not impossible but almost ruinously expensive. If they are to be reached at all by taxation some other way must be found. Hence there is exempted from income taxation in most countries a minimum which is above ordinary working-class income and above the average income of the whole people. Such was the effect in Great Britain, with the level of wages and prices that obtained before the war of 1914–18, of the exemption of incomes under £160. In the United States when incomes were taxed during the Civil War period only those over $600 were chargeable. In 1917 the exempt amount for the head of a family was $2,000.

This limitation has often been explained and defended on social grounds. The poor, it is said, and those who have barely enough to live on should not be taxed. Obviously the minimum of subsistence should not be taxed; or, to speak more accurately, the attempt to tax it should not be made since the very term implies that it cannot be reduced by taxation. When people talk of not taxing the minimum of subsistence they commonly have in mind something as variable as "the living wage." The demand for the exemption of the lowest tier of incomes results from the same state of mind as the advocacy of progressive taxation—dissatisfaction with existing inequalities and desire to lessen them. Unfortunately this feeling does not lead, so far as taxation is concerned, to any consistent results. Those who possess only the "minimum" or the "living wage," tho exempted from direct levies on their income, are in fact taxed and often taxed heavily in other ways. It is only when a proposal is made to reach them overtly that people balk and insist on exemption. In the actual arrangement of the tax system benevolent phrases of the kind cited are used to explain and justify exemptions which in fact are due mainly to the practical difficulties of reaching small incomes and (in democratic countries) the fear of irritating millions of voters; whereas, notwithstanding the phrases, taxes which reach the masses in unobtrusive ways are levied on a large scale with little apology.

Considered as a matter of principle, it is by no means desirable that the workingmen as a mass should not be subjected to taxes. Let the taxes be moderate and even, if you please, degressive; that is, lower and lower in proportion as incomes become smaller. There is no ground for the assumption that the mass of workingmen in advanced countries have barely the living wage and should therefore be exempted. It is fit that they too should contribute toward the public charges. It is desirable, moreover, that they should not only pay but should be conscious of paying. Much would be gained if they were not charged solely by veiled indirect taxes. Even tho they paid sums but small in proportion to incomes, their point of view on public affairs would be altered. Too commonly, in democratic states, they are not conscious of contributing anything at all. Their attitude toward public business is simply that there is a great fund of money from which employment or largess can be got. They rarely regard taxation as an instrument for promoting the general welfare. And yet this unfortunate situation is extremely difficult to mend. Taxes levied in small sums are not only expensive to collect but are irritating to the payers. The legislator who gets rid of them not only promotes administrative economy; he also gains popularity. Even so slight a levy as the poll tax (a fixed small sum, say $1 or $2 a year, on each male adult) is almost impossible to maintain.

§ 3. Bearing in mind that in practice income taxes are levied chiefly on the comparatively small number of the well-to-do and rich, let us consider the two great types—one of direct levy on each individual's total income, the other of levy on the several sources from which the income is derived. The direct method is best exemplified by the practice of the German states, among which Prussia is for this purpose the most instructive as well as the largest. The other method, of which the salient characteristic is stoppage at the source, was long exemplified by the practice of England. It will be convenient to examine first the British system.

The British income tax has sometimes been described as a series of taxes, in each of which a special method is adopted to attain the same end. Wherever feasible the method is to reach the taxpayer's income not after he has received it but before. Thus, to take the simplest case, the government deducts from the interest which it pays on its own debt the amount chargeable as income tax. The holder of consols hence receives his income diminished by so much; thereby the tax has been collected. Every debtor, whether private person or corporation, is required to act in substantially the same way as a sort of agent for the government in collecting the income tax from creditors. Every debtor pays tax on his full income, irrespective of his being burdened by debt and by an interest charge. But when he pays the stipulated interest to his creditor he is entitled to deduct the amount (say 10 per cent—whatever the income tax rate may be) chargeable as tax. The creditor receives 90 per cent of what would otherwise have been his due and thus his income has been reached. And, to prevent possible failure of the system to work out this result, "contracting out" is made void; it is provided that no agreement between debtor and creditor by which the latter is to receive his interest without income tax deduction shall be valid. The unrestricted self-interest of the debtor is thus brought to bear toward the collection of the tax from the creditor. In this manner the income tax is secured in regard to all bonds or debentures issued by British corporations; the corporations pay the full tax on their net receipts but deduct the proper quota from each bondholder's income.

As regards another kind of income often difficult to reach—dividends on stocks—the same principle is followed and, as regards British corporations, is followed with ease. The corporations are simply taxed on the whole of their income, and the way in which the stockholder bears the tax is that the net earnings from which his dividends arise are diminished by so much. The comparative publicity with which the affairs of corporations are conducted, especially of large corporations, is a strong preventive of fraud in their statements of earnings and facilitates the efficient collection of the tax.

Again, as regards income derived not from British debtors or British corporations but from foreigners, the principle is also followed so far as practicable. Such income is a large item in Great Britain, whose people have great investments in foreign regions. But these investments are commonly arranged and managed by bankers or other financial agents, who often act as agents for the remittance of interest or dividends to the individual investors. When they so act they are required to pay the income tax on what passes thru their hands, deducting the amount from what is payable to their clients. In this way a surprising amount is reached. Evasion or concealment is virtually impossible, since it would require collusion between the agent and the scattered clients. Obviously the method is inapplicable where remittances are made not thru a British banker or agent but from foreign parts direct to the individual investors. In such case the only way to reach the income is to levy on the investor himself, calling upon him to make a declaration of this income.

Income from land and real property is always reached with comparative ease in any tax system; for land and houses cannot be concealed and the income they yield is not difficult to ascertain. In the English system the occupier of real property is liable for income tax once for all on the rental value of the premises occupied by him. If he is owner, this ends the matter; he has paid income tax on what as owner and occupier he enjoys. If he is tenant, he is entitled to deduct from the rental payable to the landlord the income tax on that sum and the landlord thus finds his tax deducted and paid. Here, as in the similar relations between debtor and creditor, "contracting out" is made void.

Enough has been said to show how far-reaching is the method of stoppage at the source. There are, indeed, some incomes which cannot be so reached. The professional earnings of lawyers, physicians, and the like; the incomes of business men, whether shopkeepers or great manufacturers (so far as the incomes are not secured in the form of dividends from corporations of a semi-public kind); returns from foreign investment which do not go thru a British banker's hands—these cannot be tapped at the source. Here some other method must be resorted to. Declaration of income is required from the taxpayer or inquiry instituted by the tax collector. But much the greater part of the income chargeable with tax is reached without personal declaration or obtrusive inquiry. A great part of the British tax is collected without a word of inquiry or a possibility of evasion.

It is obvious, however, that this system does not lend itself easily to progression in the taxation of incomes. There is indeed a device for making the tax degressive; that is, for lowering it on modest incomes and for exempting small incomes entirely. It may easily happen that a person whose total income is below the exempt amount (£160 until 1918) may find that his income has been taxed thru stoppage at the source. He then applies to the tax authorities, declares his income to be below the taxable limit, and receives back in cash what has been reached by stoppage at the source. The same method is applied in alleviating the tax on modest incomes, up to £700. These are entitled to an "abatement," varying by gradations according to the size of the income. The possessor of an income in this range, if he has been reached by the machinery of stoppage at the source, also makes a declaration to the tax authorities and is entitled to reimbursement to such extent as will abate his income tax to the extent contemplated by the law.

But, to repeat, the principle of stoppage at the source is not consistent with progression. A person of large means pays income tax, or rather finds that income tax has been paid for him, in a number of ways—by various deductions from his rentals, interest, or dividends. He is never called on to declare his total income. Only that income which has not been taxed before it reaches him must be directly ascertained by the tax authorities. Doubtless there are persons whose entire income must be directly ascertained, such as small tradesmen, some lawyers or physicians, possibly investors in foreign property. But almost every person having a considerable income need make declaration of only part of it—very possibly of no part at all. Such was the working of the British income tax in its earlier form. The smoothness, ease, and certainty of the method of tapping the source are inconsistent with the endeavor to ascertain in one lump the income of each taxpayer; and without this there could be no application of progression.

Notwithstanding the administrative advantages thus secured by refraining from the attempt at progression, the British income tax has been remodeled precisely in the direction of progression. There can be no better evidence of the strength of the general drift toward legislation that is hostile to inequality. In 1910 the same budget which made the unsuccessful attempt to tax the rising value of urban land established also a "supertax"; that is, an additional tax on very large incomes, exceeding £5,000 a year. During the war of 1914–18 the supertax was applied to incomes over £2,000 and was made progressively higher as incomes exceeded that amount; so that on the very largest incomes the total tax became something like 50 per cent. Such an additional tax, of course, cannot be collected without ascertaining the total incomes of all who have incomes of this amount or are supposed to have. Thereby the income tax officials are compelled to face a new and difficult problem. They must secure declarations of income, with all the difficulties of evasion, concealment, fraud which this endeavor necessarily brings.

Not only in this direction was there departure from the strict principle of stoppage at the source and of proportionate levy; it was modified also by the introduction of a differentiation between labor and property incomes ("earned" and "unearned" incomes, in the British terminology). Beginning in 1907 labor incomes were taxed at a lower rate, the relief being limited, however, to those whose total income from all sources was moderate (£3,000 or less) and not extended to those having high incomes. The method of abatement was again followed in carrying out the new policy; it necessarily entailed a further enforcement of declaration by the taxpayer of his entire income and therein a further departure from the semi-automatic mechanism of stoppage at the source. The whole British income tax, thus modified in various ways, became a patched and complicated structure, not conforming to any consistent plan and troublesome in administration. Yet in fact it was administered without serious friction; and it remained extraordinarily effective as a revenue getter. The cumbrous differentiation in favor of the moderate labor incomes, like the application of progression to all incomes of large size, was testimony to the growth of the feeling that in taxation, as in other fields of government activity, regard should be had to the underlying currents of social readjustment.

§ 4. Quite different is an income tax which has regard solely to the individual's entire income. Such was the Prussian income tax before the war of 1914–18; the model which the countries of the Continent then tended to follow. It was followed too by the German Commonwealth after the war, tho with rates greatly advanced and progression sharply accentuated. Necessarily the whole of each taxpayer's income must be ascertained; and the principle of progression can be applied consistently thruout the entire range of incomes. The ascertainment of income can be secured in two ways—by assessment on the part of the authorities or by declaration required from the taxpayer. Assessment without declaration means more or less of guesswork and, especially in the case of larger incomes, great inequalities, often glaring discrepancies. Declarations must be required—required not only nominally but in the actual administration of the tax.

Declaration, however, brings difficulties of its own. The amount of the levy is made to depend on the taxpayer's own statement. The temptation to evasion and deceit is patent. Penalties for failure to make a statement or for false statement are not easy to enforce. There is constant danger of demoralization among the taxpayers, of easy-going connivance among the officials and so of failure to attain the essential object—the precise adjustment of the progressive scale to actual incomes. In their working, income taxes have too often been a byword and a reproach.

The difficulties do not arise merely from evasion and dishonesty. They rest in large part on a resentment against intrusion on what are supposed to be private affairs. Many a man who will cheerfully pay a substantial tax on his income is unwilling to submit to prying eyes a detailed statement of that income. The social philosopher may indeed say that this is an irrational frame of mind, nay is something like a confession of doubt as to the justification of the income. If it is right that one should have a large income why conceal at all its amount or its source? But men's ways, as they have developed in the centuries during which the acquisition of property has been a goal of ambition, are not so simple as this question implies. A strong instinct of privacy has extended to the possession of property and income; it is present, whether rational or not; and it is violated by a requirement of full statement, most of all by the chance of wide publicity.

These various difficulties are not insuperable. An honest, well-trained, experienced staff of officials and a well-framed tax system can meet them with sufficient success. Declarations need not be required in minute detail, nor need they be open to public inspection. Some sort of publicity is probably necessary as a safeguard against false statements; but it need not be publication to the world at large. It suffices if a select body of local persons of experience, judgment, and established position are enlisted to advise and coöperate with the permanent administrators. These advisers must be persons who are likely to know something of the probable incomes of the several taxpayers and before whom they would not wish nor dare to make statements grossly false. A device of this sort was used in the Prussian system and is used also in that part of the English system for which declaration must be resorted to. To go into the details of the several methods would pass the bounds of a book like the present. Suffice it to say that, with a proper permanent staff of capable and tactful officials, with a steady requirement of declarations, with supervision and inspection not carried to the stage of wide publicity, income taxes, even progressive, can be administered successfully. Not a little depends, to be sure, on the amount of the tax. The higher it becomes the greater is the danger of evasion, the greater the difficulty of preventing demoralization.

Income taxes are peculiarly fit for readjustment from year to year. Therein they are superior to taxes on inheritance; for these, as will presently be explained, have not the same fiscal flexibility. If income taxes are raised in one year, all bear the extra burden; if lowered another year, all get the benefit of the reduction. In Great Britain the income tax was long used as a means of keeping the public receipts adjusted to the expenditures—raised in times of financial stress and lowered in ordinary times. Obviously it is a necessary part of this policy that in ordinary times the tax should not be pushed to the maximum which can be safely exacted. A margin must be left for emergencies. The British rate in peace time had been not far from 8 pence (3⅓ per cent) during the nineteenth century; it went to something like 1 shilling on the pound (5 per cent) during the first decade of the twentieth century. After the outbreak of war in 1914 every resource was strained to the utmost and the tax was made to yield all that could be squeezed out of it. The ordinary or normal rate was raised to 6 shillings on the pound or 30 per cent; while the surtax on large incomes was put as high as 4 shillings 6 pence on the pound or 22½ per cent.

Like all taxes, this one proved difficult to lower when once forced to the top notch; and the use of the tax as a flexible instrument was endangered. Something of the same sort—to anticipate for a moment—happened in the United States. The income tax was sharply raised on the entrance of this country into the European conflict and thereafter was retained at higher rates than would have been considered at all had it not been for the acceptance during the war of measures ordinarily deemed quite impracticable.

§ 5. In the United States constitutional obstacles stood for a time in the way of a federal income tax. Such a tax had been levied and collected, it is true, during the Civil War; but when levied again at a later date (1894) was held not to be valid. This question was set at rest by the income tax amendment to the Constitution (1913), which gave Congress a free hand. In the revenue act of 1913 advantage was at once taken of the authorization by levying a general tax on incomes. In this regard, as well as in the simultaneous establishment of the Federal Reserve banking system, the country had rare good fortune. As we have seen,[1] the Federal Reserve system, set going in the nick of time, became extraordinarily serviceable during the ensuing years of the European war. In the same way the income tax, enacted at a time of profound peace, was brought into reasonably effective operation during the next two years; when the war needs came it was available for an immediate great yield of revenue thru the simple device of sharply raising the rate of a tax already established and in working order.[2]

In the act of 1913 some attempt was made to apply the principle of stoppage at the source. But the method was not fully nor consistently applied; and as amendatory provisions were added by subsequent legislation this method was thrust more and more into the background and finally was left in operation at only one point

[1] Compare Chapter 27.

[2] In the edition of this book which was published in 1914, shortly after the passage of the revenue act of 1913, I wrote of the income tax then established: "Taxation of incomes by the federal government has come to stay. It is probable not only that such a levy will be a permanent part of the revenue system of the United States but that the rate will become higher and that the progression will be accentuated. Fiscal exigencies will not fail sooner or later to lead to a rise in the rate; and the growing spirit of social readjustment will cause the progression to be more marked. That same spirit, as well as eventual fiscal need, may bring about—what is much to be desired—a reduction of the exempt minimum and a reaching down of the tax to a somewhat deeper social stratum." This forecast was verified in a surprisingly brief space of time.

of large consequence—the taxation of corporations and of the incomes of shareholders in corporations. Conditions in the United States are in many respects favorable to collection at the source. It is true that some intricate problems of administration are involved. As regards the taxation of incomes from real property there is a real or apparent conflict with the states and local bodies. Most important of all among the obstacles to its full application, however, is the inherent and inevitable conflict with the principle of progression. And so strong is the drift toward progression that any tax system which runs counter to it must sooner or later give way.

The American income tax, as developed in 1913–19, was levied in two parts: a "normal" tax, uniform for all incomes (tho subject to some degression on those of small size), and an "additional" tax or "surtax," analogous to the supertax of the British system but applying progression more systematically and sharply. The normal tax had been but 1 per cent in 1913; it was as high as 12 per cent at the time of greatest fiscal need, and was reduced to 8 per cent at the close of the war. As has just been intimated, it was applied once for all to the net incomes of corporations and, being collected from them, was deemed (as in effect it was) a tax on the source of shareholders' incomes. Incomes received by individuals on corporate shares accordingly were treated as if already taxed and dividends were not again subject to levy; to this extent the tax was collected at the source. In other respects, however, the start made in 1913 toward a wide application of that method was not maintained. Barring the treatment of corporate incomes and of dividends and some other provisions of minor consequence, reliance was placed on the taxpayer's declaration.

As in all income tax legislation a minimum was set which was exempt from taxation; with the further provision that this minimum was in no event to be reckoned as part of anyone's taxable income. Even in the case of the very largest incomes not the whole was to be taxed but only the excess above the stated exemption. The exempt amount at the outset (in 1913) was $4,000 for the head of a family (the ordinary case) and $3,000 for one not the head of a family.

These exemptions were unduly liberal. On the monetary scale of pre-war days an income of $4,000 meant a considerable degree of prosperity and gave no valid claim to complete exemption from income tax. When the exigencies of war compelled a less timorous policy the exempt amounts were lowered to $2,000 and $1,000 respectively. As it happened these lowered figures almost at once became *too* low. The inflation of prices and wages brought it about that $2,000 in 1918 and 1919 had a purchasing power less than half that of 1913. The exempt amount, unduly great at the outset, became unduly small almost immediately after amendatory steps were taken. There is no better illustration of the unexpected and complete disruption which the war brought in all pecuniary standards.

The other part of the system, the additional tax or surtax, necessarily led to a requirement of declaration by each and every person liable to any tax at all; since by this process only could it be ascertained what was the sum total of his income and whether he was liable to surtax. In 1913 the rates of the surtax, like those of the normal tax, were low. But during the war they were raised to figures that would not have been dreamed of during the first stage. The highest surtax in 1913 had been 7 per cent on that part of any person's income which was in excess of $500,000. In 1919 the highest rate was 65 per cent on that part of income exceeding $1,000,000. Ten years before such an application of progression would have been thought beyond the bounds of possibility or of reason. Yet under the stress of military and patriotic excitement it encountered no serious opposition; and it left as an aftermath of the war the permanent embodiment in the federal tax system of radically progressive taxes on large incomes.

No attempt was made to differentiate between property incomes and labor incomes. This defect—such it must be deemed in view of the general acceptance of the equity of some differentiation—was doubtless due to the initial endeavor to apply on a wide scale the method of stoppage at the source. As regards progression, the logic of that method, leading as it does to a flat rate, was disregarded from the start. It left its traces in the equal treatment of the two kinds of incomes between which there is the greatest social cleavage.

§ 6. Inheritance taxes present administrative problems somewhat different from those of income taxes. Progression is easier of application. At the same time the question of principle—is progression right?—presents itself more sharply.

The transfer of property at death must be subject to supervision by a court, or by an administrative bureau resembling a court, to prevent contention or fraud among those who may lay claim to the property. Hence in all civilized countries the making of wills is carefully regulated and probate officials or judges have supervision over the winding up of decedents' estates. Their powers are exercised directly on the persons charged by law with the distribution of the estates—the executors or administrators. This gives a convenient opportunity for collecting a tax. The executors and administrators are called on to pay the taxes and are not released from their obligations until they have given proof of the payment.

Evasion of such taxes, if they are carefully arranged, is not easy. The tax statute can be drafted in such a way that the net is tight. Change of residence may indeed be tried, to another jurisdiction where no such taxes are in force. This mode of evasion is obviously possible as regards the several states of our Union, since it is probable that some among them will not levy inheritance taxes or will levy them only at low rates. But the more widespread are inheritance taxes the less is there opportunity for a successful and convenient change of residence. Inheritance taxes levied by the federal government obviously can be evaded only by transfer of residence to a foreign country levying no such taxes or much lower ones.

Gifts made during life, especially to children, constitute another mode of evasion. They are commonly made subject to tax on the same scale as inheritances; but a more effective obstacle than such legal equivalence is the reluctance of property owners to part with their own, even to their nearest and dearest. The various possible means of evasion are of course likely to be resorted to in proportion as the rate of tax is high, most of all that of gifts *inter vivos*. Here, as with many other kinds of tax, a moderate rate is apt to be more effective in practice, more really equable, more productive of revenue, than a higher one.

Inheritance taxes are not equal in their effects—that is, do not bear equally on all the taxpayers—unless they are maintained at the same rates for a long period. Given time enough, all estates must run the gauntlet. But if the rates are changed at short intervals some successions will pay at one rate while others of precisely the same amount and kind will pay at a different rate. Hence this form of taxation, unlike the taxation of incomes, should not be resorted to in order to meet varying financial needs. In 1898, during the war with Spain, the United States levied inheritance taxes ranging (according to the size of the estate and the degree of relationship) from ¾ of 1 per cent to 15 per cent. Shortly after the war, the revenue being redundant, these taxes were repealed (1901). The estates of those who happened to die within these three years were subjected to the tax; but a vastly greater number never were. Such legislation violates the first and simplest canon of taxation—that of equality in levy on all persons in like circumstances. Great Britain followed a wiser course in maintaining her inheritance taxes unchanged even under the extraordinary exigencies of the war years 1914–18. Tho such taxes cannot be expected to remain indefinitely at the same rates—with changes in the public attitude toward the underlying social problems, new policies must come into effect—the rate should be relatively permanent, not shifted under the influences of political overturns or of current fiscal needs.

In the fully developed system of inheritance taxes of Great Britain (as consolidated under the legislation of 1894) the highest rate on estates going to direct descendants was 8 per cent, levied on estates exceeding £1,000,000; on large properties going to non-relatives the highest rate was 18 per cent. These figures were still further raised after the close of the war of 1914–18, when a deliberate revision was undertaken (1920). On moderate estates no changes of importance were made; but on larger ones the advances were sharp, the maximum (on properties over £2,000,000) being 50 per cent on transmissions to other than direct descendants. In the United States the pressure for revenue during the war of 1917–18 led once more to the enactment of a federal inheritance tax. The rates, like those of the income taxes of the same period, were made sharply progressive on the larger properties. Moderate inheritances, up to $50,000, were left entirely exempt. Above this exempt limit each successive increment was taxed at a higher rate; the first taxable increment being the amount between $50,000 and $100,000, subject to a rate of 1 per cent, while the maximum was reached with 25 per cent on the amount in excess of $10,000,000. No differentiation was attempted between direct descendants and collaterals or between relatives and non-relatives.

In the early years of the twentieth century the states of the Union had also established inheritance taxes. Sometimes these were on collateral successions only; but the tendency was to reach direct successions also, tho at lower rates. Between the several states (such of them as enacted the taxes—not all, but a steadily growing majority) the rates were unequal and the scope and the effective burdens were different. The ubiquity of corporate organization, and the endeavor of each state to secure an inheritance tax with respect to every corporation and every share of corporate property on which it could lay hands, led to irregularities and duplications. With the federal tax superadded after 1916 (when the step toward taxing inheritances was again taken by Congress) there developed an unseemly situation: a tendency in each jurisdiction to grasp everything in reach and to stretch to its advantage every doubtful question of constitutional and statute law. Among the many problems in the apportionment of revenues between the federal government and the states, and among the states themselves, this proved perhaps the most troublesome.

Something in the direction of lessening conflict between federal and state legislation, and of avoiding unmitigated double taxation by the two jurisdictions, was accomplished by the federal tax legislation of 1926. Under this a credit (i.e., a remission) was allowed, up to 80 per cent of the federal tax, for inheritance taxes paid to a state. The Roosevelt reforms of the next decade, however, saw steep increases in the federal inheritance taxes. While the credit against the 1926 rates was continued, no credit was allowed against the subsequent increases, which at the close of the thirties greatly exceeded the 1926 totals. Hardly more than the principle of federal credit remained; and this chapter in legislation was by no means closed.

§ 7. The general question of inheritance in its relation to inequality and to the working of the whole system of private property has already been considered.[1] It will suffice to refer summarily to the principles involved and their bearing on the fiscal and administrative problems.

The argument and the sentiment in favor of progression are stronger than in the case of income taxes. The inheritance of fortunes, the perpetuation thru all time of conspicuous inequality by the accident of birth, the grave doubt whether effortless acquisition and enjoyment of fortunes promote the best happiness of the beneficiaries themselves, the moral scandal of the mode of living among many of those born rich—all strengthen the objections to great inequalities in wealth. So far as inheritance taxes can be levied without serious administrative difficulties there can be no consistent argument against progression in communities which try in many other ways to lessen inequality and mitigate its consequences. Simple proportion—the same flat rate on all inheritances—can be defended only on the ground that any and every interference by the state with the existing distribution of wealth is to be opposed and condemned.

On the other hand there stands the essential ground on which the institution of inheritance rests. It is a great engine for the maintenance of capital. So long as the maintenance and increase of the community's capital depend on the way in which individuals deal with their property, inheritance cannot be struck at its roots without checking accumulation and investment.

But this ultimate limit does not mean that there is no room for the application of progression. Considerable amounts can be lopped from all properties without affecting the maintenance of capital at all; up to a certain point the taxes will be paid out of accrued income. Still larger amounts can be taken without leading to loss that is harmful. So vast is the savable fund in modern communities, so increasingly strong are the motives which lead to saving, that something can be diverted from the swelling stream without lessening its volume. Evidently the question here is one of degree. The inflowing accumulations will no doubt remain great

[1] See Chapter 56.

even tho moderate deductions be made from ordinary estates and large amounts withdrawn from the small number of great estates. Changes of this character, however, leave the situation essentially unchanged. Inheritance still retains its efficacy as the essential force for maintaining capital intact.

Pass beyond this limit—apply progression so sharply or limit inheritance so narrowly that accumulation is seriously affected—and you must supply ways of filling the gap. The public must see to it that the needed material outfit is supplied by some other process. It is not at all impossible that this should be done. The notion that capital cannot be got together except by the process of saving on the part of individuals in the familiar way is untenable. It is part of the general narrowness of thought under which no industrial structure is believed possible except that to which we are habituated. What is true, and is not usually faced by the advocates of drastic restriction of inheritance, is that something more than mere restriction is involved in their program. New institutions and new organs must be found. The state might conceivably set up its own bureau for handling estates subject to devolution, keeping the principal intact and separating the funds strictly from current budget operations. In another direction too the state might deliberately provide for the increase of capital. It might own and manage great industries, operate them at a profit, and build up new or larger plants out of the profits. Precisely in this way, by the process of putting the profits back into the enterprise, great accumulations and great fortunes have been built up under private ownership and great additions made to the community's capital.[1]

No such course of action has yet been deliberately followed by governments and no such results have yet been achieved on any considerable scale. True, public trustees under jurisdiction of courts have handled with success property in process of settlement. True, also, occasional instances can be found of industries run by governments which have enlarged their plant out of profits. But in both directions the quantitative significance is slight. It is no sensible deviation from the truth to say that governments, when

[1] Compare Chapter 57, on Great Fortunes.

they enter on industrial enterprises or enlarge them, borrow the capital; they rely on private savings. It is also no sensible deviation from the truth to say that when governments lay hands on private property thru heavy inheritance taxes they not only trench on the accumulated savings of private persons but use the proceeds for current fiscal needs and without provision for the maintenance of the capital that comes under their control. We are confronted here once more by the fundamental questions that underlie the debate between public and private management of industry and between socialism and private property. They are questions of the character and intelligence of the individuals whom we vaguely call the public. Whether conservation of capital shall be deliberately and successfully managed by government depends on the quality of the persons to whom the governmental functions are intrusted, and thus on the quality of the electorate by whom those are chosen. We have to hark back once more to the underlying problems of human character, human motives, the nature of our inborn traits, the possibilities of modifying them thru environment and education, the perfectibility of man and of man's institutions. On many of these matters we are much in the dark. And therefore we can see our way but dimly into the future, must proceed tentatively, and must remain uncertain of the kind of social structure which the coming generations will establish.

CHAPTER 71

TAXES ON LAND AND BUILDINGS

§ 1. Taxes on land (e.g. an urban site) rest definitively on the owner, and operate to lessen economic rent by so much.—§ 2. Taxes on buildings tend to be shifted to the occupier. Qualifications and limitations of this proposition.—§ 3. Effects of taxes on real property—land and buildings combined.—§ 4. In the long run it makes no difference in the incidence of such taxes whether they are first imposed on owner or tenant; but for short periods it does. Similarly it is in the main of no concern whether the assessment be on rental or on capital value; tho in some respects the two methods bring different results.—§ 5. Concealed taxation of workingmen thru taxes on their dwellings.

§ 1. TAXES on real property—land and buildings—play a large part in all modern tax systems. For long periods in the history of European countries they were almost the only taxes; since real property was the only sort of wealth which could be effectively reached. The taxes which now exist in the older countries of western civilization are largely survivals or descendants from such taxes of older days. They even descend, in a sense, from the dues of the feudal system. But they have been transformed and re-shaped, and they now retain their important place in financial legislation for the simple reason that land and buildings are on the spot, cannot be moved, and their owners must submit to whatever tax is imposed on them.

Let us consider first the effects of the taxation of land by itself —of land irrespective of any changes or improvements made by man. For the purpose of considering this case let us suppose an urban site of great value not improved by man, or improved so slightly that the important and effective element in its value is the land *per se*. Not infrequently in our American cities a central site potentially lucrative is occupied by a flimsy one-story shop, used for retail trade and commanding a considerable rental [1]—one very high compared with the cost of erecting the building. This

[1] I venture to remind the reader that I use "rental" to signify what is paid by tenant to owner for a parcel of realty; and use "rent" in the sense of economic rent.

sort of utilization of the site is but temporary, the result of hesitation on the owner's part as to when and how the full economic rent of the site can be secured; or due possibly to uncertainty in the legal title and consequent unwillingness on the part of anyone to make improvements. Not uncommonly under these circumstances a cheap dramshop is erected, because such an establishment is most sure to yield a good rental, irrespective of the neatness or attractiveness of the building itself. Assume now that, for whatever reason, a valuable site is in this state. According to our American practice it will be taxed on its full selling value as it stands—for a large sum as regards the land, a small one as regards the building. The total tax, at such a rate as is common in our cities (say 2 per cent on the capital value), will very possibly be greater than the whole rental secured from the shop. Who would bear such a tax?

The owner would gladly shift it to the tenant, by charging him a higher rental. Clearly the owner cannot do so. Presumably the tenant is already charged with a rental commensurate with the profit-yielding possibilities of the site as it stands. The owner from the outset will exact all that can be got. The tax will enable him to get no more. Nor would a reduction in the tax cause him to be content with less; he would still demand and secure all that the site was worth. The tax falls definitively on the owner.

Such is the general proposition to be laid down with regard to taxes on land. They fall on the owner once for all. They operate as so much diminution of rent. In the extreme case a tax equivalent to the full rent of land can be exacted, without any other effect than that of depriving the owner of his income. If a greater amount is assessed the land, of course, will cease to be used; the owner and occupier alike will abandon it.

This proposition rests on the assumption that land is "rack-rented"—that the owner exacts in rental as much as he can possibly obtain. Such is not necessarily the case. Thru ignorance or carelessness he may let a tenant have it for less than might be got by the sharpest bargaining. In a country like England agricultural land was long owned and managed for the satisfaction of social ambition as well as for immediate pecuniary return and was not infrequently let to farmers on indulgent terms. Under such circumstances an additional tax levied on the landholder will probably lead him to look sharply at his rentals and to take in all the slack. There is much discussion in England as well as in other countries on the expediency of taxing ground rents; that is, of making a direct levy on the owners of sites. Those who advocate the measure lay it down with confidence that such a tax will affect the owners only and will neither affect tenants nor raise the price of the articles produced (or sold) on the premises. They are right —provided that the land is already rack-rented.

Consider now the operation of such a tax if it has been long imposed at the same rate and seems certain to continue indefinitely. Anyone who thereafter purchases the land will allow for the tax and will pay a price based on the net return after the tax has been paid. This later purchaser will feel no burden from the tax; hence some persons are led to speak of this as "burdenless" taxation. It is burdenless, at the later stage, simply because the first owner has borne the burden once for all. In effect, a special permanent tax on the site amounts to the appropriation by the state of so much of the value of the site. Such appropriation may or may not be wise—this raises the whole question of the grounds for private property in land and for the private title to economic rent. The tax is burdenless only if it has prevented some part of the economic rent from ever getting into any individual's hands.

These principles hold good of agricultural land as well as of urban sites. A tax on strictly economic rent in either case falls on the owner. We have seen that in the case of agricultural land it is peculiarly difficult to draw the line between the rent of land proper and the return on capital invested in the land; [1] and for that reason the effect of a tax on agricultural land is in practice not so easy to follow. Yet there can be no doubt that there is a great amount of land in old countries, and in the older parts of new countries, which is above the margin of cultivation and yields some rent; and to all such land the propositions regarding the effects of a tax hold good.

§ 2. Taxes on buildings present a different case. Buildings may be taken as typical of improvements on land, or any capital em-

[1] See Chapter 44.

bodied in the land. The case of buildings is instructive, because it is comparatively easy to draw the line between the land itself and the capital invested in it.

Suppose a situation removed as far as possible from that considered in the previous section. Suppose a building erected on land whose value is negligible. Such, for example, are dwellings on the extreme edge of cities or suburbs, or factory buildings in small villages or in the open country. The familiar "three-decker" of New England is often of this sort—the three-story wooden apartment house occupied by mechanics and other workingmen in suburbs and outlying districts.

A tax imposed on such a dwelling tends to be borne by the occupier. If the owner is also the occupier the situation is simple enough; the burden clearly must be borne by him. If, as is commonly the case, the dwelling is let and is built with the expectation of letting, the burden is likely to be shifted to the occupier (tenant) in the shape of higher rental. The building will not be put up unless the owner has reason to believe that the rental will yield him the current return on investment and will yield that return *net;* that is, after payment of all expenses. Taxes are reckoned by him among the expenses. If a net return of 5 or 6 per cent is looked for, the rental will be expected to yield a gross return of 8, 9, or 10 per cent. The difference covers depreciation, expenses of management, repairs, insurance, and—not least—taxes. If all taxes were remitted—if the public revenue were secured in entirely different ways—competition between house owners and house builders would bring rentals down. And, conversely, if taxes were to be greatly increased house owners and house builders would sooner or later recoup themselves for this higher expense by charging higher rentals.

This would be the result in the long run. It would not necessarily or even probably appear over short periods. The proximate cause determining rentals is the supply of house accommodations in its relation to the demand. A remission of taxes would not necessarily lower them at once; this consequence would ensue only after the greater return to the owners had stimulated an increase in the supply of houses. Minor changes in the tax rate—a bit of an increase one year, a decline in another—would not change them at all. The owners alone would be affected, grumbling loudly in the one case, in the other enjoying the reduction in quiet.

There are circumstances under which the shifting of such taxes would not take place at all. In a city whose population is declining, house rentals are governed solely by the principle of quasi-rent. The houses are there and cannot be removed. The cost of erecting them and the ordinary rate of interest on investments have no influence on their return. The question is simply one of an existing supply in relation to a declining demand. An increase of taxes in such a place would not cause rentals to go up; the owners would have to pay the taxes out of their own pockets once for all. After a very long time a readjustment would doubtless take place. Houses do not last forever. As some wear out and disappear new ones will not be built in a decaying town to replace them. Given time enough, the process of shifting taxes will indeed work itself out. But the time required may be long—decades, even generations. The same situation may develop in a particular part even of a growing city. Some sections may come to be out of favor; fashion or convenience may cause people to move elsewhere; and then the houses in the half-abandoned sections will be in the same position as are all the houses in a declining town.

In a rapidly growing city the process of shifting takes place not indeed with mathematical exactness but with considerable certainty. Houses will not be built for letting unless this is worth while; and it will not be worth while unless the owners get the current rate of return over and above taxes. The increasing demand for house room due to growing population will not be met unless rentals are high enough to make good the owner's outlay for taxes. Such is the common case in our American cities. Indeed it is the case in most cities of the western world; for the phenomenon of urban growth has shown itself in almost all countries. Taxes on buildings tend to be borne by the occupiers.

What holds good of dwellings holds good also of buildings let for business purposes. Here also, if we fasten attention on a case where buildings alone figure in the capital account, it is obvious that taxes add so much to running expenses and must be recouped to the investing owner in order to induce him to erect the building. Here, also, the principle of quasi-rent must be borne in mind. A business structure once put up is there for good, and its rental depends not on the expectations and calculations of the owner but on the supply of this particular sort of accommodation in relation to the demand—on the adaptability of the premises and on the growth and prosperity of the city. In a decaying town or for obsolescent kinds of buildings, rentals will tend to decline in any case and the owner will find no possibility of shifting his taxes to a tenant.

In the case of business structures a still further process of shifting is probable. Just as the investing owner regards taxes as expenses and expects to be recouped for them in his charges, so the business occupier regards his rental as an expense and expects to be recouped for it in his profits. This is most obviously the case in retail dealings, where rental of the premises may be a large part of the total expenses of the tradesman. High charges for premises (that is, for buildings—not high ground rent) will mean higher prices for the goods sold, and the effect of higher taxes will tend to be somewhat higher charges on the community at large. Taxes will be very widely shifted and diffused; that is, they will tend to be so diffused if competition is active in the particular business and if business profits conform to their normal range.

§ 3. The common case as to urban realty is not that land alone or buildings alone stand for the greater part of the capital value but that each enters as a substantial part of the total. In the heart of a great city the site will stand for more than the buildings, even tho these be substantial and expensive. In outlying districts the buildings will represent the larger part of the selling value; yet the land still counts. Now, according to the distribution between these two constituents, the incidence of taxes will be different. That portion of the tax which is levied on the selling value (the capitalized rent) of the site remains definitively as a tax on the owner. That portion which is levied with respect to the building tends to be shifted to the tenant. Here, as in the previous section, we must have in mind the long-run operation of the taxes. The immediate effect is commonly that the owner bears the burden. Every parcel of real property yields proximately a rental fixed by its serviceableness and not directly affected by taxes. It is only by affecting the supply of buildings that taxes on them tend to be shifted to tenants.

The long-continued levy of taxes on a site at the same rate brings about, as we have seen, a decline in the selling value of the site. So much of the economic rent has been appropriated by the state. The effect of taxes has not been to raise ground rents but to lessen the net return to the owner. Where the site is highly valuable, a tax at rates such as long were common in American cities—say 2 per cent on the selling price—means the appropriation by the community of a very substantial part of the economic rent. And where the value of land is rising, taxes rise in proportion and some slice of the unearned increment is steadily going into the public treasury. If it were not for the taxes, the net yield of the sites would be so much greater and their selling price correspondingly higher. The high value of land in our large cities is thus a source of much revenue to the taxing body (that is, usually the city) and at the same time of a revenue hardly felt as a tax by anyone. It simply prevents the rent of land and its value from rising even higher; and since this is foreseen and expected by everyone, no purchaser suffers. Evidently the same result would ensue if the whole of the future rise in value were absorbed in taxation.

The large and constantly growing revenue from this source, even at the present rates, accounts in no small degree for the extravagance of American municipal government. The business districts of New York City, for example, are a vast treasure house for the tax collector, as they are also in no less degree for their owners. The enormous revenue collected from them in taxes makes possible a measure of waste and corruption which would be intolerable under taxes not levied in this burdenless way. The same is true, only to a less degree, of our other great cities, in which urban rents are also large and rising and in which also taxes on sites are steadily productive of increasing revenue.

§ 4. Whether a tax on real property be collected in the first instance from owner or occupier is, in the long run, not material. The practice in the United States is to levy on the owners; and in the preceding section the incidence of taxes has been discussed as if this were always done. In England and in European countries generally, however, the practice is to levy on the occupier.

If the occupier is called on to pay the tax or taxes on real property, both he and the owner will consider the payment in calculations about rentals. So far as the tax is levied with respect to site value, the pecuniary advantage of the site to the tenant is diminished by the amount of the tax; and the rent he will pay in order to secure the site will be so much less. If, on the other hand, the tax levied with respect to buildings and improvements is collected not from the owner but from the occupier, the owner obviously will be able to offer the facilities at a lower rate and will be impelled by competition so to offer them. The nominal rental in either case will be less if the occupier is called on for the taxes. The difference is in the mode of collection, not in the incidence of the tax.

All this, however, holds good only if taxes are certain in amount and thus calculable. Unexpected taxes are likely in all cases to remain once for all a burden on the persons from whom payment is directly demanded. If owner and tenant come to an agreement on rentals, a new tax or an increase of tax falls, during the term of the agreement, on that one of them who is directly chargeable. In the United States, where the practice is to levy on the owner, it is he who feels the brunt of all new taxes or increased taxes. He can shift them to his tenant (if at all) only when the time comes for a new lease. In England, where the practice is to levy on the occupier, he in turn must pay during the term of his lease, and can effect a readjustment in such manner as to leave the tax burden on the owner (in the case of site rental) only when the time for renewal comes. In the United States it is not infrequently stipulated in leases that the tenant shall assume all taxes, even tho the landlord be chargeable with them by the law. Clearly both the owner and tenant will consider this assumption of liability in their bargain on the stipulated rental. Such agreements concerning tax payment are often simply a way of chaffering about the rental, especially where site rent plays a large part. If the site be valuable and in demand, the tenant will assume the payment of taxes virtually as a mode of bidding higher for the site and will take his chances as to unexpected changes in tax rates.

Another difference between American and European practice is in the basis of assessment. In the United States taxes on real property are commonly assessed on capital value, that is, on selling value. In Europe they are usually assessed on annual rental value. Thus in the United States the usual tax on real property is some such rate as $1.50 per $100 of selling price, or 1½ per cent on the capital, charged on the owner. In England a common tax is 5 shillings on the pound of rental value, or 25 per cent of the rental, charged on the occupier.[1] These rates are roughly the same in their proportion to rentals. And in either case their incidence is in the end the same, differing (in the manner described above) according as the realty owes its value predominantly to site or to improvements. There is, indeed, one case in which the two methods reach different results; namely, where rental value does not correspond with capital value. This is most striking where urban land is vacant and yet has a selling value because of the rent which it would yield if occupied, or which it is expected soon to yield from the growth of population. Such land has, as it stands, no rental value or an insignificant rental value; and in England it is taxed lightly or not at all. Because it has a considerable selling value it may be taxed heavily in the United States. The case is similar where the land, tho built on and used, is not used to the best advantage, having obsolete or temporary buildings. It would then be taxed lightly in England on the basis of its actual rental. It would be taxed heavily in the United States on a selling value representing the capitalization of its potential rent.

The American practice has advantages and disadvantages. It has the advantage of forcing land into use. Every owner, being taxed on the capital value of his land, is under pressure to make its contract rental correspond to its potential rent and hence to improve it rapidly. The English practice permits the owner to wait.

[1] These at least were representative tax rates before 1914. The monetary upheavals of the European war led to chaos in tax rates as in other matters; higher figures became common, and once established were likely to persist for an indefinite period. The same is true of the United States, where the usual rate came to be much above 1½ per cent.

He will often wait partly from inertia, partly from a wish to bide his time until the most profitable use of the site becomes quite clear. The American practice has the disadvantage of stimulating a feverish haste in getting sites into use. The general speculative and profit-gathering trend of American life would doubtless lead in any event to some such haste; but it is made greater by our method of taxation. Hence the sprawling aspect of those American cities which are rapidly growing. Lots in the outlying districts are built on, perhaps prematurely, with the design of getting a return from rentals; intermediate lots are vacant, their owners holding on for a while. In England, where rental value alone is the basis of taxation, land comes into the market in a more slow and orderly fashion. The American practice has the advantage of appropriating for the community, thru the machinery of taxation, a larger slice of the unearned increment.

§ 5. Workingmen, like all occupiers of dwellings, are reached by the taxes on dwellings. They are indeed reached also by the taxes on shops and factories, which enter into the expenses of merchants and manufacturers and tend with more or less irregularity to be shifted to consumers. But this second sort of shifting is so concealed as to be difficult to follow in any concrete way. Taxes on dwellings, however, in so far as they are levied with respect to the structures, increase house rentals beyond question and so cause their occupiers, and the workingmen among them, to bear a share of the public burdens.

This indirect effect of taxation on workingmen appears not only in the United States, where all such taxes are first collected from the owners, but in England, where they are usually collected from the occupiers. The English mode of levy is subject to exception in the case of workingmen's tenements. Here the taxes are collected not from the occupier but from the owner; or, if not from the owner of the site, from a lessee who has taken the whole of the premises and sublets them to the actual occupiers. The same obstacles which stand in the way of the collection of income taxes from persons of small means appear where taxes on real property are sought to be collected from the occupiers of small tenements. The expense of administration is larger and there is irritation to the taxpayer. It is much simpler to charge the landlord a lump sum tax on the whole and let him recoup himself by larger rentals from the several tenants or subtenants. This is commonly done in London and other large English cities, the landlord being allowed to "compound," as the phrase goes, and getting a slight reduction from the usual tax rate by way of commission for thus acting as tax gatherer.

The final result is that the workingman is taxed but rarely knows that he is taxed. He pays the going rentals for his house room and does not know that in this rental is included a tax charge. The situation is doubtless inevitable; but it is unfortunate. It much affects the attitude of the average laborer toward public affairs. All that he is conscious of is the public outgo, of which he is aware because the city or state is an employer of labor. The public income from taxes does not seem to concern him. He is commonly in favor of expenditure, with little regard to the wisdom of the expenditure; for increased taxes seem to be none of his concern. Some sort of direct levy on every voter would much promote watchfulness and discrimination in public affairs; yet it seems hopeless to retain any taxes of the sort.

CHAPTER 72

TAXES ON COMMODITIES

§ 1. Direct and indirect taxes. Various ways in which "indirect" taxes are levied on commodities.—§ 2. In the simplest case, of a competitive commodity produced under constant returns, a tax will be shifted to consumers. Explanation and qualification of this principle.—§ 3. Complexities where the commodity is produced under increasing or diminishing returns; where there is monopoly. Cautions to be observed in the application of theoretic reasoning on these topics.—§ 4. Taxes on imports present no peculiarities, except as they bring a rival untaxed supply and thus raise the questions concerning protection.—§ 5. Taxes on commodities are little noticed by consumers. They are commonly on articles of large consumption, and regressive in their effects. A large and varied list of articles is most easily reached by customs duties.

§ 1. TAXES such as have been described in the preceding chapters on income, property, inheritance, are commonly spoken of as direct taxes. By this phrase is meant that the legislator, in levying them, has no expectation or intention that they shall be shifted to any other persons than those first called on to pay them. Taxes which, on the other hand, are expected to be shifted to others are called indirect taxes. As we have seen, the so-called direct taxes are shifted not infrequently; but they are not levied with this in view and the process of shifting is often uncertain. "Indirect" taxes, on the other hand, are levied on the supposition that the persons first called on will transfer the burden to others and will transfer it with tolerable ease and certainty.

The simplest and most familiar of indirect taxes are taxes on commodities. The phraseology, it must be borne in mind, is loose. Just as there are not, in strictness, any taxes on property but only taxes which persons owning property are compelled to pay, so there are no taxes on commodities but only taxes levied on persons when they deal with commodities in a particular way. A tax "on tobacco" may be, for example, a tax on the manufacturer of tobacco, levied on the basis of the number of pounds of that article as they pass out of his factory. A tax "on sugar" may be, as it formerly was in Germany, a tax of so much per hundredweight of the beets used in making the sugar, collected from the manufacturer when the beets are delivered at his establishment. A tax "on imports" is one collected from merchants and others on the occasion of their bringing articles across the frontier from other countries.

The precise stage and the precise way in which these various persons are called on to pay such taxes is much affected by the possibility of evasion. Thus, under the method of taxing sugar beets formerly followed in Germany (now given up, for reasons that need not be here discussed), evasion was difficult, because beets were bulky and the operation of bringing them to the factory could easily be supervised. The method used in our American taxes on tobacco and cigars, of compelling the taxed person to buy stamps and affix these on the articles at a given stage in his operations, has the administrative advantage that the articles cannot be marketed, in case of evasion, on any except the smallest scale; since the absence of the stamps would inform all the world of the violation of law. Taxes levied on importation are collected with great ease in modern times, because the regular channels of transportation, by railway or steamer, are extremely cheap, and smuggling by out-of-the-way routes ordinarily entails greater expense than evasion of the duty would make worth while. In the eighteenth century the situation was different and smuggling was a factor much to be reckoned with in the administration of import duties.

All these, however, are matters of detail, often very important detail, to be dealt with in special books on taxation and finance. Our concern is with some general questions concerning the economic effects of these taxes.

§ 2. Consider first the simplest case: an internal tax, or excise, imposed at some stage in the production of a commodity. A stage in manufacturing operations is usually chosen, because manufacture means concentration of operations and hence ease of supervision. Suppose the commodity to be one produced under the conditions of constant cost and free competition. Then the effect of the tax is simple. The price of the commodity will be raised by the amount of the tax. The producer will shift this amount on the consumer and the real burden will thus fall on the latter.

This result will not be necessarily reached at once. The first effect of the tax is to add so much to the manufacturer's expenses of production. He will, of course, desire to raise his price so as to make good the additional expense. In strict theory, he cannot do so except in consequence of a decrease in supply. Price is determined directly by the equilibrium of demand and supply (or, in more technical language, by marginal vendibility) and it will not rise, the conditions of demand remaining the same, unless supply be lessened. But the higher expenses of production and diminished profits will tend to lessen supply; and normal equilibrium will be restored when the manufacturers are again getting their usual returns, with lessened output and higher prices. Evidently the extent of the eventual change in the volume of output depends on the elasticity of the demand for the article. The result may even be reached, under some not improbable circumstances, without any change in supply at all. In a growing country, or for a commodity for which demand is growing, there may be no actual decrease in supply but only cessation of increase. Demand is simply allowed to catch up with the new situation.

All this supposes that the industry is in a normal state at the time when the tax is imposed—that the capitalists engaged in it are making normal profits and will be led to lessen their output, some of them perhaps even to withdraw entirely if their profits are cut down. It is perfectly possible that a tax may be imposed at a time when an industry is unusually profitable. Then its incidence may be apparently on the producers only; they may be able to pay the tax and still sell to consumers at the ordinary profit. What happens in such cases is not that the consumers pay a higher price but that they are prevented from getting the lower price which competition would eventually have brought about. This process is of course much more convenient to the producers than that of imposing a tax when an industry is in its normal state; obviously it constitutes no real exception to the rule that the tax eventually falls on the consumer.

Some industries are so much of an aleatory sort that the working of competition, and therefore of taxes, is irregular and uncertain. This seems to be in no small degree the situation with breweries, which depend for the sale of their product very much on reputation, trade mark, and the control of dramshops. A brewery is apt to be either a highly profitable enterprise or a disastrously losing one; much as is the alternative in the case of a large hotel or a city newspaper. A tax on beer at a moderate rate is likely to be a minor item in the oscillations of brewery expenses and profits and to have hardly a noticeable effect on the retail price of the beverage. Similarly, a reduction in an existing tax may simply lessen the brewer's expenses by so much and not affect the retail price. Evidently this would be true only of moderate charges. A large increase or decrease of tax would be felt by the consumer without question. And even moderate charges would necessarily show their effects in time, tho very likely not so much in altered retail prices as in a decrease or increase (as the case may be) of the customary contents of the glass or in a better or worse quality of the contents. Here, as in almost all economic phenomena, we have to deal with tendencies that work out their results more or less slowly and in ways often obscure. It is to be said, however, that taxes work out their effects on prices more quickly and surely than some other influences, such as, for example, improvements in production or deficiencies in the supply of materials; since taxes are notorious and the attention of all producers and dealers is at once fastened on them.

§ 3. Consider now some other cases, less simple. The taxed commodities may be produced under the conditions not of constant returns but under those of increasing or of diminishing returns; or they may be subject to a monopoly.

The strict theory of these cases, again, is comparatively easy to work out, being only an application of the general theory of value. A tax on a commodity produced under diminishing returns may not raise its price by the full amount of the tax. A rise in price can come only with a decline in quantity produced. But in the case of diminishing returns a decline in quantity produced means a recession of the margin of cultivation and a lowering of marginal cost. The effect of the tax in raising normal price is therefore partly offset by the lower cost due to less pressure on the sources of supply. Conversely a tax on a commodity produced under increasing returns may not only raise its price but raise it by more than the amount of the tax. In this case the rise in price, by checking consumption and lessening the amount produced, causes the cost per unit to advance and so the price to rise still further. The same sort of reasoning may be applied to the remission of an existing tax. Where the remission is on a commodity produced under diminishing returns, it is likely to increase consumption, to bring pressure to bear on the sources of supply, to raise marginal cost, and so to lower price by less than the amount of the tax remitted. On the other hand, a tax remitted under increasing returns, by stimulating consumption and output, is likely to cause a decline in cost per unit and so a fall in price greater than the mere remission alone would have brought about.

A tax on a monopolized article—to pursue the theory of these cases—is not shifted under the same influences and probably not to the same degree as a tax on an article produced under free competition. A tax directly on monopoly profits cannot be shifted at all, just as a tax on economic rent cannot be shifted at all. The monopolist presumably will have adjusted his output in such a way as to secure the maximum profit, just as the owner of an advantageous plot of land presumably will have got the maximum rent; and a tax levied directly on monopoly profits or on rent does not open any possibility of adjusting matters in a more lucrative way. The monopolist or landowner must bear the tax with the best grace he can.

A tax on a monopolized commodity, however, is not the same as one on monopoly profits. It is a tax per unit of output, not on the net monopoly gains. The tax on the commodity is much easier to levy, since it is comparatively simple to ascertain what the output is. It is very difficult indeed to measure monopoly profits with accuracy, and correspondingly difficult to assess a tax simply on the monopoly gains. The tax on the monopolized commodity, however, tho simple and comparatively certain in its financial outcome, is much more uncertain in its eventual result on prices. It affects at once all the calculations of the monopolist. His expenses of production per unit rise. If he tries to raise his price correspondingly, he will almost surely have to face a decline in consumption. If demand is elastic, this decline in consumption may be considerable and he is likely to shoulder the tax in good part (i.e. not raise his price by the full amount of the tax) rather than incur the decline in profit from a lessening of sales. If the demand is inelastic, that is, if a rise in price checks his sales but little, he is more likely to be able to shift a large part of the tax on the consumers.

Theoretic reasoning on this topic may be easily pushed further still. The monopolist may be conducting his business under constant returns, or diminishing returns, or increasing returns. His calculations will be accordingly affected. If he is producing under diminishing returns, a tax and a rise in price and a check on consumption will be less unwelcome to him; since with a lessened quantity he will also have lessened costs. If, on the other hand, he is producing under increasing returns, a rise in price and a consequent decline in consumption and output will be very unwelcome to him; since it will bring an increase in his cost per unit. If we suppose him to be quite unfettered in his monopoly, rigorously determined on the extraction of the utmost profit possible, and thoroly informed both as to the conditions of demand and his own increasing or diminishing costs—then he has a very pretty problem before him in readjusting his supply and his price after the imposition of the tax. He may be supposed to call mathematical formulae to his aid and to work out with exactness how far it will be to his advantage to submit to some part of the tax, how far to shift part of it to consumers.

The very statement of this last case points to an important limitation on the pertinence of all such analysis. There is danger of making an intellectual plaything out of intricate reasoning on the play of demand, varying costs, taxes, and the like. Some economists have given no small share of attention to problems of this kind, forgetting that their reasoning is purely hypothetical and that there may be little that corresponds to it in the concrete facts of life. All economic principles hold good only in the rough. Semi-mathematical reasoning, even pure mathematical reasoning, not infrequently aids in bringing out with clearness the underlying principles; but it can rarely be pushed with advantage into details. It cannot be so pushed with reference to the incidence of taxes—neither as regards the modification of incidence due to increasing or diminishing returns, nor as regards the effect of taxes on monopolized articles. Increasing or diminishing returns show themselves slowly and irregularly and over long periods. Taxes on commodities affected by these varying conditions are maintained only in very few cases, if in any, at a uniform high rate for so long a time as to influence sensibly marginal cost. For most practical purposes we may content ourselves with the simple result reached at the outset, under the supposition of constant returns—a tax on a commodity tends to be shifted to the consumer by its full amount. And in the same way we can dismiss most of the complicated reasoning about the working of taxes on those commodities which are commonly spoken of as monopolized. It has been noted elsewhere [1] that complete monopoly is rare. Those cases in which monopoly is supposed to exist are almost invariably much limited—limited by substitutes, by potential competition, by public opinion, by force of law. A tax on commodities produced by a quasi-monopoly is not shifted with the same certainty as one upon a competitive article; but there is a strong probability that most of the tax will be shifted in the same direction. This sort of rough and general conclusion is alone in accordance with the usual state of the facts; and it suffices for the guidance of the legislator.

§ 4. Taxes on imports present no peculiarities, so far as taxation proper is concerned. They are simply one form of taxes on commodities and what has been said in the preceding sections applies to them. They are commonly shifted to the consumer and are meant to be so shifted. In the controversy about protection, zealous advocates of high duties are led occasionally to maintain that taxes on imports are borne not by the domestic consumer but by the foreign producer. This may sometimes be the case, just as it is sometimes the case that an internal tax is borne for a longer or shorter period by the producer and not the consumer. Where the producer (domestic or foreign) has a monopoly, he may bear a part of the tax—conceivably may bear the largest part of it.

[1] See Chapter 17.

Sometimes he seems to bear it, tho he does not do so in fact. He sells the commodity at the same nominal price but with shorter measure or poorer quality. Most often of all, the same unconcealed and simple result ensues both from internal taxes and customs duties—the commodity rises in price, very likely by the full amount of the tax.

The peculiarity of duties on imports is merely that they may bring into the market a rival untaxed supply. Levied strictly with a view to their effect as taxes, import duties should always be accompanied by internal taxes at the same rates on the same commodities. If this is not done, domestic production may spring up, even tho the domestic producers cannot bring the article to market at as low a price as it could be imported for in the absence of the duties. Whether such a stimulation of domestic production is wise or not raises the whole question, sufficiently discussed elsewhere, of the effects of protective duties.[1]

§ 5. Tho the consumer almost always pays taxes on commodities, he is commonly little aware of it. The tax is paid by him in the form of a higher price. When a given price level is established for any commodity, people get used to it as the going rate and pay without grumbling. If every purchaser had to hand out directly two cents each time he bought a pound of sugar, or was called on to pay a tax of two dollars each time he bought a suit of woolen clothes (such were roughly the rates at which American consumers of these articles were taxed for half a century) —we may be sure that a mighty protest would arise. The fact that such taxes are concealed and only half understood makes them tempting for the legislator. He is constantly confronted by demand for heavier outlay and yet finds the public willingness to bear new burdens lagging behind its demand for greater public services. He is likely to turn to the taxes which will yield the largest revenue with the least protest. Such are taxes on commodities.

Obviously commodities which are produced in the greatest quantities are those likely to yield the largest revenue; and these again are likely to be commodities consumed in larger proportion by the poor than by the rich. Hence most taxes on commodities

[1] See Chapters 36, 37.

tend to be not even proportional; they are regressive. A poor man will not purchase as much sugar as a rich one; but he will spend a larger share of his income on sugar; and a tax on such a commodity bears more heavily on him. It is doubtless not impossible to select for taxation commodities used chiefly by the well-to-do and the rich, such as laces and champagnes. But taxes of this kind are rarely productive of much revenue. The very fact that a person is rich brings it about that he distributes his expenditure over many things and buys and consumes comparatively little of any one thing. Taxes on luxurious articles hence are likely to yield only driblets of revenue and to be expensive of administration. The lucrative revenue yielders are the staples consumed in great amounts and consumed chiefly by the masses. Such are, to mention articles now much taxed in civilized countries, sugar, tea, coffee, petroleum, tobacco, beer, wine, spirits. On these, to repeat, the taxes are commonly regressive.

Two sets of articles among those just mentioned are usually subjected to taxes, whether excise or customs, at an especially high rate—alcoholic liquors and tobacco. It is supposed that a decline in their consumption is to be desired rather than regretted and that taxes may be imposed on them without compunction. This attitude, to be sure, does not go far to explain the taxation of tobacco, nor that of wine and beer on the continent of Europe, where these beverages are universally used and not greatly abused. Simple fiscal convenience is the main factor. For whatever reason, large revenues are secured in almost every civilized country from such taxes. They are made to yield probably the very largest revenue by creating fiscal monopolies. That is, governments undertake their manufacture, or at least their sale at wholesale or retail, and prohibit all individuals from engaging in the business thus appropriated. Prices are charged to purchasers which are so high as to bring large profits; the result for consumers being the same, tho reached by a different process, as that of taxing the commodities in the ordinary ways. Tobacco is a fiscal monopoly in France, Italy, Spain, and other countries. Spirits are a fiscal monopoly in Switzerland. Salt is a fiscal monopoly in Italy. The method has the advantage that evasion is easily detected; the very fact that any private individual conducts the business at all is proof that he violates the revenue law. On the other hand, the system is open to all the objections to bureaucratic administration, and in particular is the more unsuitable if the civil service is ill organized and the general tone of public administration is lax.

Customs duties are made more easily applicable to a large and varied list of articles than excise taxes. Supervision need not extend over the whole land; it can be limited to the ports of entry into the country. This circumstance goes far to explain the wide prevalence of protective duties. They are a convenient way of getting revenue. Once adopted for revenue, their incidental effects on the course of domestic industry are at first overlooked and then, when they have established themselves, are welcomed. The list of articles on which customs duties are levied in the United States is an extraordinarily wide one, covering some 1,500 different things. It would be out of the question to levy excise taxes on any such list.

In fairness, it is to be said of the customs duties in the United States, as they developed under the extreme protectionist system so long maintained, that their incidence was not so clearly bad as is commonly the case with excises. Tea, coffee, cocoa, were free of duty. Sugar was the only dutiable article of food whose taxation was clearly regressive. What was true of sugar was probably true also of wool, the duty on which was perhaps the most objectionable of all the protective duties. As regards manufactured commodities, many were not affected by the duties, directly or indirectly. The commoner grades of cotton goods, for example, are produced as cheaply within the country as abroad; they would not be imported in any case; duties on them, tho they stand on the statute book, are merely nominal. The finer grades of cotton fabrics are largely imported or made within the country under the shelter of the duties. The prices of these are raised by duties and a real tax is imposed on consumers. But the consumers are if not wholly, at least to a great degree, the well-to-do and rich and the tax is in so far not open to the objection of bearing with special weight on persons of small means. The same is probably true of duties on other textiles, such as woolens and silks; tho as to these it is not so clear that duties on the cheaper qualities are merely nominal. The main objection against our régime of high protection was not so much that it caused disproportionate burdens on those least able to pay as that it gave a disadvantageous direction to the productive energies of the community.

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C. F. Bastable, *Public Finance* (3d ed., 1903), covers the whole field and is able and well-judged, tho not attractively written. A. C. Pigou, *A Study in Public Finance* (1928), comparatively brief and compact, is of later date, no less able and well-judged and covers summarily the principles of taxation and those relating to war finance. An excellent set of selections, covering the main problems, is C. J. Bullock, *Selected Readings in Public Finance* (1924).